

This part of the manual presents policies and procedures for the inspection process, the collection and presentation of data, and coordination of inspection activities of bank holding companies (BHCs).

5000.0.1 INSPECTION OF NONBANK SUBSIDIARIES OF BHCS

Notwithstanding the risk assessment that is to be performed for each nonbank subsidiary, an on-site review is required for the following nonbank subsidiaries:¹

1. *Any individual subsidiary that meets either of the following two significance criteria or that is otherwise deemed by the Reserve Bank to have a significant impact on the BHC's condition or performance:*²
 - The subsidiary has total assets equal to 10 percent or more of the BHC's consolidated tier 1 capital.
 - The subsidiary's total operating revenue equals 10 percent or more of the BHC's consolidated total operating revenue.³
2. *Nonbank subsidiaries that are issuing debt to unaffiliated parties or relying to a significant degree on affiliated banks for funding.* "Significant" is defined as debt that exceeds the lesser of \$10 million or 5 percent of the BHC's consolidated tier 1 capital.
3. *Those mortgage banking subsidiaries and other nonbank subsidiaries involved in asset securitization, and all nonbank subsidiaries that generate assets and sell them to unaffiliated parties.* Examiners involved in the on-site review of these subsidiaries should consider the appropriate examination guidelines

1. See [SR-93-19](#) for more information. The on-site review for these nonbank subsidiaries should be performed with the same frequency as required for a full-scope inspection but may be performed as a targeted review that is not concurrent with the full-scope inspection.

2. Generally, examiners would not be required to conduct an on-site review of those nonbank subsidiaries that hold premises that are necessary for the operation of the banks or other affiliates. Furthermore, these criteria are not intended to include nonbank subsidiaries that have been subject to recent on-site review by another federal or state banking agency in accordance with interagency agreements or Reserve Bank agreements with state banking supervisors (for example, the Interagency EDP Examination, Scheduling, and Distribution Policy). These criteria also should not limit Reserve Bank flexibility in coordinating supervisory efforts with functional regulators at the federal or state level.

3. For BHCs, "total operating revenue" is the sum of total interest income and total noninterest income (before extraordinary items).

for asset securitization, for example, those set forth in [SR-90-16](#) (May 25, 1990). (See section 2128.02.)

4. *All nonbank subsidiaries that broker or deal in derivative instruments, as a principal or agent, to unaffiliated parties.*

Furthermore, for each credit-extending nonbank subsidiary that meets the above on-site review criteria, examiners are to review sufficient credit files through either judgmental or attribute sampling to assess the adequacy and accuracy of internal risk-identification systems.

5000.0.1.1 Off-Site Review of Nonbank Activities

Reserve Banks should review reports submitted to the Federal Reserve to monitor the condition and performance of significant nonbank subsidiaries between inspections. FR Y-series reports on individual and combined nonbank subsidiaries should be used for this purpose and, when available, financial statements on nonbank activities that are included with the FR Y-6 annual reports of BHCs should also be reviewed.⁴

When warranted by (1) a deterioration in the condition and performance of nonbank subsidiaries, (2) the significance of the nonbank subsidiaries (including those selected for on-site review as discussed above), or (3) other reasons, Reserve Banks should require BHCs to submit additional information (for example, balance sheets, income statements, and schedules on nonperforming assets and off-balance-sheet activities) obtained from a company's internal systems. Furthermore, on an exception basis, Reserve Banks will be expected to obtain, from a BHC's internal systems, information on the off-balance-sheet exposures of nonbank subsidiaries. When exposures are considered significant, Reserve Banks will be expected to monitor the risks posed by these exposures. If the Reserve Bank determines that a situation warrants material departure from these procedures, it should be discussed with Board staff.

4. See the [Board's public website](#) for more information on report forms and reporting requirements.

5000.0.2 MULTI-TIER BHC INSPECTIONS

The Federal Reserve has had longstanding supervisory guidance addressing the coordination of supervisory activities among the Reserve Banks. For banking organizations that operate in more than one district, it is particularly important that (1) all relevant and significant supervisory findings are assessed and weighed when the consolidated banking organization is being evaluated and (2) a consistent and coordinated supervisory message is communicated to the organization.

Many multi-tier BHC structures exist in which the top-tier and second-tier institutions (as well as other lower-level tiers) are in different Federal Reserve Districts. The System has long operated under the principle that there is one responsible Reserve Bank (RRB) for each fully consolidated banking organization (i.e., each top-tier consolidated banking organization). For domestic banking organizations, the RRB typically will be the district where the head office of the top-tier organization is located and its overall strategic direction is established and overseen. For foreign banking organizations, the RRB typically will be the district where the Federal Reserve has the most direct involvement in the conduct of day-to-day supervision of the U.S. banking operations of the organization. The RRB is accountable for all aspects of supervision of the fully consolidated banking organization, including all subsidiaries and affiliates (domestic, foreign, and Edge corporations) of the organization for which the Federal Reserve has supervisory oversight responsibility. (See [SR-05-27/CA-05-11](#).)

5000.0.3 INTERAGENCY INSPECTION OR EXAMINATION AGREEMENTS

To ensure continuing close coordination and consistency in the examination and supervision of banking organizations, the three federal bank regulatory agencies, that is, the Federal Reserve System, Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), have adopted expectations intended to enhance the interagency supervision of BHCs and their bank and nonbank subsidiaries.

5000.0.3.1 Interagency Policy Statement on Examination Coordination

On June 10, 1993, an interagency policy statement was developed to strengthen coordination and cooperation among the federal banking agencies responsible for examining and supervising depository institutions and their holding companies, thus minimizing the disruptions and burdens associated with the examination process. The policy expands on existing interagency agreements. (See [SR-93-30](#).)

5000.0.3.1.1 Primary Supervisory and Coordination Responsibility

Examinations or inspections of a particular legal entity are to be conducted by the federal regulatory agency that has primary supervisory authority for that entity. In carrying out its supervisory responsibilities for a particular entity within a banking organization, each regulatory agency, to the extent possible, is to rely on examinations or inspections conducted by the primary regulator of the affiliate, thereby avoiding unnecessary duplication and unnecessary disruption of the banking organization. In certain situations, however, it may be necessary for a regulatory agency other than the entity's primary supervisory authority to participate in the examination or inspection in order to fulfill its regulatory responsibilities.

Primary supervisory authority and coordination responsibilities are organized as follows:

- OCC** national banks, federal savings associations
- FDIC** state nonmember banks, state savings associations
- FRB** parent BHCs, nonbank subsidiaries of BHCs, the consolidated BHC, FHCs, SLHCs, and state member banks

The primary federal regulator is responsible for scheduling, staffing, and setting the scope of supervisory activities, including coordinating formal and informal *administrative* actions, as necessary. In fulfilling these responsibilities, the primary regulatory agency is to consult closely with the other appropriate agencies when there is need for coordination.

