



**BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**

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**DIVISION OF BANKING
SUPERVISION AND REGULATION**

**SR 95-13 (SUP)
March 15, 1995**

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Recommendations to Increase the Portion of Examinations and Inspections
Conducted in Reserve Bank Offices**

In recent years, examiners' access to automated databases that include supervisory data on state member banks (SMBs) and bank holding companies (BHCs) has been significantly enhanced. In addition, the increased availability of copiers, fax machines, and personal computers has made it possible for SMBs and BHCs to more easily transfer data to Reserve Banks. As a result, the volume of information on SMBs and BHCs available to examiners in Reserve Bank offices has been greatly augmented and many examination and inspection activities that have traditionally been conducted in the field can now be completed in Reserve Bank offices.

There are various advantages to be gained in completing these activities in Reserve Bank offices. For example, examiners' ability to access automation resources, reference materials, and senior staff is much better in the office than on-site. In addition, in completing more activities off-site, Reserve Banks can reduce the burdens of on-site evaluations on SMBs and BHCs. Further, greater reliance on off-site work can allow Reserve Banks to reduce travel-related expenses. Finally, the use of these approaches can significantly reduce the burden on examiners of spending time away from home.

In light of the above, Reserve Banks are asked to adopt the following recommendations to increase the portion of examinations and inspections conducted in Reserve Bank offices. These recommendations were developed by a Task Force of the Supervision Efficiency Enhancement Project.

Conducting Examination and Inspection Activities in Reserve Bank Offices

Examiners should conduct in Reserve Bank offices all examination and inspection activities that can be efficiently and effectively completed off-site. Activities that may be completed off-site include planning the examination or inspection, reviewing historical information, completing preliminary financial analyses, and preparing certain report pages using data maintained at Reserve Bank offices.

When using this approach, SMBs and BHCs should be contacted by letter and

asked to forward to Reserve Bank offices financial and other information to be used in the off-site portion of the examination or inspection. Most information that has traditionally been requested in first day letters and made available to examiners at the start of an examination or inspection, with the exception of documents such as minute books or bulky printouts that would be inappropriate or impractical to have sent, should be requested. While it is anticipated that this approach will be preferred to approaches that require a longer on-site examiner presence, SMBs and BHCs are not required to be examined and inspected under this approach and should be given the option to be examined or inspected using traditional on-site approaches. Given the burdens imposed by having SMBs and BHCs prepare and mail materials to Reserve Bank offices, Reserve Banks should also offer to pay the shipping costs and give adequate lead time in requesting materials.

In the cases of certain shell BHCs, Reserve Banks are authorized to complete all inspection activities off-site on an every-other-inspection basis¹. As noted above, however, these BHCs should be given the option to be inspected using the traditional on-site approach. During a three year pilot testing period, non-complex shell bank holding companies (NCSBHCs)² with less than \$500 million in assets that on their last inspection were rated BOPEC 3 or better may be inspected off-site, subject to the following restrictions:

- If information becomes available to the Reserve Bank in the period between inspections suggesting that the condition of an organization is deteriorating significantly, an on-site inspection should be scheduled or commenced immediately if warranted.
- Deteriorating 3-rated BHCs are excluded from the pilot program and must be inspected on-site.
- When a BHC's lead bank subsidiary is a SMB, the inspection of the BHC should be carried out in the field concurrently with the examination of its lead bank.
- NCSBHCs in the same Metropolitan Statistical Area as the Reserve Bank or its bank supervision staff should be inspected on-site unless there is good reason to do otherwise.
- Newly-formed NCSBHCs or those that have recently undergone a change in control should be inspected on-site.
- In cases where a BHC is unable to forward the information necessary to conduct an off-site inspection, or where the company is assigned a BOPEC rating of 4 or 5 or is determined to be a deteriorating 3-rated organization as a result of an off-site inspection, an on-site inspection should be scheduled or commenced immediately if warranted.
- Information requested from the NCSBHC should include all information typically requested in a first day letter, as well as copies from the company's general and subsidiary ledgers that document all significant accounting entries made since the last on-site inspection; copies of cancelled checks written since the last on-site inspection; copies of the BHC's notes payable and receivable; copies of all agreements between the BHC and its bank subsidiaries; and any other information considered to be necessary to complete an off-site inspection of the institution.

- Findings regarding the BHC's condition and compliance with laws and regulations should be conveyed to management by telephone or, if the situation requires, at company or Reserve Bank offices. The examiner-in-charge should then complete an inspection report for transmission to the company.

