FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **9935**
October 22, 1985]

NEW POLICIES ON SUPERVISION OF STATE MEMBER BANKS AND BANK HOLDING COMPANIES

— Greater Frequency of Federal Reserve Examinations and Inspections
— Communicating Problems of Supervisory Concern

To All State Member Banks and Bank Holding Companies in the Second Federal Reserve District:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has announced two policies to strengthen Reserve Bank supervision of State member banks and bank holding companies.

The policies generally increase the frequency of Federal Reserve examinations of State member banks and inspections of bank holding companies and strengthen the procedures for reporting deficiencies to bank management and boards of directors.

The Board's action was taken in light of developments and trends within the banking system over the past several years. The policies announced are aimed at two broad supervisory areas:

— The early identification of problems in banking organizations through more frequent and in-depth on-site examinations;

— The correction of weaknesses through more frequent and clearer communications between bank supervisors and boards of directors.

In addition, the Board has identified the following areas in which steps to strengthen the supervisory process are being considered and where action will be taken if appropriate and necessary. These areas are:

— The prevention of supervisory problems in banking organizations through tightened prudential standards;

— Improved coordination and cooperation with other Federal and State banking departments, and;

— Strengthened examination staffs and improved examiner training programs.

The *first* policy announced provides for a general increase in the frequency of examinations of State member banks and inspections of bank holding companies. In general the policy provides that:

— Bank organizations for which the Federal Reserve is primary supervisor will be examined or inspected at least annually;

— The largest organizations and those with significant problems will be examined or inspected semi-annually;

— As an exception to the general rule, small "shell" holding companies with no known problems and low levels of debt relative to the book value of their subsidiary bank's stock are to be inspected on a more limited basis.

(OVER)

The *second* policy strengthens and formalizes current practices for communicating the findings of examinations and inspections to bank management and boards of directors when significant problems exist. This policy:

— Establishes specific criteria for determining which examination findings require follow-up meetings with boards of directors and sets out guidelines for such meetings;

— Requires that, in addition to providing a complete examination or inspection report to the bank or bank holding company, a written summary of findings be sent to the bank or bank holding company for distribution to each director;

— Requires that senior Reserve Bank officials become more involved in presenting examination findings to boards of directors.

The policies are effective immediately, with initial implementation expected January 1, 1986.

Enclosed, for State member banks and bank holding companies in this District, is the text of a letter from the Board of Governors on this matter, together with the text of the policy statements. Additional copies will be furnished upon request directed to our Circulars Division (Tel. No. 212-791-5216).

Questions on this matter may be directed to Gerald P. Minehan, Assistant Chief Examiner (Tel. No. 212-791-5881).

E. GERALD CORRIGAN,
President.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

TO: THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS
AND THE OFFICERS IN CHARGE OF BRANCHES

The Board of Governors has approved two new policies for Federal Reserve Banks to follow in supervising state member banks and bank holding companies (see Attachments A and and B). The first sets down guidelines that increase the required frequency of examinations of state member banks and of inspections of bank holding companies, except for certain relatively small bank holding companies. The policy also calls for the Federal Reserve Banks to increase their involvement in examinations/ inspections of larger organizations and weaker organizations and to place greater reliance on state banking agencies for the examination/ inspection of smaller, healthy organizations, to the extent the states are willing to assume and have the resources to take on these responsibilities.

The second policy, designed to formalize and strengthen longstanding practice, provides instructions for communicating the findings of examinations/inspections to the management and boards of directors of organizations with significant problems. The policy requires Reserve Bank officials to meet with the management and directors of organizations when an examination or inspection has revealed that the organization has significant problems. The policy also requires Reserve Banks to provide each member of the board of directors of such organizations with a summary report of the examination/inspection findings. Specifications for the form and general control of these reports are outlined in the policy.

Both policies have common objectives: (a) to help prevent the development of or intensification of problems at banking organizations; and (b) to enhance the effectiveness of the Federal Reserve in identifying and dealing with problems that develop nonetheless.

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Implementation of these policies is targeted to commence no later than January 1, 1986. Due to the potential impact on staff resources in certain Districts, however, the Board recognizes that some time may be required before complete implementation of the examination/inspection frequency policy is obtained.

The attached policy statement on frequency of examinations of state member banks and inspections of bank holding companies supersedes outstanding Federal Reserve System statements of policy pertaining to this specific subject contained in parts of F.R.R.S. 3-1531 (S-2441) and F.R.R.S. 3-1532 (S-2444). Similarly, the attached policy statement on communicating examination/inspection findings to management and directors supersedes the pertinent parts of Supervision and Regulation letters 75-288 and 79-512.