5000.0.3.1.2 Overview of Examination Coordination and Implementation Guidelines

The agencies are to make every effort to coordinate the examinations and the inspections of banking organizations. Coordinated examinations and inspections may not be practical in all cases because of resource constraints, serious scheduling conflicts, or geographic considerations; however, particular emphasis will be placed on coordinating examinations and inspections of banking organizations with over \$10 billion in consolidated assets and those banking organizations (generally, with assets in excess of \$1 billion) that exhibit financial weaknesses.

5000.0.3.1.3 Coordinating the Planning, Timing, and Scope of Examinations and Inspections

When multiple regulators have authority over a legal entity, representatives from the appropriate supervisory offices should, if necessary, meet quarterly to discuss supervisory strategies for specific banking organizations. They should meet at least annually to review and establish examination and inspection schedules, to plan for the next year, and to consider the need for coordination in the following areas:

1. sharing the strategy and scope of each examination or inspection
2. determining if agencies other than the primary regulator of a particular entity should participate in the examination or inspection of that entity
3. determining whether a consolidated request letter should be prepared to avoid duplicative information requests
4. sharing workpapers and resultant findings and conclusions from prior examinations and inspections
5. other areas as necessary

5000.0.3.1.4 Interagency Review of Bank, Nonbank, and Parent-Company Activities

Certain functions and procedures—such as internal audit, credit review, and the procedures for determining the allowance for loan and lease losses—transcend the boundaries that distinguish legal entities. Such functions and procedures may be located at the bank or holding company level. The primary regulator of the

depository institution and the holding company both may have supervisory responsibility to assess such functions. In these cases, coordinated and concurrent examinations or inspections should be conducted to avoid duplicative reviews and unnecessary disruption.

The primary regulator of the entity being examined or inspected should take the lead in a coordinated examination or inspection, unless there is an agreement that another agency will serve as the lead agency. The responsibilities of the lead agency, in consultation with other appropriate agencies, include developing the scope of the examination or inspection and determining the staff requirements. The lead agency will also coordinate scheduling of the examination or inspection and the presentation of examination or inspection findings to the appropriate management.

5000.0.3.1.5 Joint Meetings Between Regulators and Bank or BHC Management

At the conclusion of examinations or inspections conducted under the guidelines, the agencies should coordinate and plan joint meetings with the board of directors to discuss the findings and conclusions. The agencies will coordinate responsibility as outlined in the guidelines.

5000.0.3.1.6 Significant Differences in Agencies' Findings, Conclusions, and Recommendations

Before examination or inspection results are forwarded to management or boards of directors, every effort should be made to resolve any significant differences in major findings, conclusions, and recommendations. These differences should be resolved by examiners or officials at the regional level within 10 business days of identification. If the regional offices cannot resolve the matter, it should be referred to the national level, where it will be resolved within a reasonable time frame.

5000.0.3.1.7 Inspection and Examination Reports

The primary regulator should prepare the formal report of examination or inspection covering the

entity for which it is the primary federal regulator. The primary regulator will also prepare the report when it serves as the lead agency. The report should be addressed and transmitted to the directors of the entity for which the regulator is the primary federal supervisory authority. The report may also be sent to the directors of other entities that have a need for the information. The agencies may agree, if necessary and appropriate, to prepare a joint report.

5000.0.3.1.8 *Coordinating Information Requests*

Any request for information to be obtained from an entity for supervisory purposes should normally be made through the entity's primary regulator. The primary regulator should also share relevant supervisory information with the other appropriate regulatory agencies.

5000.0.3.1.9 *Coordinating Enforcement Actions*

When one or more regulatory agencies are contemplating an enforcement action, the agencies should consider initiating a joint enforcement action to address and correct deficiencies within a banking organization. *At a minimum*, each agency considering enforcement action should inform the other agencies. This provision reaffirms the existing interagency enforcement agreement. (See [SR-18-4 / CA-18-5](#).)

5000.0.3.1.10 *State Banking Departments*

The agencies will endeavor to coordinate with state banking departments, when appropriate and feasible.

5000.0.4 POLICY FOR COMMUNICATING PROBLEMS OF SUPERVISORY CONCERN TO MANAGEMENT AND BOARDS OF DIRECTORS

5000.0.4.1 Introduction

On October 7, 1985, the Board announced a second policy to strengthen and formalize practices for communicating the findings of examinations or inspections to management and boards of directors and to set out guidelines for such meetings. The policy—

1. establishes specific criteria for determining which examination findings require follow-up meetings with boards of directors and sets out guidelines for such meetings,
2. requires that, in addition to providing a complete examination or inspection report to the bank or BHC, a written summary of findings be sent to the bank or BHC for distribution to each director, and requires that senior Reserve Bank officials become more involved in presenting examination findings to boards of directors, and
3. requires that senior Reserve Bank officials become more involved in presenting examination findings to boards of directors.

The policy was effective immediately, with initial implementation on January 1, 1986.

5000.0.4.2 Meetings with Directors

The decision to hold a meeting with the board of directors at the conclusion of a state member bank examination or a BHC inspection is to be determined on the basis of the organization's financial condition, its size, the type of examination or inspection conducted, and other factors that, in the judgment of the Reserve Bank, indicate the need for a meeting. To the extent possible, meetings with the boards of directors of state member banks should include representatives of the state banking department. When appropriate, meetings with the boards of BHCs may be held jointly with the meeting of the lead bank subsidiary's board of directors and the bank's primary federal or state bank supervisor.

5000.0.4.2.1 *Criteria for Conducting Meetings*

5000.0.4.2.1.1 Condition

For those BHCs with consolidated assets of \$1 billion or more, a meeting with the board of directors is to be held at the conclusion of any full-scope inspection in which a BHC is rated composite 4 or 5. A meeting between Reserve Bank staff and the board of directors to communicate findings is not required for—

1. complex holding companies with consolidated assets of less than \$1 billion; and
2. noncomplex holding companies with consolidated assets of less than \$1 billion that have a subsidiary depository institution in less-than-satisfactory condition, or with a less-than-satisfactory risk-management rating, or where a material supervisory issue is otherwise indicated.

However, a meeting should be conducted between Reserve Bank staff and the board of directors to communicate findings when supervisory concerns warrant such action.

Except for the above situation, meetings are required if an organization is rated composite 3 and its condition appears to be deteriorating or has shown little improvement since the previous examination or inspection in which it received a composite 3 rating.⁵ A meeting should also be held with all these organizations following a limited-scope or targeted examination or inspection, if deemed appropriate and desirable by the Reserve Bank. (See [SR-95-19](#).)

5000.0.4.2.1.2 Size

A meeting will be required at the conclusion of a full-scope examination or inspection of all multinational organizations and major regional organizations with assets in excess of \$5 billion. Reserve Banks are also encouraged to conduct such meetings at the conclusion of a full-scope examination or inspection of regional institutions with assets of \$1 billion or more.

5. Reserve Banks also are encouraged to hold a meeting at the conclusion of a full-scope inspection (1) for an organization with assets of \$1 billion or more rated composite 2 if its condition appears to be deteriorating and (2) for an organization rated composite 3, even if showing some improvement.