Attachments 1 and 2 include procedures that can be used in implementing off-site approaches to the examination of SMBs and the inspection of BHCs, respectively. Attachment 3 includes procedures for implementing the pilot program authorizing off-site inspections for certain shell BHCs.

Increasing Use of Automation

In order to ensure that maximum benefit is achieved from automation resources, Reserve Banks should review their use of automation in conducting examination and inspection activities and make increased use of automation to the extent deemed to be cost effective. At a minimum, those Reserve Banks that have not developed systems capable of downloading financial data from Federal Reserve databases into automated report forms should adopt such a system. In meeting this recommendation, Reserve Banks that have already adopted such systems should be consulted in order to avoid repeating costly development processes.

Using Specialized Support Staff

Preparing for an examination or inspection involves intensive data collection and data entry. If the professional examiner staff is currently performing these functions, efficiencies can be gained by reassigning these tasks to support staff. Reserve Banks, therefore, should consider initiating the use of such support staffs when efficiencies can be obtained.

If you have any questions regarding the recommendations detailed above, please contact Kevin Bertsch at (202/452-5265).

Stephen C. Schemering
Deputy Director

ATTACHMENTS TRANSMITTED ELECTRONICALLY BELOW

Attachment 1

This attachment describes general procedures that can be followed in increasing the portion of examinations conducted in Reserve Bank offices, lists examination activities that can be completed in the office and those that should be conducted on-site, and includes a sample first day letter information request form that can be used in complying with this SR letter.

General Procedures

When institutions are examined using this approach, first day letters are sent requesting that an array of documents be duplicated and forwarded to the Reserve Bank office for use during a preliminary phase of the examination. This array includes almost all of the documents that have traditionally been compiled and held for examiners in the field.

Once requested information has been received at the Reserve Bank, staff designated to perform the examination begins its analysis of the bank using both information submitted by the institution and that already available in the Reserve Bank's office. In the process of this analysis, as much data as possible is entered into the examination report form and certain report pages are partially or fully completed. Work to be carried out in the field is also fully planned. Thereafter, field work begins and activities which can only be done effectively on-site are carried out at the subject institution.

The examination procedures described above should be tailored to the overall supervisory strategy for an institution, not applied mechanically. The total resources devoted to a particular institution, as well as the allocation of field versus office time, should be based on a thorough understanding of the risk profile of the institution. Examiners should use prior examinations, in-house financial analyses, and other sources of information to determine actual and potential areas of weakness. To the extent weaknesses or unfavorable trends are detected in any of the CAMEL components, more field time should be devoted to these areas.

Activities that can be completed in Reserve Bank offices

Reserve Banks are encouraged to conduct the following portions of commercial bank examinations in the office:

- Determination of the scope of the examination, including the cut-off for credit review;
- Review of historical financial and supervisory data, leading to preparation of draft financial analyses (e.g. earnings, capital, liquidity);
- Review of a bank's internal reports;
- Review of a bank's written policies and procedures to produce a preliminary evaluation of management and internal controls; and
- Completion of financial schedules and certain other pages.

With regard to credit review, typically the largest part of a bank examination, preliminary office work could include:

- Review of loan policies;
- Review of performance report ratio data and management reports;
- Preliminary review of the loan loss reserve methodology;
- Risk assessment to determine the areas to be emphasized in the on-site review;
- Determination of the percentage of loans to be reviewed, and selection and assignment of individual credits;

- Grouping of loans to related obligors; and
- Preparation of loan line sheets.

Activities that should be conducted on-site

It is recommended that the following examination activities continue to be performed in the field:

- Review of credit and investment files for quality, documentation, and compliance with bank policy and laws and regulations;
- In-depth discussions with management;
- Verification of selected financial information;
- Observation of bank operations and internal controls;
- Collection of follow-up documentation to complete the financial analysis;
- Review of documents such as minute books and bulky printouts that would be inappropriate or impractical to have sent to the office; and
- Exit meetings with management.

SAMPLE INFORMATION REQUEST FOR COMMERCIAL BANK

A - INFORMATION TO BE MAILED TO THE FEDERAL RESERVE

MANAGEMENT/OPERATIONS

1. Exhibits A, D, M, N, & O (attached). Please assemble applicable workpapers which correspond to reported information for verification on-site.
2. Copies of the FIRA forms 004 for each executive officer or principal shareholder of the bank (loans from correspondent banks).
3. Copies of any strategic planning documents.
4. A management organization chart detailing line and staff authority from the chairman of the board through the various division heads.
5. A copy of the most recent information package provided to the directors in connection with regular board meetings.
6. Schedules of internal audits and internal loan reviews for the prior and current year. In addition, please furnish a copy of the most recent management letter provided to the bank by its external auditing firm and management's formal response.

