RISK SCOPING ACTIVITIES

Core Analysis Procedures

Examiners are to consider the following procedures but are not expected to perform every procedure at every bank. Examiners should exclude unnecessary items from the request letter. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive. This module is intended to help the examiner-in-charge (EIC) determine the examination scope, allocate staff resources, and prepare a pre-examination memorandum. When specialty examinations are to be integrated with safety and soundness examinations and reports, procedures for these specialties should be added.

Activity Identification

Note: Completing the procedures below should require a discussion with bank management in advance of sending out the First Day information request letter (to assist in scoping the request) and after receipt of the information (to clarify understanding of information received). Also, discussions with the agency's case manager (or equivalent) and the results off-site monitoring will likely provide additional information for consideration in planning the scope of the examination.

1. Determine whether concerns or higher-risk activities are present, such as :

- **Internal control/audit issues were cited in previous examination or audit reports, including:**
  - **Excessive internal control deficiencies,**
  - **Inadequate documentation,**
  - **Out-of-balance accounts,**
  - **Inadequate account reconciliations,**
  - **Significant policy exceptions or inadequate reporting of exceptions,**
  - **Inability or unwillingness to downgrade loans or recognize impairment/loss promptly, or**
  - **Inaccurate reporting of troubled debt restructures (TDRs) in the Consolidated Reports of Condition and Income (Call Reports).**
- **Asset quality issues, such as:**
  - **Unusual loan types or particularly complex loans considering the profile of the institution and the expertise of lending staff;**
  - **A material volume of loans with high-risk characteristics (e.g., low quality, poor underwriting, nonperformance, watch-list or classified status);**
  - **Inadequate policies and procedures for obtaining appraisals/evaluations during renewals or extensions;**
  - **Significant concentrations in high-risk loans (based on loan type, borrower, geography, market segment, etc.);**
  - **Concentrations of assets for which valuation methods are complex or uncertain;**
  - **Significant volumes of loan modifications or TDRs;**
  - **Use of brokered, correspondent, or third-party arrangements to originate or service loans;**
  - **Use of volume incentives for loan originators; or**
  - **Over reliance on interest reserves.**
- **Management/strategic planning issues, such as:**
  - **Excessive growth or over reliance on nontraditional funding sources;**
  - **High-risk strategies, reliance on non-core income sources, or significant business-line changes;**
  - **Significant personnel turnover, the departure of key staff, or inadequate succession plans; and**
  - **Over emphasis on earnings without proper risk management practices or internal controls.**
- **Regulatory issues, such as:**

- **Several quarters of significant provision expenses;**
- **Marginal capacity to raise equity capital;**
- **High volume of consumer complaints;**
- **High volume of intercompany transactions (FRB Regulation W);**
- **Significant insider transactions that are not properly approved or documented (FRB Regulation O); or**
- **Parent company issues that limit its ability to serve as a source of strength to the bank (such as having low liquidity, high debt, or an overreliance on bank dividends for cash flow).**

2. Review available information to determine the significance of bank activities and associated risks.

- **Obtain from the bank:**
  - **Strategic plans and budgets;**
  - **Internal management reports;**
  - **Watch lists**
  - **Board packages;**
  - **Annual reports; and**
  - **Auditor reports, management letters, quality control reports, and other reviews (such as loan, interest rate risk, mortgage banking, and Small Business Association (SBA) loan reviews).**
- **Obtain from other sources:**
  - **Call Reports, Uniform Bank Performance Reports (UBPR), and Bank Holding Company Performance Reports;**
  - **Offsite surveillance monitoring reports;**
  - **Real Estate Stress Tests (FDIC: REST);**
  - **Problem Bank Review Summaries;**
  - **Interest Rate Risk Reports (FDIC: IRRSA);**
  - **Press releases, published news stories, and on-line information/databases;**
  - **Large Insured Depository Institution (LIDI) Reports (FDIC);**
  - **Reports of examination issued by the institution's primary regulator;**
  - **Regulatory reports of examinations relating to security- or insurance-activities conducted by bank subsidiaries or other entities;**
  - **FDIC-Assisted Transactions, loan pool purchases, mergers/acquisitions; and**
  - **Regional economic conditions.**

3. Discuss with management potential concerns identified through interim offsite reviews, financial analysis, or correspondence.