Sincerely yours,

(signed) William W. Wiles

William W. Wiles
Secretary

POLICY FOR FREQUENCY AND SCOPE OF EXAMINATIONS OF STATE MEMBER BANKS AND INSPECTIONS OF BANK HOLDING COMPANIES

This policy calls for a general increase in the frequency of examinations of state member banks and inspections of bank holding companies. The objectives sought are (a) to help prevent the development of problems at banking institutions and (b) to make more effective the Federal Reserve's ability to identify and resolve problems that develop nonetheless.

The policy requires that, in general, banking organizations for which the Federal Reserve is primary supervisor are to be examined/inspected at least annually, with the largest of such organizations and those with significant problems to be examined/inspected semi-annually. As an exception to the general rule, small "shell" holding companies with no known problems and low levels of debt relative to the book value of their subsidiary bank's stock may be inspected on a much more limited basis. Tables presenting these frequency and scope requirements are attached.

Federal Reserve Banks are to intensify their involvement in the examination/inspection of large organizations and those with significant problems. Greater reliance is to be placed on state examinations/inspections in the case of smaller organizations. If a state lacks the resources to conduct examinations/inspections in accordance with the specifications of this policy or is unwilling to do so, or, in the case of holding companies, lacks authority, the Federal Reserve Banks will conduct the examinations/inspections to the extent needed to meet the specifications. 1/ In addition, if a state member bank or bank holding company indicates its wish to be examined/inspected by its Federal Reserve Bank, that wish should be honored.

1/ It is suggested that Reserve Banks will need to exercise some flexibility when implementing the examination requirements in order to achieve operational efficiencies and appropriate coordination with state banking departments.

REQUIREMENTS FOR STATE MEMBER BANK EXAMINATIONS

No Identified Problems or Special Characteristics

Multinational state member banks and all others with assets greater than $10 billion will be subject to a full-scope examination annually. In addition, a limited-scope or targeted examination1/ should be scheduled annually for each of these banks. If, however, a bank's financial condition is judged to be clearly satisfactory--based on its last full-scope examination, the findings of the Federal Reserve's surveillance system2/ and other sources of information--the Reserve Bank may waive the limited-scope or targeted examination. Each of the required examinations should be conducted by the Federal Reserve Bank independently or jointly with the state; these banks should no longer be examined under an Alternate Year Examination Program (AEP).

Banks with total assets between $500 million and $10 billion will be subject to an annual full-scope examination to be conducted either by the Federal Reserve Bank independently or jointly with the state, or by the state alone on an every-other year basis under an AEP. Limited-scope or targeted examinations, between annual full-scope examinations, are to be conducted, if deemed necessary by the Reserve Bank.

Banks with assets between $100 million and $500 million must also be examined annually on a full-scope basis. Such examinations by the state in two out of every three years will be acceptable under an AEP. Additional limited-scope or targeted examinations will be conducted when deemed necessary by the Reserve Bank.

1/ A limited-scope examination will review all areas of activity covered by a full-scope examination, but less intensively. Targeted examinations will focus intensively on one or two activities.

2/ Refers to the Federal Financial Institutions Examination Council approved Uniform Bank Surveillance Screen for use by the bank regulatory agencies to identify on an early warning basis those banks in need of special supervisory attention.

Banks with assets of less than $100 million are also to be subject to an annual full-scope examination. It will be acceptable for the Reserve Bank to limit its involvement in such examinations to once every four years, if the state conducts annual examinations under an AEP in the other three years. Additional limited-scope or targeted examinations will be conducted when deemed necessary by the Reserve Bank.

Banks Requiring Special Supervisory Attention

Banks receiving a CAMEL [1/] composite rating of 4 or 5 on an examination must be examined on a twice-a-year basis thereafter until the problem is resolved; at least one of these two must be a full-scope examination. If a bank has total assets in excess of $500 million, both examinations must be conducted by its Federal Reserve Bank, independently or jointly with the state. If a bank has total assets of less than $500 million, an examination conducted independently by the state on an every other-time basis will be acceptable.

All banks rated a CAMEL composite 3 on their last examination are to have an annual full-scope examination conducted by the Federal Reserve, independently or jointly with the state. In addition, a limited-scope or targeted examination of composite 3-rated banks with total assets greater than $500 million must be conducted during the year by the Federal Reserve, independently or jointly with the state.

