FFIEC Emphasizes Risk-Focused Supervision in Second Update of the Examination Modernization Project

The Federal Financial Institutions Examination Council today provided a second update on its Examination Modernization Project.

The project identifies and assesses ways to improve the effectiveness, efficiency, and quality of community financial institutions safety and soundness examination processes, particularly through increased use of technology.

The project is a follow-up to the review of regulations under the Economic Growth and Regulatory Paperwork Reduction Act. FFIEC members with safety and soundness examination responsibilities expect these efforts to help reduce unnecessary regulatory burden on community financial institutions.

On March 22, 2018, the FFIEC issued a press release providing a first update on the Examination Modernization Project. That update noted the steps taken to improve the examination process, which included the identification of areas with the potential for the most meaningful supervisory burden reduction. This second update is focused on tailoring examination plans and procedures based on risk, which is another area that holds promise for reducing burden.

A risk-focused supervision process is where more resources are used to address institutions or areas that present heightened risk versus those that do not.

As an initial step in enhancing their respective risk-focused approaches to supervision,
the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the State Liaison Committee reviewed and compared principles and processes for risk focusing examinations of community financial institutions.

This review concluded that the state and federal regulators have developed and implemented similar programs and processes for risk tailoring examinations. Common risk tailoring principles and practices include:

- Recognizing there are financial institutions, or areas within institutions, that present low risk, and in those cases, minimum examination procedures are generally sufficient to assess the institution’s condition and risks.
- Allocating more examination resources to higher risk areas and fewer resources to lower risk areas.
- Using data from the quarterly Call Report filings to monitor changes to the institution’s business model, complexity, and risk profile between examinations.
- Leveraging available information, including analyses and conclusions from ongoing offsite monitoring and previous examinations to determine the financial institution’s risk profile and the scope of the next examination.
- Considering the financial institution’s ability to identify and control risks when risk-focusing examinations.
- Tailoring the pre-examination request list to the institution’s business model, complexity, and risk profile.
- Contacting institutions between examinations or prior to finalizing the scope of the examination to help inform an examiner’s assessment of an institution’s risk profile.
- Following up between examinations on institutions’ actions taken to address areas in need of improvement.

The FRB, FDIC, NCUA, OCC, and SLC each committed to issue reinforcing and
clarifying examiner guidance to their examination staffs on these risk-focused examination principles if necessary. Examiner guidance has or will cover the following community financial institution examination risk-focusing practices:

- Consider the unique risk profile, complexity, and business model of the institution when developing an examination plan.
- Analyze existing information such as Call Report data, publicly available information, and confidential supervisory information to help identify areas of higher and lower risk when planning examinations.
- Monitor financial institutions between examinations.
- Tailor the document request list based on the financial institution’s business model, complexity, risk profile and planned scope of review.
- Apply examination procedures in a way that reduces the level of review of low risk institutions or low risk areas.
- Discuss financial conditions, risk profiles, new or expanded business lines, and pertinent new supervisory or regulatory information with institution management prior to finalizing the scope of review.

Examiners will generally discuss the examination plan and its rationale with institution management at the beginning of the examination.

The FFIEC members may take further actions on the other areas of the examination process as the Examination Modernization Project progresses.

The FFIEC was established in March 1979 to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. It also conducts schools for examiners employed by the five federal member agencies represented on the FFIEC and makes those schools available to employees of state agencies that supervise financial institutions. The Council consists of the following six voting members: a member of the FRB; the Chairman of the FDIC; the Director of
Bureau of Consumer Financial Protection (BCFP); the Comptroller of the Currency; the Chairman of the NCUA; and the Chairman of the SLC.

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