

RISK SCOPING ACTIVITIES

Core Analysis Procedures

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. The references are not intended to be all-inclusive, and additional guidance may exist. This module will help the examiner-in-charge 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

1. **A. Identify the significant and higher risk activities of the bank inclusive of off-balance sheet activities and other proposed ventures. To the extent possible, identify whether any of the following “Red flags” exist:**
 - Excessive growth.
 - High-risk business models and strategies.
 - Management issues.
 - Departure of key staff and/or significant turnover.
 - Loans that are unusual considering the size of the institution and the expertise of lending staff.
 - A significant increase in the volume of low quality or poorly underwritten loans OR significant increase in nonperforming loans, watch list loans and/or classified loans.
 - Significant concentrations in high-risk loans (based on loan type, borrower, geography/market).
 - Significant volume of loan modifications and TDRs.
 - Current or prior use of brokered channels to originate loans.
 - Current or prior use of volume incentives for loan originators.
 - Slowness to downgrade loans and recognize impairment and loss.
 - Over reliance on interest reserves.
 - Concentrations of assets for which valuation methods are complex or uncertain.
 - Excessive reliance on volatile funding sources.
 - Overemphasis on earnings at the expense of safety and soundness.
 - High reliance on non-core sources of income.
 - Several quarters of significant provision expenses.
 - Modest capacity/ability to raise equity capital.
 - Basic internal controls deficiencies.
 - Significant number of policy exceptions.
 - Out-of-balance conditions.
 - Instances of poor or incomplete documentation as cited in previous examination or audit reports.
 - Significant insider transactions that are not properly approved or fully documented.
 - High volume of consumer complaints with potential safety and soundness implications.
 - High volume or history of intercompany transactions.
 - Parent company has a limited or no ability to serve as a source of strength to the subsidiary depository institution(s) (e.g. lack of liquidity, inability to raise capital, highly leveraged, overreliance on bank dividends for cash flow, etc.).
- B. Consider the following sources of information in order to determine the significance of activities to the bank and associated risks posed to the bank.**

- **Uniform Bank Performance Reports (UBPR) and Bank Holding Company Performance Reports.**
- **Reports of Condition & Income.**
- **Strategic plans and budgets.**
- **Internal management reports.**
- **Board of directors' packages.**
- **Annual reports.**
- **Auditors' reports, management letters, and external reviews (e.g., Loans, IRR).**
- **Offsite surveillance systems.**
- **Real Estate Stress Tests (FDIC: REST).**
- **Problem Bank Review Summaries and Watch List Reports.**
- **Interest Rate Risk Reports (FDIC: IRRSA; FRB: FOCUS).**
- **Press releases and published news stories.**
- **Alternative sources of information such as on-line databases (available to case managers), which include data about a bank's market area (FDIC).**
- **Quarterly Lending Alert (FDIC: QLA).**
- **Regional Economic Conditions (Recon) published by the FDIC's Division of Insurance.**
- **Large Insured Depository Institution (LIDI) Reports (FDIC).**
- **Reports of examination issued by the institution's primary regulator.**
- **Reports of examinations issued by a functional regulator of securities or insurance activities conducted by bank subsidiaries or other entities on bank premises or on behalf of a bank.**

Comments:

1. **Schedule a pre-examination visit to the bank or conduct a telephone conversation with management if a meeting is not feasible. This meeting or discussion should focus on changes to bank policies, strategic direction, management information systems, electronic and internet banking activities, and significant activities that have occurred since the previous examination. The meeting also provides the examiner-in-charge with management's perspective about economic conditions, internal and external audit programs, and the risk management process.**
 - A. **Identify economic conditions that may have a direct or indirect impact on the bank's overall financial condition. Discuss with senior management the following issues:**
 - **The bank's primary trade area and the principal types of businesses within the area. Include, if possible, the size of the bank's trade area (for example, boundary description, population, per capita income, and employment growth and unemployment rates, if available).**
 - **Management's views regarding the trends of the bank's local economy.**
 - **Local economic conditions that positively or negatively affect the bank (for example, new businesses or expansion plans, business closings or planned layoffs).**
 - **Other factors that could adversely affect local economic conditions.**
 - **Types of loans currently emphasized and any material changes in loan types or volume.**
 - **The competition in the bank's area and how it affects the bank's pricing.**
 - **The bank's dependence upon a particular industry or economic sector (for example, oil and gas, government, agriculture).**
 - B. **Identify operational and functional changes. Determine if there have been any changes, or if any changes are anticipated, in the following areas:**
 - **The bank's overall objectives or management philosophy.**
 - **Key personnel and ownership.**

