

Pre-Examination Planning

Introduction

The objective of the pre-examination planning process is to collect necessary information to understand the institution and the risks of consumer harm prior to the on-site phase of the examination. This information allows the Examiner-in-Charge (EIC) and the examination team to plan and conduct the off-site and on-site phases of the examination, to develop the scope of the examination, and to accomplish supervisory objectives in an efficient and effective manner.

This chapter discusses the three phases of the pre-examination planning process and usage of the Pre-Examination Planning System (PEP System), which is a web-based automated system used to generate the various pre-examination planning documents. The pre-examination planning process involves the following three phases:

1. Information Package (IP)
2. Pre-Examination Planning Phase 1 (PEP-1)
3. Pre-Examination Planning Phase 2 (PEP-2)

Information Package (IP)

The examination planning process begins with sending the IP to the institution's management. The IP is designed to increase banker awareness of the examination process prior to the examination; promote open communications with examination staff; and ensure that the institution's management team knows what to expect during the examination and where to go in the event their expectations are not met. The IP module in the PEP System is used to produce the IP package.

The IP consists of a standardized introductory letter that provides an overview of the of the examination process; discusses various resources available to help the institution understand the examination process; identifies the appropriate communication channels for any concerns about the examination process or the resultant ratings; and provides contact information for the Field Supervisor (FS) and/or the Supervisory Examiner (SE). In addition, the IP includes informational brochures and a sample list of interview questions for the institution's management team to review prior to the EIC's pre-examination interview.

The IP is to be mailed by the FS or SE to all institutions no less than **75 calendar days** prior to the scheduled on-site date of the examination. The IP letter has been standardized and automated within the PEP System and should be consistently used by all field offices without changes. A sample IP letter is included in this Manual (see Section III).

Data Validations: For the largest Home Mortgage Disclosure Act (HMDA) reporters (over 500 LAR lines) and/or Community Reinvestment Act (CRA) reporters, validation testing should be conducted in advance of scheduled fair lending and CRA examinations. This approach will allow the institution to resolve any data errors so the examination can proceed without significant delay. In addition, validation testing must be conducted for HMDA Outlier reviews prior to the start of the on-site review. For examinations of all other reporters, the validation testing will generally be conducted during the on-site review. However, a Field Office has the option to perform a data validation for other institutions before the on-site review if the Field Office has sufficient resources to complete the validation prior to the on-site examination date. The HMDA validations should be conducted following the FDIC HMDA validation procedures, considering the scale and complexity of the institution's mortgage lending activities and an overall assessment of the institution's prior practices and compliance risk profile.

A HMDA/CRA Validation Letter is to be provided to institutions when data validations occur prior to any examination. A data validation letter has been standardized and included in the IP module of the PEP System and should be used consistently. This letter is either sent with or after the IP to allow sufficient time for the data validation process.

Pre-Examination Planning Phase 1 (PEP-1)

The risk assessment of the institution begins during PEP-1. Every bank has inherent risk based on strategic plans, products, past supervisory actions, business activity, and other factors. PEP-1 starts the process of identifying and documenting risk based on the institution's structure, supervisory history, and the operational areas. The various activities performed during PEP-1 are meant to promote critical thinking about the possible inherent risks in the institution being examined.

PEP-1 consists of the following activities:

- A. Gathering information about the institution from both internal and external sources;
- B. Contacting the institution to conduct the pre-examination interview (PEP interview);
- C. Preparing and sending the Entry Letter to the institution along with the Compliance Information and Document Request (CIDR) that primarily requests CMS-related information and documents; and
- D. Completing Section 1 of the ARCH, "Identification of Inherent Risk", to the extent possible.

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PEP-1 should begin no less than **45 calendar days** prior to the scheduled on-site date of the examination. However, institutions must have at least 30 days to complete the CIDR and upload requested documents to FDICconnect. Longer time periods may be necessary based on the institution's size, resources, and complexity. The EIC should communicate with the institution's management during the PEP interview to determine a sufficient amount of time to provide the requested materials. This timeframe is also discussed in the Entry Letter.

A. Gathering Available Information

Examiners should first concentrate on gathering as much of the information as possible from FDIC records and databases and from publicly available sources before obtaining information from the financial institution. The following is a list of some key documents and information that the EIC should obtain for review because of their relevance to the financial institution's compliance posture.

