



The 5 Things You Need To Know To Prepare For Your Next Regulatory Exam

“Exams ain’t what they used to be.” Poor grammar, but a true statement. As a financial institution examiner for more than 30 years, I can attest to that. No longer do the examiners show up unannounced on Monday and send rookie examiners to stand behind each teller and count and balance cash, while more senior examiners took control of the note vault and loan documentation. You will receive an extensive request list for records and documentation, including raw loan data files in a specific format, and a request for electronic credit file documentation once the regulators have determined the scope of the loan review.

Much of the financial information in the Report of Examination will have already been completed off-site based on the most recent quarterly Report of Income and Condition, and preliminary exam report comments will have been prepared in advance by an analyst located in the regulator’s office. Those comments and financial data will be verified by the on-site examiners. So what do you need to be doing well in advance of your next exam?

1. **Maintain comprehensive, well-organized electronic loan files to facilitate examiner review, minimize examiner questions, and alleviate examiner fatigue in “reading the story”.** Since the late 1990’s, examiner loan review has been automated and subject to more off-site review. The loan review examiners may be on-site with examiners connected to the bank’s network, or may be off-site in the regulator’s office, or even at the examiner’s home VPN’d into a secure network. This fact makes it essential that loan files be adequately documented so that examiners may determine the credit quality of the loan - pass or adversely classify – with a minimum of credit officer involvement.

What has changed? Credit quality has improved since the financial crisis. The FDIC’s Quarterly Banking Profile for the Second Quarter 2015 indicates that the quarterly charge-off rate for the industry and community banks is the lowest in nearly a decade. Additionally, banks’ loan grading systems have vastly improved over the years and credit standards have been tightened since the financial crisis. The loan review may even be conducted by relatively inexperienced examiners. Senior examiners will analyze policies and methodologies associated with the Allowance for Loan and Lease Losses (ALLL), to ensure that appropriate reserves are maintained.

2. **Make sure your ALLL policy and methodology are well documented and in compliance. Be prepared to answer questions about the bank’s readiness to implement CECL.** Examiners will place more emphasis on the bank’s methodology and policies for calculating the ALLL and the bank’s preparedness for the Current Estimated Credit Losses (CECL) standard.
3. **Have an adequate and reasonable process for back-testing and stress-testing for all key models utilized by the bank (ALLL, IRR, Liquidity, and Credit).** Since 1997 when the Sensitivity component was added to the CAMEL rating, the requirement for banks to measure sensitivity has become more sophisticated and complex, with methodologies based on verifiable reasonable assumptions. Interest Rate Risk (IRR) is a significant factor in the bank’s viability. The bank’s processes for back-

testing and stress-testing are becoming subject to increased scrutiny, and the fact that the bank's model passed muster at the last examination, is no assurance that it will be satisfactory at the next exam.

4. **Make sure accurate and complete documentation (including contracts, agreements and due diligence) is maintained for outsourced functions and all required Currency Transaction Reports (CTRs), Suspicious Activity Reports (SARs), loan approvals and denials, and disclosures.** Your bank will be subject to examinations of your Information Technology systems, including in-house systems, mobile banking, and functions outsourced to vendors. Data breaches and systems vulnerability have been in the news lately and you should ensure that appropriate security is in place for in-house systems and services provided by vendors. Unauthorized exposure of customer data can result not only in financial risk but also significant reputational risk. Your bank will also be examined for compliance with the Bank Secrecy Act/Anti-Money Laundering statutes and Consumer Protection regulations. Compliance with these statutes and regulations is critical, and violations can result in significant civil money penalties.
5. **Communicate! Maintain active and constant communication with examiners leading up to, during, and after the exam.** Make sure you retain records or evidence (emails, etc.) of files and/or discussions in regard to the pre-exam request list or off-site analyst. At the start of the exam or before if scheduling permits, meet with the Examiner-in-Charge (EIC), Asset Manager, and Detail/Operations Manager, and include key bank personnel contacts so that everyone is familiar with the examination process and expectations.

At the close of the examination, the examiners will conduct an exit meeting with management and summarize the results of the exam and tentative rating of each CAMELS component. If proper communication has been maintained throughout the exam, the results should come as no surprise; however, if there are disagreements, this is an opportunity to resolve any differences.

There are several companies that can assist you with developing appropriate pre-exam preparation and support, exam responses, and compliance with enforcement actions. One such company with extensive banking and regulatory experience is [FSRA](#) which offers a wide range of services to ensure compliance with state and federal regulations and guidance.

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