

## RISK SCOPING ACTIVITIES

### Core Analysis Procedures

*Examiners are to consider these procedures but are not expected to perform every procedure at every institution. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.*

#### References

- FDIC: [Section 21.1](#) of the Risk Management Manual of Examination Policies
- FRB: [SR 16-8](#), “Off-site Review of Loan Files”

#### Considerations and Background

This module is intended to help the examiner-in-charge (EIC) determine the examination scope, allocate staff resources, and prepare an examination planning memorandum using a risk-focused approach. When specialty examinations are integrated with safety and soundness examinations and reports, procedures for these specialties should be addressed. Examiners should tailor the request list to include only those items necessary to examine the institution based on its unique business model, risk profile, and complexity.

#### Business Model, Risk Profile, and Complexity Identification

*Completing the procedures below may require a discussion with institution management in advance of sending out the first day information request letter (to assist in scoping the request) and after receipt of the information (to clarify understanding of information received). Also, discussions with the agency’s case manager (or equivalent) and reviews of off-site monitoring activities will likely provide additional information for consideration in planning the examination scope.*

##### 1. Determine whether concerns or higher risk conditions are present, such as:

- Internal controls, audit, or any other weaknesses referenced in prior examination or audit reports
- Unusual loan types, higher risk asset categories, or products with excessive volumes of complaints relative to the business model and staff expertise
- Higher risk business strategies or business lines relative to financial and managerial resources
- Significant changes in key staff, excessive personnel turnover, or inadequate succession plans
- Significant changes in earnings or balance sheet composition<sup>1</sup>
- Marginal capacity to raise equity capital
- Significant insider transactions (FRB Regulation O)
- Parent company issues<sup>2</sup>

<sup>1</sup> Examples may include rapid growth, increases or negative quarterly provision expenses, and changes in asset or liability composition.

<sup>2</sup> May include high volumes of intercompany transactions (FRB Regulation W) or issues that limit its ability to serve as a source of strength to the bank. These issues may include low liquidity, high debt, or an overreliance on bank dividends for cash flow.

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

- **Obtain from management:**
  - Strategic plans and budgets
  - Internal management reports
  - Watch lists
  - Board packages
  - Annual reports
  - Auditor reports, management letters, quality control reports, and other reviews<sup>3</sup>
- **Obtain from other sources:**
  - Call Reports, Uniform Bank Performance Reports (UBPR), and Bank Holding Company Performance Reports
  - Offsite monitoring reports<sup>4</sup>
  - Problem Bank Review Summaries
  - Press releases, published news stories, and on-line information/databases,
  - Reports of examination issued by the institution's primary regulator<sup>5</sup>
  - FDIC-Assisted Transactions, loan pool purchases, mergers/acquisitions
  - Regional economic conditions

**3. Review the findings of internal and external audits. Determine whether findings exist relating to:**

- Internal controls
- Accounting practices
- Regulatory reporting
- Exposure to high-risk activities

**4. Consider whether to contract or expand examination activities based on the quality of internal controls, internal audit programs, and the absence or presence of adverse audit findings. As part of this evaluation, consider the following:**

- Independence and experience of personnel conducting internal control reviews
- Appropriateness of the audit universe, risk assessment, schedule, and scope
- Adequacy of the size of the internal audit staff given the complexity and risk profile of the institution
- Effectiveness of internal control reviews and reporting
- Completeness of audit reports, management's written responses to audit findings, and exception tracking mechanisms
- Accuracy and completeness of workpapers, if necessary

<sup>3</sup> Examples include credit, interest rate risk, mortgage banking, and Small Business Association (SBA) loan reviews.

<sup>4</sup> FDIC: Examples of offsite monitoring reports include Real Estate Stress Tests (REST), Interest Rate Risk Reports (IRRSA), and Large Insured Depository Institution (LIDI) Reports.

<sup>5</sup> If applicable, also obtain reports of examinations related to security- or insurance-activities conducted by bank subsidiaries or other entities.

