

**First Quarter FY 2008  
(October 1 - December 31, 2007)  
OIG Report on the Survey of FCS Institutions  
Regarding the Examination Function**

**Introduction**

Based on the interface FCS institutions had with the Agency's examination function during the period October 1 – December 31, 2007, OE identified 19 FCS institutions that were in a position to provide meaningful survey responses. (Institutions are surveyed no less frequently than every 18 months and, generally, no more frequently than every 12 months.)

The OIG sent surveys to those 19 institutions on January 23, 2008. A follow-up e-mail was sent to nonresponding institutions on February 25. Of the 19 institutions surveyed, 14 submitted completed surveys. If the 5 nonresponding institutions subsequently send a completed survey, they will be included in the next quarterly report.

Three responses to the survey issued for the fourth quarter of 2007 were received subsequent to the fourth quarter report and are included in this FY 2008 first quarter report. As a result, this report covers a total of 17 responding institutions.

The survey asked respondents to rate each survey statement from "1" (Completely Agree) to "5" (Completely Disagree). The rating options are as follows:

Completely Agree	1
Agree	2
Neither Agree nor Disagree	3
Disagree	4
Completely Disagree	5

There is also an available response of "Does Not Apply" for each survey statement.

Narrative responses are provided verbatim, except that any identifying information has been removed and any grammatical or punctuation errors may have been corrected. Information in "brackets" has been inserted based on OIG follow-up with the institution.

**Reporting**

The OIG will provide an e-mail report to you based on each fiscal year quarter-end, i.e., December 31, March 31, June 30, and September 30 so that you may timely take whatever action you deem necessary to address the responses. A summary report will also be issued to you covering aggregate survey results for each fiscal year ended September 30.

## **Survey Results – First Quarter FY 2008**

1. Average numerical responses to survey statements 1 - 10 range from 1.9 to 2.2. (For FY 2007, the range averaged 1.7 to 2.2.)
2. The average response for all survey statements is 2.0. (For FY 2007, the average response for all statements was 1.9.)

One institution rated survey statement 2 (The examination process helped the institution understand its authorities and comply with laws and regulations.) and 4 (Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.) as a "4" (Disagree). Comments related to these two ratings are the first bullet under survey statement 2 and the second bullet under survey statement 4 below.

The same institution rated survey statement 6 (Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.) and 8 (Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.) as a "5" (Strongly Disagree). The comment related to the rating for survey statement 6 is the first bullet under survey statement 6 below. [No comment was provided for the institution's rating for survey statement 8 as the institution felt their comments related to survey statements 2, 4, and 6 already addressed their concerns.] This institution's comments are perhaps the most negative and comprehensively presented of any received from an institution since the resumption of the survey at the beginning of FY 2007.

Another institution rated survey statement 1 (The scope and depth of examination activities focused on areas of risk to the institution and were appropriate for the size, complexity, and risk profile of the institution.) and 4 (Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.) as a "4" (Disagree). Comments related to these two ratings are the first bullets under survey statements 1 and 4.

The majority of narrative comments to survey statements 1 - 10 were positive. However, 23 percent of the comments were negative to varying degrees. Negative comments are found under survey statements 1, 2, 3, 4, 6, and 9. These comments may provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 11a asks for feedback on the most beneficial aspects of the examination process. Many very positive comments were provided.

Survey item 11b asks for feedback on the least beneficial aspects of the examination process. The comments received to this question may also provide opportunities for you to refine examination methodology and communications, and examiner training.

Survey item 12 asks for any other comments. While most were positive, a few were negative, one very much so.

## **Responses to Survey Statements 1–10**

### **Risk-Based Examination Process**

**Survey Statement 1:** The scope and depth of examination activities focused on areas of risk to the institution and were appropriate for the size, complexity, and risk profile of the institution.

**Average Response:** 2.0

**Comments:**

- We question whether the emphasis on E-Commerce is excessive considering our institution has small chartered territory. Also, Business Continuity Planning requirements are burdensome. A useable template would have been very helpful.
- The review was highly compliance oriented. We assume that is appropriate for our institution's profile at FCA.
- Given the size, risk profile and capital position of our institution, examination activities have been suitably focused.

**Survey Statement 2:** The examination process helped the institution understand its authorities and comply with laws and regulations.