5000.0.4.2.1.3 *Guidelines for Meetings*

Meetings with boards of directors will have to be tailored to meet the needs of each specific situation. In general, meetings with the full board are preferred, but in certain cases the Reserve Bank may determine that a meeting with a committee of the board of directors, such as the executive or audit committee, will serve adequately. In all cases, however, the written summary of examination or inspection findings is to be provided to each member of an organization's board of directors.

For BHCs with consolidated assets of \$1 billion or more, the Reserve Bank's presentation to the board should ordinarily be chaired by a Reserve Bank official, with the examination staff in attendance. The larger the organization or the more serious its problem, the more senior the Federal Reserve official should be.

Reserve Bank presidents are expected to become directly involved in the supervision of multinational organizations and regional institutions with more than \$5 billion in assets that have been rated composite 3, 4, or 5. Reserve Banks have the discretion to determine the circumstances under which the participation of Reserve Bank presidents is appropriate and necessary. It may be necessary for the Reserve Bank president to meet with the board of directors and become involved in other ways; the precise nature of involvement will depend on the situation.

A meeting with the board of directors should include a formal, structured presentation containing a clear statement that an institution is considered a "problem" institution or is about to become a problem institution if existing conditions deteriorate.⁶ The use of slides, other visual aids, and hard-copy handouts is encouraged. Information should also be presented on financial trends and peer-group comparisons. The presentation should make clear the nature of problems uncovered, such as—

1. deficiencies in capital, asset quality, earnings, or liquidity;
2. violations of law;
3. inadequacies in policies, practices, and reporting systems necessary for the proper administration of the organization;

6. As has been long-standing Federal Reserve practice, the exact composite or component ratings assigned in the examination or inspection are not to be disclosed to persons other than the directors or senior management.

4. the lack of well-documented lending, collection, investment, and liability-management policies;
5. the failure of management to address previously discussed deficiencies;
6. the lack of reporting systems sufficient to keep senior management and the board of directors fully informed; and
7. the failure of the board of directors to participate in the active management of the organization.

5000.0.5 COMBINED EXAMINATION/INSPECTION REPORT FOR BHCs WITH LEAD STATE MEMBER BANKS

Reserve Banks are permitted, under the circumstances and procedures specified in [SR-94-46](#), to issue a combined report for a BHC and its lead state member bank subsidiary. A letter should be sent to the qualified holding companies that explains their option of receiving a combined report. The combined report may be issued when—

1. a BHC's lead bank subsidiary is a state member bank,⁷ and
2. the holding company's board of directors formally approves, by board resolution, a combined report being released to its lead state member bank subsidiary.

A combined examination/inspection report format is attached to SR-94-46. At a minimum, a combined report will contain all examination report pages required by the interagency bank examination report instructions as well as information on the parent holding company, its bank and nonbank subsidiaries, and the consolidated BHC organization. For detailed information on required and optional report pages, see the *Commercial Bank Examination Manual*.

Separate examination and inspection Supervisory Information System (SIS) entries are required for each combined report. The combined report's cover page is to be green, must provide BHC and Bank RSSD numbers, and must clearly indicate that the report is a combined report.⁸

7. In cases in which the company has more than one state member bank, separate examination reports should be prepared for all other state member bank subsidiaries.

8. Research, Statistics, Supervision and Regulation, and Discount and Credit (RSSD)

Procedures for “Limited-Scope” Inspection Report Preparation (General Instructions) Section 5040.0

5040.0.1 OBJECTIVES

The limited-scope inspection will review all areas of activity covered by a full-scope inspection report but less intensively.

5040.0.2 IMPLEMENTATION GUIDELINES

The ultimate responsibility for determining the appropriateness of the limited scope, and the actual elements of the scope of the inspection beyond the guidelines, rests with the Reserve Bank.

Certain report pages are required to be included in the limited-scope inspection. Other pages are required when certain events trigger their applicability, “exception (E)” pages. Pages not required may be included at the Reserve Bank’s option. These are labeled as “optional” pages.

5040.0.2.1 Required Report Pages

As in the full-scope inspection report,¹ the limited-scope inspection report is divided into

1. The basis for the limited-scope inspection report will be the “large” report, FR 1225.

three parts: a core section, a section consisting of report pages that provide support to the core section, and a confidential section.

Core section. The core section of the report serves as the main vehicle for communicating the results of the inspection to management. The core pages contain the scope of the inspection, comments on administration of policies and supervision over subsidiaries, and an analysis of the RFI/C(D) rating components (see section 4070.0), any or all of which could be used to support supervisory action, when necessary.

Support section. The supporting report pages contain narrative and financial and other data to support the analyses in the core section. The *required* pages provide the primary statistical support when addressing important supervisory problems or issues, and as appropriate, the RFI/C(D) rating, or supervisory action, when needed.

Confidential section. The pages in this section are also required since they address matters of supervisory importance and other matters not deemed appropriate in the open section.

For a limited-scope inspection, the following report pages are *required*:

Manual Section

<i>No.</i>	<i>Page Location</i>	<i>Page Title</i>
5010.2		Cover (FR 1427)
5010.3	Page i	Table of Contents
5010.4	Core Page 1	Examiner’s Comments
5010.5	Core Page 2	Scope of Inspection
5010.41	Confidential Page B	Condition of the BHC

The Directors’ Summary Report will be required as in the full-scope inspection. Appropriate information provided by other reporting vehicles, inspection/examination activities, or other finan-

cial institution regulatory agencies should be considered. Refer to footnote 3 for further guidance as to the need for a Directors’ Summary Report.

5040.0.2.2 Exception Limited-Scope Report Pages

The following “exception (E)” pages should be included in the report as indicated below:

<i>Manual Section No.</i>	<i>Page Location</i>	<i>Page Title</i>
5010.6	Core Page 3	Structure and Abbreviations
5010.7	Core Page 4	Analysis of Financial Factors
5010.10	Core Page 7	Summary of Consolidated Classified and Special Mention Assets, and Other Transfer Risk Problems
5010.11	Core Page 8	Consolidated Comparative Balance Sheet
5010.12	Core Page 9	Comparative Statement of Income and Expenses (Consolidated)
5010.13	Core Page 11*	Capital Structure (Consolidated) ²
5010.14	Page	Policies and Supervision
5010.15	Page	Violations
5010.16	Page	Other Matters
5010.17	Page*	Classified Assets and Capital Ratios of Subsidiary Banks
5010.19	Page*	History and Structure
5010.27	Page	Cash Flow Statement (Parent)
5010.28	Page	Parent Company Liquidity Position
5010.29	Page*	Parent Company and Nonbank Assets Subject to Classification
5010.31	Page*	Nonbank Subsidiary
5020.2	Page	Other Supervisory Issues
5010.40	Confidential Page A*	Principal Officers and Directors
5010.43	Confidential Page D	Administrative Matters

Pages with an (*) are optional if the limited-scope inspection is preceded by a full-scope inspection within the same annual period.

2. The corresponding FR 1241 page may be used if the basis is to be a lead bank subsidiary rather than on a consolidated position.