- **Board composition.**
- **Investment strategies or brokers.**
- **Operations, including information systems.**
- **Policies and procedures.**
- **Formal committee structure.**
- **Scale and trends of functionally regulated securities or insurance activities conducted by bank subsidiaries or other entities on bank premises or on behalf of the bank.**

C. Determine what senior management considers to be the highest risk areas.

Comments:

2. Review the findings of the internal auditor or other personnel responsible for evaluating internal controls. As part of the evaluation, review the following items:

- **Independence and experience of personnel conducting control reviews, adequacy of staff size, appropriateness of the audit universe, audit schedule and sufficiency of scope.**
- **Effectiveness of internal control review.**
- **Audit reports and management's written response to auditors' findings.**
- **Workpapers, if necessary.**

Comments:

3. Review the findings of the external auditors. Note: Examiners should contact the external auditor to gain insight into the control environment. Consider the following items:

- **Completing the CPA Review Reference Module. Typically, examiners should review the external auditors' workpapers if the following circumstances exist: (FDIC: On 4 and 5 composite rated institutions, examiners are required to review the external auditor's workpapers. Once a determination is made to conduct a workpaper review, a request must be made in writing by the Regional Director, Deputy Regional Director, or Assistant Regional Director to the office of the accountant.)**
- **Internal control problems.**
- **Aggressive accounting practices.**
- **Substantial exposure to high-risk activities (trading, derivative securities).**

Comments:

4. Determine the perceived control risks within the bank based on specific internal control weaknesses identified by the internal or external audits, the previous examination, or by other control procedures.

Comments:

5. Review information regarding consumer complaints or problems noted in other specialty areas (trust, IT, functionally regulated securities, or insurance activities) and determine the potential for safety and soundness concerns. Consideration should be given to the materiality of the activity in terms of sales volume, revenues and expenses as well as the significance of risks posed to the bank.

Comments:

6. Determine the significance of any activities conducted by a functionally regulated subsidiary of the bank and whether such activities would pose a material risk to the insured depository institution. Contact the functional regulator of the functionally regulated subsidiary to obtain available information about an entity that warrants further review. Consider whether the subsidiary's functional regulator has 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 DSC Regional Office; FRB: Consult with Board staff.)**
- **An examination of a functionally regulated subsidiary should be undertaken only after consultation with and direction from FDIC DSC Regional Office or 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)].**

Comments:

Resource Allocation 

7. Review the relevant examination modules and identify those areas and procedures expected to warrant greater emphasis.

Comments:

8. Allocate resources accordingly based on the bank's activities, the preliminary assessment of the control environment, and the areas targeted in the examination modules.

Comments:

Scope Memorandum 

9. Prepare a scope memorandum. The scope memorandum should be tailored to the size and complexity of the bank and define the objectives of the examination. Address growth expectations, management or ownership changes, and the status of prior examination criticisms. Include the following information:

- **Summary of pre-examination meeting or discussion.**
- **Summary of audit and internal control environment.**
- **Preliminary risk assessment addressing CAMELS components.**
- **Assess credit, market, liquidity, operational, legal, and reputational risk associated with the institution.**
- **Summary of examination procedures. Include a discussion of the modules to be completed and the depth of coverage in different areas.**
- **Summary of anticipated loan review.**
- **Examination staffing.**

Comments:

End of Core Analysis. 