FDIC Records and Databases

- Data Gathering Tool, which compiles institution, examination, supervisory, and financial information from multiple FDIC systems and databases
- Prior ARCH and other information from the System of Uniform Reporting of Compliance and CRA Examinations (SOURCE) or Regional Automated Document Distribution (RADD)
- Previous Reports of Examination (ROE) and supporting workpapers for compliance, risk management, trust, and information systems
- Prior corrective actions (such as restitution) and responses to ROE
- Risk management supervisory plan (for complex institutions, or others, as available)
- CRA Performance Evaluations and community demographic data
- Uniform Bank Performance Reports (UBPR) and Call Reports
- FDIC monitoring reports
- Complaint and correspondence files
- Applications in process

External Sources

- Previous years' HMDA and CRA data disclosure reports
- Content of the financial institution's website
- Public records, such as securities filings
- Newspaper or website articles that raise examination-related issues
- Community contacts (for CRA evaluations)

B. PEP Interview

The EIC will contact the institution and arrange a PEP interview to be conducted either by telephone or through an in-person discussion. The PEP interview questions are maintained in the C-PREP module of the PEP System and updated on an ongoing basis. The interview questions are also provided to the institution with the IP discussed previously.

The purpose of the interview is to gather current information to understand the institution's risk profile, size, complexity, and the types of products offered. The interview responses are input to the C-PREP module to ensure that the CIDR is tailored to request only what is necessary to conduct the examination. The EIC should also use the interview as an opportunity to answer the institution's questions about the examination process and to discuss the timing and logistics of the on-site examination. Additionally, the EIC should determine the applicability of the FDIC's e-Exam Policy and should discuss and address electronic document/data access requirements and delivery method(s) with the institution's management. It also provides an opportunity to identify the institution's staff members who will need to be available to the examination team during the on-site portion of the examination. This will allow the institution to take steps to ensure, to the extent possible, that those persons are available when needed.

Director Involvement: During the PEP interview, the EIC should also inform management that the institution's board members are welcome to participate in regularly scheduled meetings with examiners or to schedule individual meetings with the EIC, if desired. The EIC should emphasize that such participation is purely voluntary and that a lack of participation will not be viewed negatively. As stated in the memorandum announcing this initiative, "The primary objectives are to improve communication with outside Directors, increase director knowledge of the examination process, provide an opportunity for Directors to discuss their views with examiners on banking related matters, and give examiners the opportunity to gain further insight into the experience levels and leadership qualities of bank management."

C. CIDR and Entry Letter

The C-PREP module in the PEP System is used to produce the Entry Letter and Electronic Data Download Instructions and the CIDR. These documents must be tailored, as appropriate, for each institution.

After conducting the information gathering and PEP interview outlined above, the EIC (or a designee with whom he or she communicates closely) is required to use C-PREP to customize and create the CIDR based on an institution's risk profile, size, complexity, and type of

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products offered. C-PREP filters the CIDR to make available certain items based on the institution's responses to the PEP interview questions. Time periods should be specified when seeking periodic reports, administrative changes, etc., to avoid receiving data not relevant to the examination. Additional information about how to use C-PREP can be obtained from the user guide available within the PEP System.

The CIDR developed during PEP-1 primarily requests CMS-related information and documents. As discussed later in this chapter, the majority of transaction-level documentation will be requested during PEP-2 after completion of the ARCH. The initial request will provide the EIC with enough information to properly scope the examination and to identify products, services, and markets (PSMs) that exhibit inherent risk not sufficiently mitigated by the institution's CMS (i.e., residual risks). These residual risks will be the basis for requesting transactional testing related documentation (i.e., disclosures, loan files, etc.) during PEP-2.

The Entry Letter may be provided to the institution in either hard copy or electronic format. The letter instructs the institution on how to deliver the materials to the EIC or examination team and in what format. As previously discussed, the timing of the request and the turnaround must ensure that the institution has sufficient time to assemble the requested information and the examination team has sufficient time to adequately review the materials. Where appropriate and with supervisor approval, the EIC may visit the institution prior to the formal on-site date to either pick up the documents or review on-site any documents that are too bulky to duplicate or that are confidential. *FDICconnect* may be used for secure requests and transmission of electronic examination files and is the preferred method for transmitting examination information.

D. ARCH – Section 1

The ARCH is used to document the scope of the examination and assists with prioritization of efforts, time, and resources toward those PSMs with the highest residual risk of consumer harm. The EIC will complete the ARCH prior to the on-site examination using available information gathered. Additional information about preparing the ARCH is included in this Manual (see Section II – Review and Analysis). A sample ARCH template is included in this Manual (see Section III). Information about how to use the ARCH module can be obtained from the user guide available within the PEP System.