5040.0.2.2.1 Reasoning for Including “E” Pages

The “E” pages are included when the activities are present, or have been disclosed through the inspection process, or when significant findings or issues must be reported and communicated to management or to the appropriate supervising agency(ies). The limited-scope inspection report may include, at the discretion of the appropriate Reserve Bank, copies of the Bank Holding Company Financial Statements (FR Y-9) and Reports of Condition of Subsidiary Banks in place of pages containing required or optional financial statements. The FR Y-9 statements or the Reports of Condition should only be included when the financial statements accurately represent the condition of the bank holding company as determined during the inspection.

5040.0.2.3 Optional Limited-Scope Report Pages

In the limited-scope inspection, several pages have been labeled as optional because of the nonexistence of an activity or the absence of a problem in that area. Any inspection report page may be included in the report at the option of the Reserve Bank or the examiner-in-charge. Note that the “Commercial Paper” and related pages (5010.21 through 5010.23) are optional since the existence of this activity would be a “complex” organization, requiring a full-scope inspection within the same annual period.

The *optional* pages are:

<i>Manual Section No.</i>	<i>Page Location</i>	<i>Page Title</i>
5010.8	Core Page 5	Parent Company Comparative Balance Sheet
5010.9	Core Page 6	Comparative Statement of Income and Expenses (Parent)
5010.18	Page	Organization Chart
5010.20	Page	Investment in and Advances to Subsidiaries
5010.21	Page	Commercial Paper (Parent)
5010.22	Page	Lines of Credit (Parent)
5010.23	Page	Commercial Paper and Lines of Credit (Parent)
5010.24	Page	Contingent Liabilities and Schedule of Balance Sheet Accounts Not Detailed Elsewhere (Parent)
5010.25	Page	Statement of Changes in Stockholders' Equity
5010.26	Page	Income from Subsidiaries (Fiscal and Interim)
5010.30	Page	Bank Subsidiaries
5010.32	Page	Nonbank Subsidiary Financial Statements and Condition
5010.33	Page	Fidelity and Other Indemnity Insurance
5010.34	Page	Audit Program
5010.37	Page	Interest Rate Sensitivity—Assets and Liabilities
5010.42	Confidential Page C	Liquidity and Debt Information

5040.0.3 LIMITED-SCOPE INSPECTION PROCEDURES

Procedure:	Complete FR 1417 and indicate that the scope was limited (“L”).
Nature of Inspection:	Disclose on the “Scope of Inspection” page that the scope is limited, including any additional procedures utilized for a certain area or activity during the inspection that might be comparable to a full-scope inspection.
Directors’ Summary:	Required under the same conditions as in the full scope. ³
Rating:	Assign RFI/C(D) rating (see section 4070.0) as appropriate. Indicate under what circumstances the rating was assigned and what components were changed, including the reasons why they were changed.
Inspection Cover:	Cover will designate “limited” scope (FR 1427) and will be a designated color other than the full-scope reports.

3. Should generally be prepared in accordance with the requirement for the preparation of written reports to directors summarizing the inspection finding following a full-scope

inspection. Reserve Banks that have previously identified the problems and provided a report to the directors are not required to prepare the summary for the limited-scope inspection.

5040.0.4 LIMITED-SCOPE INSPECTION REPORT COVER (FR 1427)

FR 1427-Cover
(Revised 7/08)



REPORT OF
BANK HOLDING COMPANY
INSPECTION
(Limited Scope)

Name: _____ Inspection Commenced: _____
Location: _____ Inspection Concluded: _____
RSSD ID Number: _____ Inspection Date: _____

THIS REPORT OF INSPECTION IS STRICTLY CONFIDENTIAL

This report has been prepared by an examiner selected or approved by the Board of Governors of the Federal Reserve System. The report is the property of the Board of Governors and is furnished to directors and management for their confidential use. The report is strictly privileged and confidential under applicable law, and the Board of Governors has forbidden its disclosure in any manner without its permission, except in limited circumstances specified in the law (12 USC 1817(a) and 1831m) and in the regulations of the Board of Governors (12 CFR 261.20). Under no circumstances should the directors, officers, employees, trustees or independent auditors dis-

close or make public this report or any portion thereof except in accordance with applicable law and the regulations of the Board of Governors. Any unauthorized disclosure of the report may subject the person or persons disclosing or receiving such information to the penalties of Section 641 of the U.S. Criminal Code (18 USC 641). Each director or trustee, in keeping with his or her responsibilities, should become fully informed regarding the contents of this report. In making this review, it should be noted that this report is not an audit, and should not be considered as such.

FEDERAL RESERVE BANK OF

Procedures for “Targeted” Inspection Report Preparation (General Instructions) Section 5050.0

5050.0.1 OBJECTIVES OF A TARGETED INSPECTION

A targeted inspection is designed to focus intensively on one or more specific areas, activities, or problems relating to a bank holding company. Such inspections may be conducted for various reasons, including serving as a com-

plement to an annual full-scope inspection.¹ Targeted inspections are conducted as directed by the System or at the discretion of the individual Reserve Banks. As a minimum, the inspection procedures used are comparable to a full-scope inspection.

1. FR 1225 will serve as the basis for a targeted inspection.

Report Pages Included: Cover (FR 1428)

Table of Contents for included pages and a key for abbreviations used in the report

Examiner’s Comments

Scope of Inspection

Other report pages supporting the scope, and the nature of the targeted inspection, as deemed appropriate by the Reserve Bank and the examiner-in-charge.

Confidential pages consisting of confidential page B, “Condition of the Bank Holding Company,” and confidential page D, “Administrative Matters.”

Nature of Inspection: Disclose on the “Scope of Inspection” that the scope is targeted and describe the procedures utilized for the targeted areas or activities.

Directors’ Summary: Required as prescribed in the full scope.²

Rating: A new RFI/C(D) *composite rating* of 1 through 5 would only be assigned if the bank holding company inspection results provide sufficient information to either reaffirm or modify the most recently assigned RFI/C(D) composite rating. At least one component area must be rated between 1 and 5 in order to assign a new composite rating; otherwise, a composite rating of 0 should be assigned.

2. Should generally be prepared in accordance with the requirement for the preparation of written reports to directors summarizing the inspection’s findings following a full-scope

inspection. Reserve Banks that have previously identified the problems and provided a summary report to the directors are not required to prepare the summary for the targeted inspection.

