

Federal Exam Observations for Boards to Consider

Presented to the



Community Bankers Directors College

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Rationale for Exams

- Maintain public confidence in the banking system
- Ensure adherence to laws and regulations
- Protection of deposit insurance fund
- Evaluate safety and soundness trends

Authority

- Section 10(b) of the Federal Deposit Insurance Act empowers the FDIC to examine every insured depository institution
- Full-scope safety and soundness exam of non-member banks every 12-18 months
- Coordination with state bank regulators
- Specialty exams: Trust, IT, BSA, Consumer Compliance, CRA – generally the same timing

Uniform Financial Institutions Rating System

- Composite rating
 - Not an arithmetic average of component rating
- Component ratings:
 - Capital Adequacy
 - Asset Quality
 - Management Capability
 - Earnings Quantity and Quality
 - Liquidity Adequacy
 - Sensitivity to Market Risk

Management Capability

- Management responsible for day-to-day operations
- Directors' role is to oversee and monitor (except when bank is in troubled condition)
 - Provide clear guidance regarding acceptable risk exposure levels
 - Ensure that appropriate policies, procedures and practices have been established

Preparation for an Exam

- Review exam reports for last two exams – make sure all criticisms have been addressed
- Anticipate loan review – perform random samples
- Respond to questionnaires and information requests
 - Typically, minutes and presentations to Board, Audit Committee and Risk Management Committee
 - Financial and audit report
 - Significant contracts (particularly in technology exams)
- Consult FDIC manuals
- Management liaison with regulators
- Work space plans – comfortable, not lavish

The Exam Process

- Ongoing communication is critical
- Directors should attend all meetings conducted to improve director knowledge of exam process
- Discussion of material preliminary findings – generally with management, but will be with Board if
 - Bank likely to be assigned composite rating of 3, 4 or 5
 - Bank likely to be assigned a management component rating of 3, 4, or 5
 - 36 months have elapsed since last meeting with Board

Responding to Exam Reports

- Time lag between exam and report
- Follow traditional format – criticisms in bold followed by response
- Respond fully with dates on which issues will be corrected
- Exam results are confidential and protected from public disclosure due to exemptions to the Freedom of Information Act
 - State governments and state regulators are subject to similar freedom of information laws

Common Violations

- Extensions of credit in excess of legal lending limit
- Non-conforming extensions of credit to insiders
- Non-conforming extensions of credit to affiliates

Other Concerns

- Financial Services Regulatory Relief Act of 2006 preserves a claim of attorney-client privilege if a bank provides an examiner otherwise privileged material.
 - Applies to FDIC-insured bank
 - Applies to documents provided to bank regulators during a supervisory or regulatory process
- “The submission by any person of any information to any Federal banking agency, State bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process . . . shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information under Federal or State law . . .” (Section 607)

Current Areas of Supervisory Focus

- Underwriting
- Consumer Protection
- Capital
- Concentrated Risk
- Liquidity
- Public Stakeholders

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