Banks With Special Characteristics

State chartered banks applying for membership in the Federal Reserve System are to receive a full-scope examination by the Federal Reserve before membership is granted. Particular attention is to be given in these examinations to the quality of assets and the adequacy of capital.

Similarly, a full-scope examination by the Federal Reserve, independently or jointly with the state, will be required within 12 months following (1) the formation of a de novo state member bank or (2) the change in control of a state member bank.

Banks which in the judgment of the Reserve Bank fail the surveillance screen or which the Reserve Bank, on the basis of other information, has reason to believe may have significant problems, are to receive an in-depth, off-site review to determine whether an on-site examination should be conducted by the Federal Reserve, independently or jointly with the state.

1/ CAMEL refers to the rating system used by the federal supervisory agencies to assess the financial condition of commercial banks (F.R.R.S. 3-1575).

REQUIREMENTS FOR BANK HOLDING COMPANY INSPECTIONS

Bank Holding Companies With No Identified Problems or Special Characteristics

Multinational bank holding companies and all others with consolidated assets over $10 billion are to receive a full-scope inspection annually to be coordinated with the examination of the lead bank to the extent possible. Although the inspection of the holding company and the examination of the lead bank need not be commenced simultaneously, they should overlap and rely on financial statements as of the same date, if possible, in order to facilitate the analysis and the presentation of findings to management and directors. A limited-scope or targeted inspection of these companies is also to be conducted between the annual full-scope inspections, the precise timing to be determined by off-site surveillance reports and by opportunities to coordinate with the examination of the lead bank. The requirement for a limited-scope or targeted inspection may be waived by the Reserve Bank if, on the basis of the findings of the last full-scope inspection and of the surveillance system, the institution is judged to be in satisfactory condition.

Complex bank holding companies (defined as companies with nonbank subsidiaries that extend a material amount of credit or companies whose parent has a material amount of debt outstanding to the general public) with consolidated assets between $500 million and $10 billion receive a full-scope inspection annually. Noncomplex "shell" organizations in this size group are to receive a limited-scope inspection every two years. These inspections should be conducted, to the extent possible, in coordination with the examination of the lead bank. All bank holding companies in this size group should be subject to additional limited-scope or targeted inspections when the Reserve Bank has information that suggests the institution may be developing significant problems.

Complex bank holding companies with consolidated assets between $150 million and $500 million are to receive an annual full-scope inspection. Noncomplex shell bank holding companies in this size group are to receive a limited-scope inspection on a once in three year basis.

Inspection frequency for bank holding companies with consolidated assets of less than $150 million is to be determined by their structural characteristics and their debt levels. Complex bank holding companies are to receive a full-scope inspection every other year. Noncomplex shell companies with parent debt exceeding the book value of the stock of the company's bank (or banks) should be inspected every other year. These inspections may be either full-scope, limited-scope or targeted as deemed appropriate.

Noncomplex shell companies (with consolidated assets less than $150 million) with a ratio of parent debt to the book value of the stock of the company's bank (or banks) of less than 100 percent will be inspected on a sample basis: a 20 percent sample will be drawn of companies with a ratio between 75 to 100 percent for inspection each year; a 10 percent sample will be drawn of companies with a ratio below 75 percent for inspection each year. These inspections may be either full-scope, limited-scope or targeted as deemed necessary. (NOTE: Companies that received a BOPEC[1/] composite rating of 3, 4, or 5 or failed a surveillance screen will not be included in the population from which samples are to be drawn and should be inspected in accordance with the frequency requirements set forth below.)

In addition to the above inspection requirements, in the case of companies with less than $150 million in consolidated assets, primary federal and state bank supervisors are to be asked to review, during their examination of a bank, any significant dealings between the bank and the holding company and to report such findings along with any other relevant information on the health of the organization to the Federal Reserve. (A short form will be provided to make such reports to the Federal Reserve.) The Federal Reserve Banks will review this and other information to determine whether an inspection of the holding company should be conducted. Further, the Federal Reserve will be prepared to inspect any of these small bank holding companies--as well as any larger holding company--at the request of the bank's primary supervisor.