5050.0.2 TARGETED INSPECTION REPORT COVER (FR 1428)

FR 1428—Cover
(Revised 7/08)



**REPORT OF
BANK HOLDING COMPANY
INSPECTION
(Targeted Scope)**

Name: _____ Inspection Commenced: _____
 Location: _____ Inspection Concluded: _____
 RSSD ID Number: _____ Inspection Date: _____

THIS REPORT OF INSPECTION IS STRICTLY CONFIDENTIAL

This report has been prepared by an examiner selected or approved by the Board of Governors of the Federal Reserve System. The report is the property of the Board of Governors and is furnished to directors and management for their confidential use. The report is strictly privileged and confidential under applicable law, and the Board of Governors has forbidden its disclosure in any manner without its permission, except in limited circumstances specified in the law (12 USC 1817(a) and 1831m) and in the regulations of the Board of Governors (12 CFR 261.20). Under no circumstances should the directors, officers, employees, trustees or independent auditors dis-

close or make public this report or any portion thereof except in accordance with applicable law and the regulations of the Board of Governors. Any unauthorized disclosure of the report may subject the person or persons disclosing or receiving such information to the penalties of Section 641 of the U.S. Criminal Code (18 USC 641). Each director or trustee, in keeping with his or her responsibilities, should become fully informed regarding the contents of this report. In making this review, it should be noted that this report is not an audit, and should not be considered as such.

FEDERAL RESERVE BANK OF

A management information system (MIS) can be described as an automatic data processing system designed to aid in the performance of management functions. The MIS system is used in the decision-making process, which facilitates the collection and presentation of information to plan, organize, and control activities within the confines of the organizational culture. MIS encompasses the policies, procedures, and internal controls pertaining to management reporting which provide the information needed by the board to monitor and ensure control of operations and activities. MIS supports all levels of the organization in the execution of their duties—from the board of directors down to the lowest level of management within the company. A successful MIS will support the strategic direction of the company and promote the process by which decisions are made.

The objective of a targeted MIS inspection is to determine if the corporation has in place a management information system which is capable of providing its board of directors and senior management committees with sufficient, reliable, and timely data from which informed decisions can be made to monitor and manage risks. As a result, the targeted inspection uses a “top-down” approach, which focuses on the information used by the board and senior management committees and on the overall MIS architecture. For further inspection guidance, see the MIS sections 2060.0 to 2060.5 and SR-95-45 and its exhibits. The MIS supporting other levels of management should be reviewed during subsequent bank holding company inspections.

A targeted MIS inspection should be performed in companies in which there has been a notable alteration in the risk profile or aggressive expansion, or in which significant changes in information systems have occurred. This will ensure that executive management and the board have taken into consideration MIS and its ability to keep up with the changes in the organization. It should be noted that there is no one management reporting system. Depending on the structure of the organization, the activities that it engages in, the risk profile that results, and the technological environment that it operates under, MIS will be different in each bank holding company.

A key element of a successful MIS is the creation of the necessary technological support system. Since MIS is the primary tool for executive management and the board to monitor risk and measure performance, it is vital that the

generated reports are accurate, provide sufficient information, and address all areas of the organization. Thus, data integrity is a key factor in analyzing the MIS process; inaccurate data can lead to faulty conclusions by management and the board. In addition, information flows to the top level of the organization should be comprehensive enough to allow for informed decisions. An overload of trivial information can cause confusion and slow the decision-making process.

The MIS inspection process focuses on three broad areas:

1. Relevance and Use of MIS
 - overall risk assessment of the corporation
 - identification of risk responsibilities and reporting lines within the organization
 - evaluation of the quality and relevancy of MIS reports
2. Internal Controls over MIS Integrity
 - identification of information flows and internal control points
 - evaluation of internal controls over information flows
 - evaluation of the report-development process and contingency plans
3. MIS Architecture and Planning
 - analysis of corporate strategic and technology plans, and the effect of their interrelationship on MIS
 - identification of the system architecture, including planned enhancements, and its effect on MIS
 - evaluation of the capability of system architecture to assimilate acquired organizations and the subsequent effect on MIS

The targeted MIS inspection evaluates the information flows to senior management and the computer or manual systems which support them. Bank holding company inspections place emphasis on reports generated by MIS rather than on the process by which they are created.

Management information systems are made up of various subsystems and will generally be unique to the organization. MIS will be influenced by the structure of the organization, its activities, its risk profile, and its technological capabilities. The targeted MIS inspection guidelines and procedures focus on the three broad areas outlined above and provide examiners

with guidance on how to evaluate a bank holding company's MIS process.

5052.0.1 RELEVANCY AND USE OF MIS

Management information requirements will be determined by the size and complexity of an organization's operations. As an organization grows in size and its operations become more complex, management must recognize that information needs change. In addition, strategic goals may dictate a change in the focus of the company, requiring revisions in data collection and presentation. Guidelines and requirements for reports that flow to executive management and the board should be established, recognizing, however, that different levels of the organization have different informational needs.

The effectiveness of MIS has to be analyzed in terms of its ability to assist executive management and the board in identifying, monitoring, and controlling risks throughout the organization. Reports should be analyzed for quality, timeliness, and consistency. They should provide coverage of the major areas in the institution and communicate information clearly and concisely. An organization might have a comprehensive MIS, but if pertinent information is not flowing to executive management and the board of directors, the system is not effective.

Information must be presented in a summarized form, which is easy to read and understand. Procedures must be in place to allow for rapid collection and assimilation of data allowing for timely presentation to executive management and the board. The presentation of data should be consistent from one period to another to avoid any undue confusion. Changes in format need to be agreed on by all users of the report before implementation. Data should cover all areas of risk within the organization and provide comparisons to enable executive management and the board to measure performance.

An assessment of the executive management committee and board members should be performed. A review of reporting lines should also be performed. (See section 2060.4.)

5052.0.2 INTERNAL CONTROLS OVER MIS INTEGRITY

The review of data integrity of reports to the

board of directors and executive management committee is essential to ensure that information flows are accurate and that reports are consistently prepared. For each report reviewed, the flow of information through MIS must be identified, including computer platforms, applications software, and interrelationships with other computer systems. Controls such as data entry and modification, data security, disaster recovery, back-up, and program changes should be assessed. Any points in the system where manual intervention occurs should be identified, and information on the flexibility of the system should be obtained.

The procedures used to assess the data integrity controls will vary depending on the nature of the computer platform and application software and on the amount of manual intervention required to produce the report. However, in all cases, the assessment of MIS data integrity controls should begin with a review of the results of prior inspections and the result of internal and external audit reports. Previously identified deficiencies that have not been corrected can affect the integrity of current data.

Reports produced by a mainframe application system should have controls within the mainframe environment and in the application system used to produce the report. These controls are reviewed during EDP examinations and periodic EDP audits. These examination and audit reports should be used as leverage during the MIS inspection, and the current status of deficiencies noted should be ascertained through discussions with internal auditors and management.

Reports may also be produced by personal computers using spreadsheet and other office-product software in a distributed processing environment. Reviews of distributed processing systems require interviews with the persons responsible for preparing the reports. Any instances of manual intervention in such an environment must be identified and evaluated. The most recent EDP examination report should also be reviewed for any deficiencies noted in the bank holding company's microcomputer policies and procedures. A review of internal audit reports for the applicable business area and discussions with audit personnel will reveal whether this PC/spreadsheet application has been audited recently.

5052.0.3 MIS ARCHITECTURE AND PLANNING

The business plan and the computer system's architecture plan should be designed to comple-

ment each other and must support the strategic plan. The business plan identifies the goals, target markets, and areas of risk of the organization. The architecture plan describes the corporate technological plans for implementing the systems that will achieve the strategic and business goals, and it should include MIS.