<b>5. Assess uncorrected control weaknesses identified by internal or external audits, the previous examination, or other control procedures.</b>
<b>6. Assess the potential for safety and soundness concerns associated with consumer complaints or problems noted in specialty areas.<sup>6</sup> Consider the materiality of activities in terms of sales volume, revenues, and expenses, as well as the significance of risks posed to the institution.</b>
<b>7. Determine whether activities conducted by a functionally regulated subsidiary of the institution or holding company pose a material risk to the institution. Contact the functional regulator to obtain available information about the functionally regulated subsidiary that warrants further review. Consider whether the subsidiary's functional regulator identified any significant supervisory concerns.<sup>7</sup></b>
<b>8. Discuss with management potential concerns identified through interim offsite reviews, financial analysis, correspondence, audit findings, or consumer complaints.<sup>8</sup> The discussion should focus on emerging risks, changes to institution policies, strategic direction, new products or delivery channels, and significant activities that have occurred since the previous examination. Determine what senior management considers the most significant factors affecting the institution, including high or emerging risks. Consider the following items for discussion:</b> <ul style="list-style-type: none"> <li>• <b>Economic conditions and competitive factors that may affect the institution's overall financial condition, such as:</b> <ul style="list-style-type: none"> <li>○ The institution's primary trade area and principal business activities within the area</li> <li>○ Management's views regarding local economic trends and other factors<sup>9</sup> that may affect the institution</li> <li>○ Deposit levels and trends and any plans for new or special-rate deposit products</li> <li>○ Types of loans currently emphasized and material changes in loan types or volumes</li> <li>○ Loan and deposit competition and pricing strategies</li> </ul> </li> </ul>

<sup>6</sup> Specialty areas include Anti Money Laundering/Countering Financing of Terrorism, accounting, capital markets, compliance, trust, information technology, mortgage banking, or other specialty activities.

<sup>7</sup> If supervisory information on a functionally regulated subsidiary of the bank is not available, information may be requested of a functionally regulated subsidiary itself only in limited circumstances (FDIC: consult with the regional office; FRB: consult with Board staff). An examination of a functionally regulated subsidiary should be undertaken only after consultation with and direction from the FDIC regional office or the FRB Board staff, except for subsidiaries that sell insurance products on bank premises or on behalf of the bank, which may be examined for compliance with the Rules and Regulations on Consumer Protections for Depository Institution Sales of Insurance [FDIC: 12 CFR. Part 343; FRB: 12 CFR Part 208 (Regulation H)].

<sup>8</sup> The EIC can schedule an examination planning visit or telephone conversation with management, as appropriate.

<sup>9</sup> For example, new businesses, expansion plans, business closings, or planned layoffs within the market area.

- The institution's dependence on any particular industry or economic sector
- Managerial, operational, and functional changes, or anticipated changes, in areas such as:
  - Overall institution objectives, risk appetites, or management philosophies
  - Ownership, board composition, key personnel, or audit firms
  - Products, services, or trade areas
  - Lending or investment strategies or brokers
  - Operations, including information technology or use of emerging technologies (e.g., artificial intelligence/machine learning, application programming interfaces, distributed ledger technology, emerging digital payment, or digital lending solutions)
  - Policies and procedures
  - Committee structures, reporting relationships, and recordkeeping systems
  - New or expanding business lines, such as mortgage banking, government guaranteed lending (e.g., SBA, USDA, FHA), and commercial and industrial lending, crypto-asset related activity, digital lending, banking as a service, or other fintech programs
  - New or significant third party relationships
- Controls or procedures management has implemented to mitigate the risk of insider abuse and fraud

### Resource Allocation

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

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

### Scope Memorandum

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

- Summary of examination planning meetings or discussions
- Summary of audit and internal control environment and a general statement regarding the level of reliance examiners can place on internal controls and the audit function
- Overview of the business model, risk profile and complexity
- Preliminary risk assessments addressing CAMELS components, and comments regarding the ability to assess certain CAMELS components offsite (assess credit, market, liquidity, operational, and legal/compliance, ~~and reputational risk associated with the institution~~)

## Core Analysis

- **Summary of examination procedures, including a discussion of the examination procedures to be completed and the depth of coverage in different areas**
- **Summary of anticipated loan reviews**
- **Summary of specialty areas targeted for examination (e.g., mortgage banking, specialty lending, or other business lines)**
- **Examination staffing requirements and identification of any training opportunities or specialized skills needed**

**End of Core Analysis.**