7. Insurance policies: basic blanket bond, excess fidelity, and D & O. Please include a copy of the cover pages of each policy along with the amount of coverage and expiration date.
8. Copies of the most recent due-from account reconcilements for all correspondent relationships.
9. Litigation letters from the bank's attorney(s) relating to the status of all lawsuits in which the bank, any officer, director, or policy-making employee is named defendant. If none, please submit a letter from an officer of the bank indicating such.
10. Current stockholder list. If owned by a bank holding company include a shareholder list for the parent (Exhibit A).
11. A complete copy of all written policies which have been amended or adopted since the previous FRB examination.
12. List of non-book assets.
13. Operating policies and procedures governing the sale of mutual funds and other non-deposit investment products, if applicable. Include the investment strategy for such activity and policies governing sales, compliance, hiring, training, compensation, complaints, suitability, operational policies and controls, accounting controls, and dealings with third-party providers. Also provide the most recent management report summarizing sales volume and profitability.
14. Information on any "split-dollar" or "key man" life insurance policies, deferred compensation plans, or bonus plans for any officer, director, shareholder, or employee of the bank.

LENDING (date of examination)

15. Exhibits B, C, E, F, G, H, I, J, K, & L (attached).
16. Trial balance for commercial, agricultural, real estate, and instalment loans. If all loan categories are included on one trial balance, please include an index to allow identification of each loan type. An alphabetical listing which includes a "customer total" for each borrower is preferable.
17. List of past due, restructured, and nonaccrual loans and overdrafts; watch list report; and any results of internal loan grading systems.
18. Loan loss reserve adequacy evaluation. Include the most recent calculation for assessing the adequacy of the loan loss reserve based on the bank's internal methodology.
19. List of other real estate owned, contracts receivable, repossessions, and other assets. The list should include a reconciliation of each account, including the name and book value associated with each individual account.

20. Reconciliation of the loan loss reserve from the previous FRB examination through the date of this examination. Information should include the name and amount of each charge-off or recovery.
21. Balance of each loan category for the date of examination, consistent with Schedule RC-C of the Report of Condition and Income.
22. If the bank has established a "basket" of loans with minimal documentation as outlined in the March 30, 1993 interagency policy statement, provide a list of loans included in the basket and the delinquency status of these loans as of the date of examination.

EARNINGS/CAPITAL

23. Call Reports: A copy of the call report for the latest quarter-end, including the corresponding internal balance sheet, income statement (daily statement), and accompanying workpapers. The bank's copy of the most recent two year-ends and the current year's interims should be available for review on-site.
24. Balance sheet and income statement (trial balance) as of the date of examination and most recent month-end.
25. List of gains or losses on securities since the previous FRB examination.
26. Risk-based capital analysis for the most recent quarter-end, including workpapers. Break out guaranteed loans and loans secured by certificates of deposit. Also include the total amount and proportionate guarantee of each loan guaranteed by the FmHA, SBA, VA, etc.
27. A copy of any capital or dividend plans or projections.
28. Current and upcoming year's budgets.
29. Reconciliation for fixed assets and all capital accounts from the previous FRB examination through the date of examination.

INVESTMENTS/FUNDS MANAGEMENT (date of examination)

30. Exhibit P (attached).
31. Securities inventory listing reconciled to the date of examination (including book, par, and market values). Inventory should segregate securities according to FASB 115 accounting rules.
32. List of certificates of deposit of \$100,000 or more, breaking out those due within one year.
33. Copy of the current Reserve Requirement Report.

34. Most recent market rate survey for local deposits.

35. Most recent internal interest rate sensitivity analysis and liquidity analysis.

B - INFORMATION TO BE PROVIDED AT THE BANK

36. Minutes: Board of directors, shareholders, and any committees. Include a list of committees and their members, and fees paid to directors.

37. Access to all written policies pertaining to specific operational areas (e.g. loans, funds management, investments, capital/dividends, audit).

38. Access to internal audit and internal loan review reports and work papers.

39. Payment System Risk assessment (daylight overdrafts).

40. Exemption list for all currency transactions in excess of \$10,000. Include a copy of the bank's policy for compliance with financial recordkeeping and reporting requirements of the Bank Secrecy Act (31 CFR 103) and Regulation H.