Information is a valuable corporate asset. In a competitive banking environment, the ability to effectively manage this asset is crucial to a bank holding company's ability to remain competitive, introduce new products and services, and achieve desired goals. Therefore, the computer system's architecture plan should be developed in conjunction with its business plan. The architecture plan should ensure that mainframe processing and MIS are appropriately integrated and in place for the banking organization to achieve its strategic goals.

The dynamic and competitive banking and technology environments make effective planning critical. Reconciliation of the business and computer system's architecture plans is necessary to determine the effectiveness of the banking organization's planning process. With the proliferation of mergers and acquisitions in the financial industry, this process becomes more complicated. It is essential that management have a clear vision of its strategic and business goals and the technology required to achieve them if it is to effectively manage the divergent technologies that may be inherited through mergers and acquisitions. Bank holding companies in this situation should decide which acquired systems will survive. Documentation should support management's decision, and formal conversion plans should be documented. Telecommunications, compatibility of systems, data integrity, capacity, contingency planning, and data security are especially critical in this situation and should be evaluated in the planning and conversion process.

Ultimately, the business and the computer system's architecture plans should support the strategic plan. If these plans do not complement one another, the ability of management to achieve its goals may be difficult.

5052.0.4 INSPECTION OBJECTIVES

1. To review the organizational structure to determine the various levels of decision-making and reporting lines, risk assessment, and controls, including board and executive management committees.
2. To assess the adequacy of the management reports generated for their timeliness, qual-

- ity, accuracy, and coverage of crucial areas.
3. To evaluate reports in terms of their ability to measure the company's progress in meeting its financial and business goals, including the capability to produce forecasts using various scenarios.
4. To evaluate management procedures for reacting to elevated risk, weaknesses, or deficiencies disclosed by the MIS, and the system's ability to adapt to change caused by regulatory and accounting issues or by other market conditions.
5. To determine if the policies, practices, procedures, and internal controls regarding management information systems and management reporting are adequate.
6. To evaluate the controls in place to ensure the integrity of the information within MIS, including data security, disaster recovery, and the system's development life cycle.
7. To determine if the functions of automated systems, reconciliation procedures, and reporting processes are completely understood by staff and that these functions are fully documented.
8. To ensure that an architecture plan exists that includes MIS and that it supports the business and strategic plans.
9. To determine if a management process exists for MIS planning, including organizational responsibility, development, and implementation.
10. To determine if a strategy exists for an effective consolidation of systems in the event of a merger or acquisition.
11. To recommend enhancements and/or corrective action when policies, practices, procedures, internal controls, or MIS are deficient.

5052.0.5 INSPECTION PROCEDURES

5052.0.5.1 General

1. Present the first-day request letter to executive management well in advance of the targeted inspection commencement date, allowing sufficient time for data collection (e.g., at least two weeks before). (See SR-95-45, exhibit A, for a sample first-day letter.) The examiner-in-charge should review the responses well in advance of the start of the inspection.
2. Solicit the cooperation of key senior officials

in organizing and conducting a meeting to discuss with them the identification, control, and reporting of identified risks within the various key operating areas of the bank holding company. Request that key senior management officials make or arrange for presentations during this meeting that will identify the major departments, functions, and activities within the organization and how MIS is used to identify and manage risk. (See SR-95-45, exhibit B.)

3. Draft the inspection report for participating examiners to review before the close of the on-site phase of the inspection, ensuring the inclusion of all relevant findings.

5052.0.5.2 Relevancy and Use of MIS

1. Review the organizational structure to determine reporting lines and the various levels of decision making, risk assessment, and controls. Determine if there are any corporate policies specific to risk management or internal reporting requirements.
2. Review the board and executive management committee structure, including its membership, mission, and authority and the experience levels of the members.
3. Read board and committee minutes and obtain sample copies of the board and committee packets.
4. Obtain a listing of internal reports that are submitted to corporate executive management and the board of directors. Ask that copies of each of these *top-level* reports be attached to the listing.
 - a. Review each listed report for timeliness, clarity, completeness, relevancy, and measurability.
 - b. Analyze the management reports for information sufficient to measure the company's progress in meeting its financial and business goals, including the ability to produce various forecasting scenarios.
5. Identify management procedures for reacting to elevated risk, weaknesses, or deficiencies disclosed by MIS. Evaluate the system's ability to handle regulatory and accounting issues and to adapt to change.
6. Discuss the examiners' perceptions of MIS reports with executive management as to their timeliness, clarity, completeness, relevancy, and measurability.

5052.0.5.3 MIS Integrity and Internal Controls

1. Review and analyze any policies, procedures, and practices governing the corporation's MIS, including descriptions of existing controls to ensure data integrity throughout the system, disaster-recovery plans, and standardized procedures for the development and use of systems and applications.
2. Review the architecture of MIS. Determine whether there is a single MIS system or a number of related systems. Ascertain if MIS is produced by the mainframe, distributed processors, personal computers, or a combination of these systems. Identify the databases in use for MIS reporting.
3. For each board and executive management report identified, review and verify the flow of data through MIS to the reports, include all computer platforms and application software used. Identify risk points and the controls in place to ensure data integrity. (See SR-95-45, exhibit C for a suggested format.)
4. For each report, verify the controls over data input and the report-distribution process. Determine that sufficient controls are in place to reasonably ensure the accuracy and confidentiality of the data.
5. Review all internal and external audit, regulatory examination, and outside consultant reports concerning MIS since the previous inspection. Note any deficiencies and/or recommendations, and determine whether management has taken appropriate corrective action. Perform follow-up action on any unresolved issues.
6. Through discussions with management and other personnel, determine if any significant changes to MIS are planned. If so, obtain and document the details and analyze their potential effect on MIS integrity.

5052.0.5.4 MIS Architecture and Planning

1. Review the corporate strategic, business, and computer architecture plans, if applicable, to determine if the architecture plan supports the strategic and business goals. The business plan should reflect goals in support of the strategic plan, and any differences between these plans should be reconciled. If a reconciliation has not been performed, request that management complete one during the inspection. Otherwise, complete the reconciliation.

2. Request (or create) a conceptual overview model to identify the flow of information through the organization. (See SR-95-45, exhibit D.)
3. Evaluate management's conversion planning process by selecting a recently converted or consolidated MIS application for review. This application will be emphasized when completing other sections of the work program.
4. After determining the extent of merger and acquisition activity at the institution, review conversion plans and the methodology for consolidating systems and ascertain their effectiveness.
5. Review a copy of development plans for any significant MIS-related projects. Determine if they address cited MIS weaknesses, meet strategic and business goals of the organization, and are in compliance with established policies.
6. Discuss with executive management any inconsistencies among the business, system architecture, and strategic plans.

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 inspection activities that have traditionally been conducted in the field can now be completed in Reserve Bank offices.