Bank Holding Companies Requiring Special Supervisory Attention

Inspection frequency of bank holding companies requiring special supervisory attention is to be determined by both the size and complexity of the organization. The most intensive frequency requirements are directed at bank holding companies rated BOPEC composite 4 or 5, or whose lead bank subsidiary has been rated CAMEL composite 4 or 5. All bank holding companies so rated with consolidated assets over $500 million are to receive an annual full-scope inspection and a limited-scope or targeted inspection during the interval between full-scope inspections. The same requirements apply to complex bank holding companies with assets between $150 million and $500 million. To the extent possible, inspections of these 4 and 5 rated bank holding

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1/ BOPEC refers to the Federal Reserve's rating system for bank holding companies (F.R.R.S. 4-865).

companies are to be coordinated with the examination of the lead bank subsidiary. Noncomplex bank holding companies with assets of $500 million or less are to receive an annual inspection whose scope may be determined by the Reserve Bank based upon the nature of the companies' problems.1/ Complex holding companies with assets under $150 million are to receive a full-scope inspection annually.

Bank holding companies rated composite 3 with consolidated assets over $500 million are subject to the same requirements as those rated 4 or 5. Bank holding companies with consolidated assets between $150 million and $500 million with complex structures are to receive an annual full-scope inspection; those with noncomplex structures are to receive an annual inspection, the scope of which is to be determined by the Reserve Bank. Complex bank holding companies with assets under $150 million should receive a full-scope inspection annually; noncomplex bank holding companies with assets less than $150 million are to be inspected every other year. The type of inspection for these small noncomplex companies may be determined by the Reserve Bank.1/

Bank Holding Companies with Special Characteristics

Bank holding companies formed to acquire an existing bank are to be inspected to determine their compliance with Federal Reserve regulation and the extent to which they have fulfilled commitments the Board of Governors required of the organization in approving its application. Such inspections should be conducted between the 6th and 18th month after the acquisition; their scope is to be determined by the Reserve Bank. If information available to the Reserve Bank--the most recent examination of the bank, the most recent FR Y-6 and FR Y-9 reports from the holding company and other pertinent information--indicate that (a) the condition of the bank and bank holding company is satisfactory, (b) the bank holding company is fulfilling its commitments to the Board of Governors, and (c) the ratio of the parent's debt to the book value of the subsidiary bank (or banks) is less than 75 percent then, at the Reserve Bank's discretion the inspection may be delayed as long as 36 months after the formation. Moreover, the requirement for an inspection may be

1/ Reserve Banks may, under appropriate circumstances, enlist the assistance of the primary bank regulator in conducting these inspections.

waived in the case of a bank holding company whose bank subsidary has less than $50 million in total assets, if in the Reserve Bank's judgment, (a) the holding company's financial condition is satisfactory, and its commitments to the Board of Governors are being fulfilled, and (b) the ratio of the holding company's debt to the book value of the subsidiary bank (or banks) is less than 75 percent.

Bank holding companies that have undergone a change in control and de novo bank holding companies organized to acquire de novo banks, are to receive a full-scope inspection within 12 months following the change in control or formation. A limited-scope or targeted inspection may be conducted in lieu of the full-scope inspection, if, in the judgment of the Reserve Bank, the financial condition of the holding company appears satisfactory.

In those cases where bank holding companies fail the surveillance screen or where other information suggests the company has experienced an adverse development, an in-depth off site review will be made to determine the need for a limited-scope or targeted inspection.

TABLE 1

FREQUENCY AND SCOPE OF EXAMINATIONS OF STATE MEMBER BANKS

<table>
<tr><th>Asset Size
Rating</th><th>$10 billion +</th><th>$500 mm - $10 billion</th><th>$100 mm - $500 mm</th><th>Less than $100 mm</th></tr>
<tr><td>1 or 2</td><td>Full-scope required annually (FR or Joint). Limited-scope or targeted presumed annually (FR or Joint).</td><td>Full-scope required annually (FR, Joint or AEP on basis of every other year). Limited-scope or targeted when needed.</td><td>Full-scope required annually (FR,Joint or AEP on basis of every three years). Limited-scope or targeted when needed.</td><td>Full-scope required annually (FR,Joint or AEP on basis of every four years). Limited-scope or targeted when needed.</td></tr>
<tr><td>3</td><td colspan="2">Full-scope required annually (FR or Joint). Annual limited-scope or targeted also required (FR or Joint).</td><td colspan="2">Full-scope required annually (FR or Joint). Limited-scope or targeted when needed.</td></tr>
<tr><td>4 or 5</td><td colspan="2">Exam required every six months, one must be full-scope, one may be limited-scope or targeted. (Both must be FR or Joint.)</td><td colspan="2">Exam required every six months, one must be full-scope, one may be limited-scope or targeted. (At least one must be FR or Joint.)</td></tr>
</table>

Special Characteristics:
1. New member banks: full-scope FR exam required before membership granted.
2. Change in control or de novo member bank: full-scope exam (FR or Joint) required within 12 months.
3. Banks that fail surveillance screen or for which other significant adverse information is received: triggers in-depth, off-site review to determine need for examination to be conducted by FR or jointly with state.