ARCH Section 1 starts the process of identifying and documenting inherent risk during PEP-1 based on the institution's structure, supervisory history, and

operational areas. In an effort to make the PEP process more efficient, Section 1 of the ARCH has been coordinated with and linked to the PEP interview. Several responses for Section 1 of the ARCH will pre-populate based on what is entered into the C-PREP module of the PEP System from the PEP interview. In other words, completing the PEP interview in the C-PREP module should result in completing portions of Section 1 of the ARCH, to the extent possible. However, examiners should review the pre-populated questions and answers to ensure they are correctly completed.

Pre-Examination Planning Phase 2 (PEP-2)

During PEP-2, examiners will conduct an initial assessment of the institution's CMS, which may or may not mitigate the inherent risks identified during PEP-1. Examiners will analyze how effective the CMS is in identifying, addressing, and mitigating the potential for consumer harm. This information will primarily be obtained from the institution's responses to the pre-examination interview and the CIDR. The areas that indicate a moderate or high level of potential consumer harm risk not mitigated by the strength of the CMS will potentially require further evaluation during the on-site examination. In PEP-2, examiners will finalize the examination scope and establish specific areas for on-site review or transaction testing.

PEP-2 consists of the following activities:

- A. Reviewing the CIDR responses and requested items;
- B. Completing the ARCH;
- C. Requesting additional documents for PSM transactional testing; and
- D. Getting the ARCH approved.

Supervisors will ensure sufficient time is scheduled prior to the on-site date of the examination for PEP-2. The amount of time needed to complete PEP-2 will vary based on the size and complexity of the institution. Each Field Office will establish procedures to ensure that PEP-2 starts early enough to provide sufficient time for the institution for gathering additional documents for transaction testing.

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A. Review CIDR Responses and Requested Items

The EIC and examination team will review the information and documents provided by the institution in response to the CIDR. If documents necessary to complete the ARCH, such as Board minutes or monitoring/audit reports, are not provided in response to the CIDR, the EIC may go on-site during PEP-2 to review this information as time, resources, and travel requirements permit. Follow-up contact with the institution's personnel during PEP-2 is encouraged to properly answer any questions and to determine the most appropriate examination scope.

B. ARCH Completion

Based on the information provided by the institution, the EIC will complete the ARCH. This will involve finalizing Section 1 of the ARCH, as necessary, but will primarily involve completing: Section 2, "Initial Assessment of CMS/Internal Controls"; "Decision Point"; and Section 3, "Scope of Examination". The EIC will identify the PSMs warranting transactional testing and any additional documentation needed for the on-site examination. Additional information about completing the ARCH is included in this Manual (see Section II – Review and Analysis).

C. Transaction Testing (TT) Request

The EIC will prepare and send a TT Request to the institution based on the scope of the examination. If the scope is changed to add a PSM subsequent to sending the TT Request, the examiner has the option to request necessary documents for the additional PSM(s) once on-site instead of sending another TT Request. If, however, a PSM is deleted, the EIC should discuss why the area will not be reviewed in the entrance meeting.

Documents requested during PEP-2 will largely be transaction-level documentation such as loan files, account disclosures, system parameters, etc. that will assist with further evaluating the effectiveness of the institution's CMS or performing CRA, HMDA, or Fair Lending reviews, as applicable. The documents requested should be consistent with the approved scope of the examination. These items will generally be held at the institution for the on-site portion of the examination, unless alternative arrangements, such as the usage of *FDICconnect*, are agreed to by the institution and the EIC.

In order to facilitate preparation of this TT Request, the C-PREP module of the PEP System will allow examiners to develop the separate TT Request list. The TT Request should specify the review time periods when seeking loan and/or deposit records, periodic statements, disclosures, etc., to avoid receiving data not relevant to the examination.

The EIC will provide the TT Request through *FDICconnect* or secure e-mail to the institution's designated contact. Based on the size, complexity, and resources of the institution, examiner judgment should be exercised regarding the approximate number of days the institution needs to gather the requested documents. Additionally, it is important that examiners communicate to the institution which documents are needed at the start of the examination. This communication will help prioritize the TT Request and allow the institution additional time to gather lower priority documents during the examination.

D. ARCH Approval

The EIC will finalize the ARCH using information obtained during PEP-2 to determine residual consumer harm risk and to establish the scope of the compliance examination. The completed ARCH will be submitted to the supervisor for approval. Each Field Office will establish procedures to ensure that the ARCH is approved by the FS or SE prior to the examination start date.

PEP Record Retention

To ensure consistency in record retention, PEP documents should be maintained as follows:

- The IP letter should be stored in the correspondence folder in RADD;
- PEP interview questions and answers should be completed within C-PREP and maintained as an examination workpaper in RADD;
- The completed CIDR should be retained as an examination workpaper in RADD;
- The approved ARCH should be stored as an examination document in SOURCE; and
- The TT Request list should be retained as an examination workpaper in RADD.