**Average Response:** 2.1

**Comments:**

- In some areas, primarily finance, the findings of the examination were inconsistent with findings of previous examinations on the same operational issues. This leads to confusion rather than a better understanding. For example, this examination noted exceptions in compliance with a 1991 Book Letter in an area that we have had examined at least 15 times with no exceptions noted by the prior examinations. Examiners noted exceptions but could not give specific examples of what was needed for corrective actions. It is our opinion that the pre-commissioned examiners noting the exceptions did not understand the intent of the Book Letter.
- We were visited by numerous teams and they all were professional.
- Ongoing communication with our institution's EIC has proven the best conduit for board and management to understand laws, regulations and authorities.

**Survey Statement 3:** The results and recommendations of the examination process covered matters of safety and soundness, and compliance with laws and regulations.

**Average Response:** 2.0

**Comments:**

- Recommendations from examinations appropriately cover matters of compliance, safety and soundness.
- The results and recommendations are relevant, but the recommendation for complete removal of the CEO from the ICR report writing process was overreaching due to the fact the contract ICR team from our bank attested to the reliability.

**Survey Statement 4:** Examiners were knowledgeable and appropriately applied laws, regulations, and other regulatory criteria.

**Average Response:** 2.1

**Comments:**

- We were very disappointed in the way the issues involving the AMIS and Annual Report were handled. FCA examiners need to better research the regulation compliance issues prior to making assertions that an institution is not in compliance. It took us an excessive amount of time and resources to do our own research and respond. Many issues initially raised by FCA proved to not be well supported.
- The non-commissioned staff members were making judgements regarding findings without understanding how the regulations must be reasonably applied to the differing operations and risk profiles of individual institutions.

**Communications and Professionalism**

**Survey Statement 5:** Communications between the Office of Examination staff and the institution were clear, accurate, and timely.

**Average Response:** 2.0

**Comments:**

- Communication with Sr. Staff and EIC were much clearer than with the non-commissioned staff.
- We thought we understood what the examiners shared and we encouraged consistent communication from FCA Board level and exam staff.
- Communications between examiners and institution management are professional, accurate, and timely.

**Survey Statement 6:** Examination communications included the appropriate amount and type of information to help the board and audit committee fulfill their oversight responsibilities.

**Average Response:** 2.1

- Communication of the report to the full Board, both written and at the formal presentation, was either so poorly delivered, or so dramatically different from previous examinations, that the Board and Management had great difficulty comprehending the content, the level of materiality or severity of the findings, etc. The Board felt the tone of the formal presentation was very condescending.
- The type and amount of information communicated is appropriate for the board and audit committees to fulfill their oversight responsibilities.

**Survey Statement 7:** The examiners were organized and efficiently conducted examination activities.

**Average Response:** 1.9

**Comments:** No comments received.

**Survey Statement 8:** Examiners fairly considered the views and responses of the board and management in formulating conclusions and recommendations.

**Average Response:** 2.2

**Comments:** No comments received.

### Best Practices and Regulatory Guidance

**Survey Statement 9:** The results and recommendations of the Office of Examination's national examination activities (e.g., information technology, finance, credit, etc.) and its reports on identified best practices have assisted your institution.

**Average Response:** 2.0

**Comments:**

- Hard to determine what applied to our institution.
- The national exam information and best practices are very useful. Utilizing the information to what is applicable to an institution our size and scope is sometimes problematic.
- The process provided some useful guidance to Business Continuity Planning.

**Survey Statement 10:** FCS-wide guidance from the Office of Examination (e.g., bookletters, informational memoranda, etc.) was timely, proactive and helpful.

**Average Response:** 1.9

**Comments:**

- Brings some value.