Notes:
1. A full-scope examination covers all areas of interest to the Federal Reserve in depth; a limited-scope examination will review all areas of activity covered by a full-scope examination, but less intensively; targeted examinations will focus intensively on one or two activities.
2. The Alternate-year Examination Program (AEP) provides for Federal Reserve and state examinations of state member banks on alternating periods.
3. Joint examinations are conducted by the Federal Reserve and the state, simultaneously, with one joint report being prepared.

TABLE 2

FREQUENCY AND SCOPE OF INSPECTIONS OF BANK HOLDING COMPANIES

<table>
<tr><th>Asset Size</th><th>$10 billion +</th><th colspan="2">$500 mm to $10 billion</th><th colspan="2">$150 mm - $500 mm</th><th colspan="2">Less than $150 mm</th></tr>
<tr><th>Rating</th><th></th><th>Complex</th><th>Noncomplex</th><th>Complex</th><th>Noncomplex</th><th>Complex</th><th>See Note #4 Noncomplex</th></tr>
<tr><td>1 or 2</td><td>Full-scope required annually. Additional limited-scope or targeted presumed annually.</td><td>Full-scope required annually Limited-scope or targeted when needed.</td><td>Limited-scope required every two years. Additional limited-scope or targeted when needed.</td><td rowspan="2">Full-scope required annually.</td><td>Limited-scope required every 3 years.</td><td>Full-scope required every other year.</td><td>See Note #3</td></tr>
<tr><td>3</td><td rowspan="2" colspan="3">Full-scope required annually. One limited-scope or targeted also required annually.</td><td>Inspection required annually, may be limited-scope or targeted.</td><td>Full-scope inspection required annually.</td><td>Inspection required every other year.</td></tr>
<tr><td>4 or 5</td><td>Full-scope required annually; one limited-scope or targeted also required annually.</td><td>Inspection required annually.</td><td>Full-scope inspection required annually.</td><td>Inspection required annually.</td></tr>
</table>

Special Characteristics:

1. BHCs formed to acquire going concerns: inspection to be conducted between the 6th and 18th month of operation; or within 36 months under specific conditions; or waived if under $50 mm with specific conditions.
2. Change in control or de novo BHCs: inspection required within 12 months.
3. BHCs that fail surveillance screen or for which other significant adverse information is received: triggers in-depth off-site review to evaluate need for limited-scope or targeted inspection.

Notes:

1. A full-scope inspection covers all areas of interest to the Federal Reserve in depth; a limited-scope inspection will review all areas of activity covered by a full-scope inspection, but less intensively; targeted inspections will focus intensively on one or two activities.
2. A complex BHC is defined as one with material credit-extending nonbank subsidiaries or debt outstanding to the general public. A noncomplex BHC is one without material credit-extending subsidiaries and public debt.
3. The frequency of inspection of noncomplex "shell" BHCs that are rated BOPEC 1 or 2 is based upon the ratio of parent debt to the book value of the bank's stock: a) if over 100 percent--inspect every other year; b) if 75-100 percent--inspect a 20 percent sample each year; c) less than 75 percent--inspect a 10 percent sample each year.
4. For small noncomplex BHC's, Reserve Banks should explore the possibility, under appropriate circumstances, of enlisting the assistance of the primary bank regulator in conducting the inspection.

Attachment B

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

Previously, Federal Reserve examiners and other designated personnel have held a meeting with a banking organization's management and board of directors after an examination or inspection if it is a large organization or if the examination/inspection revealed that the organization had significant problems. In addition, a copy of the examination/ inspection findings has been provided to every bank examined and bank holding company inspected for review by its management and members of its board. That policy is now being modified for the purpose of formalizing and strengthening these traditional Federal Reserve practices for communicating the findings of examinations and inspections to the management and boards of directors of banking organizations.

The new policy establishes specific criteria for determining which examination/inspection findings require follow-up meetings with boards of directors and presents guidelines for the conduct of these meetings. It also introduces the requirements that a written summary of examination findings--separate from the complete examination or inspection report--be distributed to each director and that senior Reserve Bank officials become more involved in communicating and presenting examination/inspection findings to the boards of directors. It is intended that these initiatives will ensure that each director of a state member bank or a bank holding company considered to be a "problem" organization or identified as having a significant weakness, will clearly understand the nature and dimension of their organization's problems and the responsibilities of its board of directors to correct them.