- **Identify economic conditions that may affect the bank's overall financial condition and discuss issues such as:**
  - **The bank's primary trade area and its principal business activities within the area. Consider issues such as the size of the bank's trade area, boundary descriptions, population levels and trends, per capita income, employment growth, and unemployment rates;**
  - **Management's views regarding local economic trends and other factors that may affect the bank (for example, new businesses, expansion plans, business closings, or planned layoffs);**

  - **Deposit levels and trends and any plans for new or special-rate deposit products;**
  - **Types of loans currently emphasized and any material changes in loan types or volumes;**
  - **Competition and how it affects loan and deposit pricing; and**
  - **The bank's dependence on any particular industry or economic sector (for example, oil and gas, government, or agriculture).**
- **Identify managerial, operational, and functional changes. Determine if there have been any changes, or anticipated changes, in areas such as:**
  - **Overall bank objectives, risk appetites, or management philosophies;**
  - **Ownership, key personnel, or audit firms;**
  - **Board composition;**
  - **Investment strategies or brokers;**
  - **Operations, including information systems;**
  - **Policies and procedures;**
  - **Committee structures, reporting relationships, and recordkeeping systems;**
  - **The level and trend of regulated security or insurance activities conducted by bank subsidiaries or other entities on bank premises or on behalf of the bank; and**
  - **The scale or trend of other business lines (new or expanding) such as, mortgage banking, SBA lending, and commercial and industrial (C&I) lending.**
- **Determine what senior management considers the most significant factors affecting the bank, including high or emerging risks.**

Note: The EIC should schedule a pre-examination visit to the bank or conduct a telephone conversation with management if a visit is not feasible. The meeting or discussion should focus on emerging risks, changes to bank policies, strategic direction, new products or delivery channels, and significant activities that have occurred since the previous examination. The meeting provides the EIC the opportunity to solicit management's perspective about economic conditions, local and regional competition, internal and external audit programs, loan review activities, and overall risk management practices.

4. Review the findings of internal and external audits regarding the adequacy of internal control programs. Consider the degree to which examiners can rely on internal audits, and whether certain examination activities can be reduced or omitted due to the strength of internal controls, internal audit programs, and the absence of adverse audit findings. As part of this evaluation, review the:

- **Independence and experience of personnel conducting internal control reviews;**
- **Appropriateness of the audit universe, schedule, and scope;**
- **Adequacy of the size of the internal audit staff given the complexity and risk profile of the bank;**
- **Effectiveness of internal control reviews and reporting;**
- **Completeness of audit reports and the adequacy of management's written response to audit findings; and**
- **Accuracy and completeness of workpapers, if necessary.**

5. Review the findings of external auditors. Determine whether findings exist relating to:

- **Internal controls,**
- **Accounting practices,**

- **Regulatory reporting, and**
- **Exposure to high-risk activities.**

6. Assess any control weaknesses identified by internal or external audits, the previous examination, or other control procedures.

7. Review information regarding consumer complaints or problems noted in other specialty areas (Bank Secrecy Act, compliance, trust, information technology, mortgage banking, or other specialty activities), and assess any potential safety and soundness concerns. Consider the materiality of activities in terms of sales volume, revenues, and expenses, as well as the significance of risks posed to the bank.

8. Determine the significance of any activities conducted by a functionally regulated subsidiary of the bank or holding company and whether such activities pose a material risk to the insured depository institution. Contact the functional regulator to obtain available information about the functionally regulated subsidiary that warrants further review. Consider whether the subsidiary's functional regulator identified any significant supervisory concerns.

- **If supervisory information on a functionally regulated subsidiary of the insured depository institution is not available from the bank or the functional regulator of the subsidiary, information may be requested of a functionally regulated subsidiary itself only in limited circumstances. (FDIC: Consult with the regional office; FRB: Consult with Board staff.)**
- **An examination of a functionally regulated subsidiary should be undertaken only after consultation with and direction from the FDIC regional office or the FRB Board staff, except for subsidiaries that sell insurance products on bank premises or on behalf of the bank, which may be examined for compliance with the Rules and Regulations on Consumer Protections for Depository Institution Sales of Insurance [FDIC: 12 C.F.R. § 343; FRB: 12 C.F.R. § 208 (Regulation H)].**

Resource Allocation

9. Review relevant examination documentation modules and identify areas warranting greater emphasis or areas that may be suitable for limited reviews due to low risk profiles. Determine the feasibility of performing offsite loan review.

10. Allocate examination resources based on the bank's activities and risk profile, preliminary assessments of the control environment, and areas targeted in examination documentation modules. Also, consider the relative skills and experience of the available examination staff.

Scope Memorandum

11. Prepare a scope memorandum per applicable agency policy. The memorandum should be tailored to the risk, size, and complexity of the bank and define the objectives of the examination. The memorandum should address growth expectations, management or ownership changes, and the status of prior examination findings and criticisms. Include the following information:

- **Summary of pre-examination meetings or discussions;**
- **Summary of audit and internal control environment and a general statement regarding the level of reliance examiners can place on internal controls and the audit function;**
- **Preliminary risk assessments addressing CAMELS components, and comments regarding the ability to assess certain CAMELS components offsite (assess credit, market, liquidity, operational, legal/compliance, and reputational risk associated with the institution);**
- **Summary of examination procedures, including a discussion of the examination procedures to be completed and the depth of coverage in different areas;**
- **Summary of anticipated loan reviews (FRB: See SR 16-8, *Off-site Review of Loan Files* for more information on conducting all or portions of the loan review offsite);**
- **Summary of specialty areas to be targeted for examination (for example, mortgage banking, specialty lending, or other business lines); and**
- **Examination staffing requirements and identification of any training opportunities or specialized skills needed.**

End of Core Analysis.