The option to complete certain inspection activities in Reserve Bank offices has various advantages. 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 of SMBs and BHCs. Further, greater reliance on off-site work can allow Reserve Banks to reduce travel-related expenses.

5060.0.1 CONDUCTING INSPECTION ACTIVITIES IN RESERVE BANK OFFICES

Examiners should conduct in Reserve Bank offices all inspection activities that can be efficiently and effectively completed off-site. Activities that may be completed off-site include planning the inspection, reviewing historical information, completing preliminary financial analyses, and preparing certain report pages using data maintained at Reserve Bank offices. For additional information, see SR-95-13 (SUP) and SR 02-1.

When using this approach, examiners should contact BHCs by letter and ask them to forward to Reserve Bank offices financial and other information to be used in the off-site portion of the inspection. Most information that has traditionally been requested in first day letters and made available to examiners at the start of an inspection should be requested, with the exception of documents such as minute books or bulky printouts that would be inappropriate or impractical to have sent. While it is anticipated that this approach will be preferred to approaches that require a longer on-site examiner presence, BHCs are not required to be inspected under this approach and should be given the option to be inspected using traditional on-site

approaches. Given the burdens imposed on BHCs to 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 basis. As noted above, however, these BHCs should be given the option to be inspected using the traditional on-site approach. Noncomplex shell bank holding companies (NCSBHCs)¹ with consolidated assets of less than \$1 billion and that on their last inspection were rated RFI/C(D) 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 and must be inspected on-site.
- When a BHC's lead bank subsidiary is an 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 also be inspected on-site.
- If a BHC is unable to forward the information necessary to conduct an off-site inspection, or if the company is assigned a RFI/C(D) 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

1. Noncomplex shell bank holding companies are those companies with less than \$1 billion in consolidated assets without credit-extending nonbank subsidiaries or debt held by the general public whose condition is predicated almost entirely on the condition of subsidiary banks.

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 necessary to complete an off-site inspection of the institution.

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

5060.0.2 OFF- AND ON-SITE BHC INSPECTION PROCEDURES— APPENDIX 1

This appendix includes inspection procedures that can be completed in the Reserve Bank's offices and those procedures that should be conducted on-site. A sample first day letter information request form is included.

5060.0.2.1 Activities That Can Be Completed in the Office

Work to be performed in the office in preparation for a bank holding company inspection should include the—

- 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 (for example, parent, subsidiary banks, consolidated entity).

In addition, if centralized management functions (for example, 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 (see sections 5010.6.3 and 5010.31) can be performed in the office, based on information submitted by the institution.

5060.0.2.2 BHC Inspection Activities That Should Be Conducted On-Site

The following inspection activities are recommended and should continue to be performed at the bank holding company:

- review of credit and investment files at holding company and nonbank subsidiaries for quality, documentation, and compliance with policy, 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 Reserve Bank's office;
- exit meetings with management.

5060.0.2.3 Sample Information Request for a Bank Holding Company

Information To Be Sent to the Federal Reserve Bank

1. Exhibits A through N (See attachment #2, SR-95-13). Also, please assemble applicable workpapers that 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 that 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 organization'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 such entities as the FmHA, SBA, and VA.

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 subsidiaries. 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 from the holding company's attorneys relating to the status of all lawsuits in which the holding company or its subsidiaries 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 that have been amended or adopted since the previous FRB inspection.

24. A copy of the bank's most recent Report of Condition and Income (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 the inspection date.

26. Copies of any "key man" or "split-dollar" life insurance policies held at the holding company or the subsidiaries.

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 banks.

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; and (e) a trial balance of all credits, delinquency reports, nonperforming reports, and watch-listed loans for credit-extending subsidiaries.

Information To Be Provided at the Holding Company

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

32. Access to internal audit and internal loan review reports and workpapers.

33. Minutes of meetings of the 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 workpapers. 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, and check registers.

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) a listing of directors and officers; and (e) access to credit policies and credit files for all nonbank credit-extending subsidiaries.

40. Access to due-diligence reports and workpapers and assimilation plans.

41. Any available information on local economic conditions.

5060.0.3 PROCEDURES FOR IMPLEMENTING OFF-SITE INSPECTIONS FOR CERTAIN SHELL BHCS—APPENDIX 2

This appendix includes procedures for implementing the program authorizing off-site inspections for certain shell BHCs. Listed below are general procedures that can be followed in implementing the program for off-site inspections of certain noncomplex shell bank holding companies (NCSBHCS). Sample documents are included 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.

5060.0.3.1 General Procedures for Off-Site Inspections

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

1. Senior management of bank holding companies should be notified before 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, 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 examiners 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 examiners 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 LETTER



Date:

BHC Official
 BHC Name
 Address

Dear BHC Official:

This year, the Federal Reserve Bank of New York will conduct off-site inspections of certain bank holding companies. Your company will be inspected during 19X0 and presently qualifies for an off-site review by our office.

As part of our off-site program, you will receive an information request form which must be completed and returned to the Reserve Bank. The Reserve Bank will reimburse you for postage expenses. The form requires responses to several questions, as well as submission of copies of certain holding company financial documents. Our examiners will review the information, complete their analysis, and discuss their findings with management, either by telephone conference or, if necessary, at the offices of your bank holding company. Following the off-site review, holding company management will receive a written report which will include the following:

- a description of the scope of the inspection;
- the examiner's presentation of the financial condition and performance of the parent company and the subsidiary bank;
- an evaluation of the company's compliance with laws and regulations; and
- the examiner's comments, conclusions, and recommendations.

We have found that the off-site inspection program has proved attractive to many banking organizations. However, participation is not mandatory. Therefore, if you do not wish to participate, please sign and mail the enclosed form by DATE. We do want to make it clear, however, that while we plan to conduct an off-site review of your company if you accept this proposal, we still may conduct an on-site inspection if conditions change or if examiners are otherwise in your vicinity.

Should you have any questions concerning the off-site inspection program, please contact OFFICE STAFF MEMBER at (800) ____-____, extension ____.

Sincerely,

Officer
 Title

Enclosure

SAMPLE RESPONSE FORM



OFF-SITE INSPECTION PROGRAM
FEDERAL RESERVE BANK OF NEW YORK
RESPONSE FORM

We do not wish to participate in the off-site inspection program
in 19X0.

Name of Company: _____

City: _____

State: _____

Signed: _____

Title: _____

SAMPLE LETTER



Date:

BHC Official
BHC Name
Address

Dear BHC Official:

Pursuant to our telephone conversation of (Date) , an off-site inspection of (BHC Name) , will be conducted by our office. Please respond to each item of the information request form attached and complete the enclosed schedules. Please be aware that all items submitted for review will be retained by our office and not returned to the company. Therefore, it is advisable to submit copies of records rather than originals. Upon receipt of the items requested, we will reimburse your bank holding company for the postage expense.

In order for us to use the off-site program, you must submit a complete response to this information request no later than (Date) . If we are unable to satisfactorily resolve any issues arising from your response to this request, or if the information contained in your response is substantially incomplete, we will schedule the company for an on-site inspection.