**[Responses to Additional Survey Items 11a, 11b, and 12](#)**

**Survey Item 11a:** What aspects of the examination process did you find **most** beneficial?

- Good open communication with FCA examiners.
- The examiner in charge was very approachable, competent, and respectful to our institution. He provided excellent reporting to the board and management. He also listened well and took those comments into consideration.
- The examination was a rigorous compliance review. Exceptions were found and corrective actions were taken.
- Dialogue on Scope and Eligibility.
- The fact that we are in the limited review group requires less on site time and thus less interference with the daily work in the institution.
- Confirmation of acceptable business practices.
- Compliance with FCA Regulations and required institution policies. Required and recommended actions in the Report of Examination. Reporting of Capital Markets loan portfolio to Board quarterly.
- The willingness to discuss different issues, fairness and attitude of exam; the team.
- Off-site exam process.
- This examination brought to our attention several situations our institution needed to improve on. We have begun necessary steps in making sure we are headed in the right direction.
- Discussion re: best practices in other institutions and references for contacting those institutions.
- The areas of Board and Management Activities, especially Governance, Internal Controls and Business Planning were useful.
- The report was fairly concise and specific.
- Best practice info from examiners' perspective, when available.
- Questions from the reviewer.
- We received information that will be helpful as we improve our corporate governance policies.
- The examination report really gave us excellent insight on identifying risk in areas of our institution that we, as an audit committee, might not have analyzed as consistently as needed. I believe we have a more comprehensive perspective now.
- Compliance to regulations.

**Survey Item 11b:** What aspects of the examination process did you find **least** beneficial?

- Not sure if sending examiners out on National Examination activities is efficient given that regular examiners are already visiting.
- From time to time we have had discussions related to scope, eligibility, and mission that result in the examiner having to look for direction from McLean, Virginia. This appears to occur as there are differences on issues between the areas of examination and policy.
- We do not feel the examination evaluated the risk in the operations or the loan portfolio of the institution. Perhaps this is an indication that the Agency is comfortable with the risk management systems the institution has in place.
- Concern if consistent interpretation of Scope and Eligibility would be a part of next exam.
- All alright.
- Reviewers' occasional inflexible position on arbitrary issue.
- Mission Related Activities.
- Nothing comes to mind in this regard.
- Credit review.

**Survey Item 12:** Please provide any additional comments about the examination process and related communications.

- We applaud many of the areas that FCA has provided broader interpretation on. But it is clear there is an inconsistency in philosophy on areas of scope, eligibility and mission that result in confusion for the System.
- Regulatory guidance usually requires differential interpretation and application by each entity based on its unique operating and risk environment. Regulations usually must be flexible to allow for the differences in the environment in which entities operate. This flexible interpretation must be based on Safety and Soundness first, and then on efficiency and practicality of implementation. Finally, there must also be some consideration for the intent of the author when developing the rule. This examination was conducted by a group of pre-commissioned examiners who clearly do not use or understand this principle of differential interpretation and application. If the institution was not operating according to the examiner's very narrow interpretation and understanding, a serious exception was noted. There was little or no dialog regarding "why" the institution's interpretation was different from the examiner or why it may not be applicable to the institution's unique operations. Some exceptions were noted where the examiner could not provide management with an explanation of how to correct the exception based on the institution's operating environment. Communication was largely one-way; "exceptions exist and I really don't care to hear why your interpretation is different." The Management Team and Board struggled greatly with the communication during both the on-site exam and the presentation of the report. The presentation of the Examination Report to the Board went so poorly, a follow up visit by the Examiner in Charge was felt appropriate. We sincerely appreciate the follow-up actions in personally visiting with the board. Our institution has a very long tenured Board and Management

team who have been through many FCA examinations. This is the first examination where material differences have been found in the interpretation of FCA guidance. In the past, exceptions may have been identified, but only after examiners had fully discussed the exception with Management and applied “common sense” logic to the institution’s interpretation and application of the rule. Examiners were always capable of explaining the exception and how the exception could be corrected. In summary, we believe the problems associated with this examination are related to the very high number of “trainee” staff assigned to the examination team. We commend the on-site manager for her efforts in attempting to train, as well as supervise, the conduct of the exam. However, one manager, with five or six trainees, attempting to conduct an exam in a short period of time is perhaps a recipe for poor communication. We regret any failure in communication on our part and again wish to thank FCA managers for their direct involvement in reconciling differences we had with the on-site team.

- Professional and complete.
- We view the FCA Comments and examination as another independent outside opinion to help improve our operation.
- Excellent two-way communication.
- Communications between institution management and EIC have been professional and informative.
- FCA should further consider its approach to examination. I don’t believe we have saved time or money in spite of our safety, soundness, and size. Also, examiners need to communicate in writing and with more specificity with institution CEOs. It is disrespectful to rely on phone calls except for routine questions.
- Off site examinations are effective and provide good coverage.
- Excellent dialogue and interaction that will benefit our organization.
- Reviewing information through the year and staying engaged with the institution has multiple benefits.