41. Information on any officer and director overdrafts since the previous FRB examination. Include date and amount of any overdraft of an executive officer or director.

42. Information on local economic conditions.

*43. Verification of Federal funds sold and purchased, including any agency-based agreements with correspondents.

*44. Verification of: 1) participations sold and purchased; 2) interest-bearing bank balances; and 3) due-from accounts.

*45. Safekeeping list: Request verification from the correspondents.

(NOTE: Items marked with an * should be requested immediately so that verifications of balances as of the date of examination will be available for examiners at the bank.)

[Exhibits A through P \(167 KB PDF\)](#)

Attachment 2

This attachment lists inspection activities that can be completed in the office and those that should be conducted on-site and includes a sample first day letter information request form that can be used in complying with this SR letter.

Activities that can be completed in the office

For bank holding company inspections, Reserve Banks are encouraged to adopt the same approach as that described in attachment 1 for bank examinations. Specifically, work performed in the office in preparation for a bank holding company inspection should include:

- Determination of the scope of inspection;
- Completion of financial schedules and certain other pages; and
- Review of historical financial and supervisory data leading to preparation of draft financial analyses (e.g. parent, subsidiary bank(s), consolidated entity).

In addition, if centralized management functions (e.g. investments, asset/liability management, internal audit, or loan review) are performed by the bank holding company, a preliminary understanding of these functions can be obtained in the office by reviewing policies, reports, and other relevant materials. Further, if the bank holding company has nonbank subsidiaries, the preliminary risk assessment mandated by SR 93-19 can be performed in the office, based on information submitted by the institution.

Activities that should be conducted on-site

It is recommended that the following inspection activities continue to be performed in the field:

- Review of credit and investment files at holding company and nonbank subsidiaries for quality, documentation, and compliance with policy and laws and regulations;
- In-depth discussions with management;
- Verification of selected financial information;
- Review of selected tax workpapers, including the review of intercompany tax allocations;
- Observation of operations and internal controls;
- Collection of follow-up documentation to complete the financial analysis;
- Review of documents such as minute books for the holding company and nonbank subsidiaries and bulky printouts that would be inappropriate or impractical to have sent to the office; and
- Exit meetings with management.

SAMPLE INFORMATION REQUEST FOR BANK HOLDING COMPANY

A - INFORMATION TO BE MAILED TO THE FEDERAL RESERVE

1. Exhibits A, B, C, D, E, F, G, H, I, J, K, L, M, N (attached). Also, please assemble applicable workpapers which correspond to reported information for verification on-

site.

2. The corporation's current legal-entity and management organization charts, detailing line and staff authority from the chairman of the board through the various division heads.
3. Copies of any strategic planning documents.
4. A copy of the most recent information package provided to the directors in connection with regular board meetings.
5. A copy of any other management reports which summarize the performance of the subsidiary banks.
6. Schedules of internal audits and internal loan reviews for the prior and current year. In addition, please furnish a copy of the most recent management letter provided to the corporation by its external auditing firm and management's formal response.
7. List of consolidated past due, restructured, and nonaccrual loans and overdrafts; watch list report; and any results of internal loan grading systems.
8. Loan loss reserve adequacy evaluation (consolidated and lead bank). Include the most recent calculation for assessing the adequacy of the loan loss reserve based on the organizations's internal methodology.
9. Risk-based capital analysis (consolidated and lead bank) for the most recent quarter-end and two prior year-ends, including workpapers. Break out guaranteed loans and loans secured by certificates of deposit. Also include the total amount and proportionate guarantee of each loan guaranteed by the FmHA, SBA, VA, etc.
10. Current and upcoming year's budgets (consolidated and lead bank).
11. A copy of any capital, dividend, or cash flow plans or projections.
12. Most recent internal consolidated interest rate sensitivity analysis and liquidity analysis.
13. Parent-company consolidating entries and consolidated comparative financial statements as of the most recent quarter-end.
14. Parent-company-only comparative financial statements as of the most recent quarter-end.
15. The parent company's trial balance as of the most recent quarter-end.
16. Details of any items included in parent-company "other" assets, liabilities, income or expense, which cannot be readily identified from the most recent quarter-end trial balance.
17. A summary of insurance coverage for the parent company and its subsidiary(ies). Please include a copy of the cover pages of each policy, along with the amount of coverage and expiration date. In addition, also indicate the most recent board approval

of such coverage.