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 bank holding company inspection is to be determined on the basis of the organization's financial condition, its size, the type of examination/inspection conducted and other factors which, in the judgment of the Reserve Bank, indicate the need for such a meeting. To the extent possible, meetings with the boards of directors of state member banks should include representatives of the state banking department. Where appropriate, meetings with the boards of bank holding companies 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.

Criteria For Conducting Meetings

Condition

A meeting with the board of directors is to be held at the conclusion of any full-scope examination or inspection in which a state member bank is rated CAMEL composite 4 or 5 or a bank holding company is rated BOPEC composite 4 or 5. Such meetings are also required if an organization is rated composite 3 and its condition appears to be deteriorating or has shown little improvement since a previous examination/inspection in which it received a composite 3 rating. [1/] A meeting should also be held with all these organizations following a limited-scope or targeted examination/inspection, if deemed appropriate and desirable by the Reserve Bank.

Size

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

Guidelines for Meetings

It is understood that 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 to be preferred, but in certain cases the Reserve Bank may determine that a meeting with a committee of the board of directors, such as executive or audit committees, will serve adequately. In all cases, however, the written summary of examination/inspection findings is to be provided to each member of an organization's board of directors.

1/ Reserve Banks also are encouraged to hold a meeting at the conclusion of a full-scope examination/inspection of an organization with assets greater than $500 million rated composite 2, if its condition appears to be deteriorating and those rated composite 3 even if showing some improvement.

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 more serious its problem, the more senior should be the Federal Reserve official. In general, Reserve Bank presidents are expected to become directly involved in the supervision of multinational organizations and regional institutions with over $5 billion in assets that have been rated composite 3, 4 or 5. The president ordinarily will meet with the board of directors and may become involved in other ways, the precise nature of which to 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 1/ or about to become a problem institution if existing conditions deteriorate. Use of slides, other visual aids, and hard copy handouts are 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:

- Deficiencies in capital, asset quality, earnings, or liquidity;
- Violations of law;
- Inadequacies in policies, practices and reporting systems necessary for the proper administration of the organization;
- Lack of well documented lending, collection, investment and liability management policies;
- Failure of management in addressing previously discussed deficiencies;
- Lack of reporting systems sufficient to keep senior management and the board of directors fully informed;
- Failure of the board of directors to participate in the active management of the organization.

1/ As has been long standing Federal Reserve practice, the exact numeric rating assigned in the examination/inspection is not to be disclosed.

SUMMARY OF EXAMINATION FINDINGS

The Federal Reserve Banks will begin providing written reports to the directors summarizing the examination/inspection findings for all organizations rated composite 3, 4 or 5, and for those rated composite 1 or 2 showing signs of a significant deterioration in condition or apparent violations of law. The summary report to the directors is intended to complement the complete report of examination/inspection findings prepared for use by bank management and the directors of an organization. The summary report is to focus on identified problems--rather than on the strength of the organization--and present them in a manner that is succinct and unmistakeably clear. In all cases the types of actions to be taken by the directors and management to address these problems should be specifically noted. Institutions rated 4 or 5 are to be told they are "problem" institutions that warrant "special supervisory attention." Institutions rated 3 are to be informed that their condition is not satisfactory, that they are subject to more than normal supervision, and that they may become "problems" if their weaknesses are not addressed adequately. A summary report should also be prepared when significant weaknesses are uncovered in the examination/inspection of 2-rated institutions. The organization, style and content of the directors summary report is also to be utilized for the summary of the examiner's comments on page one of the complete examination/ inspection report. The summary report should also emphasize the responsibilities of the directors to ensure that corrective actions are taken to address all deficiencies noted as presented in a section entitled "Matters Requiring Board Attention."

The summary report will be sent directly to the banking organization's management for their distribution to each director. The transmittal letter to the banking organization is to state that the report is a summary of identified problems and contemplated supervisory actions and to request that management distribute the report to each director. The letter is to state further that each director should read the report, sign the introductory statement attesting to having read the report, and return the report to management. Management is to keep on file copies of the statements signed by the directors but is to destroy all but a file copy of the summaries themselves.

It is essential that the directors summary report be completed and distributed before any Reserve Bank meeting with the board of directors in order to provide the directors with prior notice of the deficiencies to be discussed. Reserve Banks should also make every effort to distribute the complete examination/inspection report to management prior to meeting with directors.