Upon review of the information submitted, we will contact you to schedule a meeting with our examiners. If you have any questions concerning the inspection process or the preparation of your responses, please contact (Office Staff Member) at (800) - - - - , extension - - - - .

Sincerely,

Name
Examiner

Enclosures

SAMPLE INFORMATION REQUEST FORM



BHC
 OFF-SITE INSPECTION CONDUCTED AS OF
 DATE ___/___/___

INFORMATION REQUEST FORM

Please submit or provide responses to the following (if non-applicable, answer N/A):

1. Statements for the most recent quarter and the two latest fiscal years:
 - A. Parent Company -- Balance Sheet
 - B. Parent Company -- Income Statement
 - C. Parent Company -- Statement of Changes in Stockholders' Equity
 - D. Bank -- Reports of Condition and Income (most recent quarter only)
 - E. Reconciliation of the parent company's "Investment in Bank" account to the subsidiary bank's "Stockholders' Equity" as reported in the Reports of Condition
2. The bank's daily statement and income and expense statement dated ___/___/___.
3. Projected cash flow worksheet for the year 19X1 (see attached form).
4. Excerpts from the company's general ledger and subsidiary ledgers containing all significant accounting entries since ___/___/___.
5. Detail of any "other assets" or "other liabilities" accounts for the company, as well as "other income" or "other expense" items, presented in financial statements requested above IF the amounts exceed \$500.
6. Details on any liabilities, contingent or otherwise, not appearing in the financial statements.
7. A copy of the company's bank statements and its check register and/or cancelled checks issued since ___/___/___.
8. A copy of any notes payable and/or receivable of the bank holding company (including a copy of any related loan agreements) if they have been put in place or amended since the last inspection.*

*The last inspection of (BHC Name) was conducted on (Date) .

SAMPLE INFORMATION REQUEST FORM—Continued

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9. A copy of any agreements originating since the last inspection between the company and the bank, between stockholders, or between the bank holding company and the stockholders.
10. A list of changes of specific services performed by the holding company for the bank or for any other company since the last inspection. Also indicate the method for computing fees, provide copies of any relevant agreements, and provide documentation supporting any management/service fee assessments.
11. For any changes to the parent company's investments in stocks of companies OTHER THAN subsidiaries, a list of the (1) date of acquisition/sale, (2) number of shares acquired/sold, (3) resulting percentage ownership, and (4) nature of business engaged in by the subject company.
12. A copy of any internally prepared reports of problem loans and nonperforming assets for the banking organization.
13. A list of any stock issuances or redemptions by the company since the last inspection, including the issue/redemption date and price. Also, list all stockholders and their percentage interest in the holding company as of __/__/__.
14. A statement of the date and amount of any capital injections into the bank since the last inspection.
15. A copy of the minutes of all shareholders'/directors' meetings for the company held since the last inspection.
16. For each director of the holding company, provide his or her (1) date of birth, (2) date first elected to the board, (3) position in the bank holding company, (4) position in the bank, (5) principal occupation if different than bank or bank holding company officer, (6) ownership percentage in other financial institutions, and (7) positions in other financial institutions.
17. A statement of any material litigation affecting the company or the bank.
18. A list of all tax transactions since __/__/__. These transactions would include those between the bank and the holding company as well as any transactions with the tax authorities. (See attached example.)
19. A copy of the last two years' federal and state income tax returns, including any amendments.
20. A copy of your accountant's workpapers showing the calculation of the holding company tax benefit or liability for the last two years.

SAMPLE INFORMATION REQUEST FORM—Continued

- 3 -

21. If the parent company filed for a tax loss carryback in the last two years, provide documents filed with the IRS and related prior-year tax returns.
22. A copy of the tax sharing agreement between the bank holding company and its bank subsidiary if amended or redated since the last inspection.
23. The date of the last IRS audit of the bank holding company's tax returns, an identification of the tax periods covered in the audit, and an indication of whether any assessments or refunds remain unsettled.
24. A copy of the bank's current year budget and operating projections, if available.
25. If the subsidiary bank maintains a correspondent balance at any creditor bank of the holding company, copies of (1) the monthly analysis of the account provided by the correspondent for the last 12 months, (2) any agreement whereby the loan to the holding company is contingent on the subsidiary bank maintaining such a balance, and (3) an explanation if the balances maintained by the subsidiary bank exceed the level required for services received.
26. If any Employee Stock Ownership Plan (ESOP) owns stock in the holding company, provide copies of (1) the ESOP plan and trustee agreement; (2) the ESOP's current balance sheet; (3) the independent appraisal used to determine the value of the holding company stock purchased by the ESOP; (4) any note payable, security agreement, loan agreement, and guarantees. Also provide (1) the date the plan was accepted by the IRS; (2) a description of the ESOP's current investments, including the date they were purchased and their cost; (3) the names of the individuals who have the power to vote the ESOP's stock; (4) a list of individuals having the power to make investments for the ESOP; and (5) a list of the beneficiaries of the ESOP.
27. Copies of the articles of incorporation and by-laws for the bank holding company, if amended since the last inspection.
28. If the holding company is selling insurance, list the (1) licensed agents employed by the company; (2) compensation received by each agent; (3) method for determining compensation; (4) a description of how customers of the bank are informed that they are not obligated to purchase insurance from the holding company in order to obtain credit; and (5) a breakdown of insurance accounts receivable, past due more than 90 days.

SAMPLE INFORMATION REQUEST FORM—Continued

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29. If the subsidiary bank is providing the holding company with either personnel or facilities for the sale of insurance or any noninsured investment products, a statement indicating whether the subsidiary bank is reimbursed for its expenses. If the bank is reimbursed, a description of the method used to determine such amounts. Indicate when this reimbursement method was approved by the respective boards of directors.
30. If the holding company is involved in the sale of any non-insured investment products such as annuities or mutual funds, describe the program including any arrangements that involve the use of third-party brokers. If the holding company receives any share of the related commissions or lease income or if employees of the holding company or a nonbank subsidiary of the holding company are involved in the program, please describe.
31. Copies of the dividend policies of the holding company and the subsidiary bank. If no written policy exists, provide a description of the methods used to determine the amount of dividends paid by the bank holding company or any of its subsidiaries.
32. The dates and amounts of dividends paid by the subsidiary bank since the last quarter-end.
33. A description of any changes made to the holding company's audit and/or credit review programs.
34. Details of any directors and officers liability insurance maintained by the organization or indemnification provisions adopted by the bank or bank holding company.
35. For banker's blanket bond and excess fidelity bond coverage, please provide (1) name of surety; (2) form number; (3) primary and excess amount of coverage; (4) expiration date; (5) name of insured; (6) an indication of whether all officers and employees of the holding company, bank, and any nonbank subsidiaries are covered; (7) the date the insurance coverage was last approved by the bank holding company's board of directors and the bank's board of directors; and (8) a description of how insurance premiums are allocated among the entities of the organization.
36. Details of any significant transactions since ___/___/___ not already described in responses to the above questions.