18. A detailed schedule of all consolidated borrowings as of the most recent quarter-end. Include the average interest rate paid on each type of borrowing.
19. For the parent company only, please provide the following information on all outstanding obligations: (a) amount outstanding, (b) lender (if publicly held, only note holders of greater than 10 percent), (c) origination and maturity dates, (d) interest rate and payable dates, (e) principal repayment schedule, and (f) reason for incurring debt.
20. A schedule of the fiduciary holdings of the parent company's stock and convertible debt by the parent's subsidiaries. Indicate the degree of investment authority the respective trust departments have over these shares.
21. Copies of all intercompany management and service agreements along with (1) the names of the staff members responsible for the administration of these activities and (2) documentation showing the basis of the assessments.
22. Litigation letter(s) from the holding company's attorney(s) relating to the status of all lawsuits in which the holding company or its subsidiary(ies) is named defendant. If none, please submit a letter from an officer of the holding company indicating such.
23. A complete copy of all written policies which have been amended or adopted since the previous FRB inspection.
24. Call reports: A copy of the most recent call report, including the corresponding internal balance sheet and income statement (daily statement), for the lead bank.
25. Daily statement for the lead bank as of date of inspection.
26. Copies of any "key man" or "split-dollar" life insurance policies held at the holding company or the subsidiary(ies).
27. Copy of compensation agreements with subsidiary bank personnel who sell credit-related life insurance for the holding company, along with any tie-in policies, if applicable.
28. Copy of any other compensation arrangement either at the holding company or between the holding company and the subsidiary bank(s).
29. Most recent market rate survey for local deposits at the lead-bank.
30. For all nonbank subsidiaries, please provide: (a) financial statements for the most recent quarter-end; (b) strategic plans; (c) directors' monthly reports; (d) internal audit reports; (e) for credit-extending subsidiaries, provide a trial balance of all credits, delinquency reports, nonperforming reports, watch-listed loans.

B - INFORMATION TO BE PROVIDED AT THE HOLDING COMPANY

31. Access to all written policies pertaining to specific operational areas (e.g. due diligence/acquisitions, lending, funds management, tax allocation, dividends, etc.).

32. Access to internal audit and internal loan review reports and work papers.
33. Minutes: Board of directors, shareholders and any committees. Please include a list of committees and their members, and fees paid to directors.
34. Holding company articles of incorporation and by-laws.
35. Stock register.
36. Access to Federal tax returns filed since the most recent FRB inspection, along with work papers. In addition, provide schedules of intercompany tax allocations for the corresponding periods, including projected allocations.
37. Access to parent company accounting records such as ledgers, journals, check registers, etc.
38. Access to monthly account analysis statements for any parent company transaction accounts held at a subsidiary bank.
39. For all nonbank subsidiaries, please provide: (a) directors' minutes; (b) annual budgets and cash flow projections; (c) checking account statements and check registers and/or cash receipts and disbursements registers; (d) listing of directors and officers; (f) for all nonbank credit-extending subsidiaries, access to credit policies and credit files.
40. Access to due diligence reports and work papers and assimilation plans.
41. Any available information on local economic conditions.

[Exhibits A through N \(66 KB PDF\)](#)

Attachment 3

This attachment describes general procedures that can be followed in implementing the pilot program for off-site inspections of certain non-complex shell bank holding companies (NCSBHCS). In addition, the attachment includes sample documents that can be used in implementing the program, including examples of correspondence with eligible bank holding companies and a sample first day letter information request form.

General Procedures

In implementing the pilot program, Reserve Banks should conform to the following procedures:

1. Senior management of bank holding companies should be notified prior to or early in the calendar year if their company qualifies for a full off-site inspection. They should also be informed that they may opt out of the off-site process and that, even if they choose to participate, the Reserve Bank may conduct the inspection on-site if conditions change or if it turns out that at some point during the year examiners will be traveling to the company's vicinity to carry out other activities.

2. When the Reserve Bank is ready to conduct the off-site inspection, the holding company should be contacted by telephone, as well as by letter. An information request form should be attached to the letter.
3. After assigned examiner(s) have reviewed information forwarded by the company, additional information may be requested by telephone or other means if deemed necessary. Once all necessary information has been received, the designated examiner(s) should commence the off-site inspection.
4. Findings of the inspection should be conveyed to company management by telephone or, if the situation requires, at company or Reserve Bank offices.
5. The examiner-in-charge should then complete an inspection report for transmission to the company.

[Sample documents \(29 KB PDF\)](#)

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