

# Acknowledgements

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## Section 1000.1

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The Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations was prepared under the direction of the Federal Reserve Board and Reserve Bank supervision personnel. Federal Reserve staff acknowledge and thank the staff of the New York State Banking Department, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Conference of State Bank Supervisors for contributing to the devel-

opment of the manual. Accordingly, this manual reflects general policies and procedures to be used in conducting examinations of individual branches and agencies of foreign banking organizations.

The manual will be updated periodically to reflect changes in examination policies and procedures. We solicit the input and contribution of all supervisory staff and others in the refining and modification of its contents.

Foreign banking organizations have had a long-standing presence in the United States. Their operations encompass a wide variety of banking and nonbanking activities, through subsidiaries, branches, agencies, and representative offices. These activities are located primarily in the major U.S. cities where finance and international trade are most actively conducted.

Branches of foreign banking organizations are licensed by the state banking authorities or the Office of the Comptroller of the Currency. In addition, certain grandfathered branches may be insured by the Federal Deposit Insurance Corporation. Agencies are licensed by the state banking authorities. The Federal Reserve, therefore, shares its regulatory responsibility with other state and federal supervisory authorities. Separately, the Board of Governors delegates certain of its supervisory and regulatory functions to the Reserve Banks and directs, coordinates, and reviews actions taken by the Reserve Banks.

Prior to the December 1991 passage of the Foreign Bank Supervision Enhancement Act (FBSEA), the examination of federal and state branches and agencies of foreign banks was largely the responsibility of the respective licensing authorities (the states and the OCC). The

International Banking Act of 1978 instructed the Federal Reserve to use, to the extent possible, the examination reports of other state and federal regulators in carrying out its responsibility for overseeing the U.S. operations of foreign banking organizations. Enactment of FBSEA was intended to fill gaps in the supervision and regulation of the U.S. operations of foreign banks and to ensure that the banking policies established by Congress are implemented in a fair and consistent manner with respect to all entities (domestic and foreign) conducting a banking business in the United States. FBSEA established uniform federal standards for entry and expansion of foreign banks in the United States and substantially increased the role of the Federal Reserve in the supervision and regulation of their U.S. activities. Under FBSEA, the Federal Reserve may examine any office or affiliate of a foreign bank in the United States and is to coordinate such examinations with the OCC, FDIC, and appropriate state banking supervisors to the extent possible. A comprehensive set of procedures has been developed to provide a uniform framework to be used in examining branches and agencies of foreign banking organizations.

### FORMAT

This manual is divided into sections dealing with particular banking activities that relate specifically to the examination and evaluation of U.S. branches and agencies<sup>1</sup> of foreign banking organizations (FBOs). Each section, in turn, may be divided into up to five subsections, depending upon the topic of discussion. These subsections are:

- Overview.
- Examination Objectives.
- Examination Procedures.
- Internal Control Questionnaire.
- Audit Guidelines.

The manual is intended to provide a comprehensive overview of banking activities that may be conducted in a wide variety of branches. Not all activities will be conducted by every branch. Accordingly, the examiner-in-charge should plan the examination, particularly as it relates to examination procedures and internal control questionnaires, based on the range of activities of the particular branch under examination. (This point is discussed in greater detail below.)

### Overview

The Overview section presents background information on the respective topics. This information will be supplemented and reinforced through the supervisory agencies' educational programs, updates to existing supervisory policies, and the examiner's growing on-the-job experience.

### Examination Objectives

The subsections in the Examination Objectives section list the goals that should be of primary interest to the examiner. Examination objectives are broadly stated and are thus similar for most manual sections. The objectives directly relate to procedures that will be performed at the examination and thus will influence the scope of the examination for the specific focus of examination interest.

1. Collectively referred to as "branches" throughout this manual, unless otherwise indicated.

In general, key examination objectives are designed to determine how well risk is managed by: (1) determining the adequacy of the system of internal control and of policies, practices, and procedures; (2) evaluating the scope and adequacy of the internal control environment and audit function; (3) determining compliance with laws, regulations, and rulings; and (4) evaluating adherence with internal policies and procedures. These objectives all relate to the overall assessment of the branch as described in the ROCA rating system and ultimately could result in the implementation of corrective action, if appropriate.

### Examination Procedures

These subsections include procedures to be performed during a comprehensive examination of the particular area of examination interest. There may be instances where the procedures will not apply in their entirety to a particular branch; thus, the examiner-in-charge should exercise judgement as to which procedures will be conducted during the on-site examination. The procedures to be addressed should be based upon the particular characteristics of the branch under examination, such as size, range, and complexity of activities and condition. The materiality and significance of a given area of a branch's operations are primary considerations in determining the scope of the examination and the procedures to be performed. Examiner flexibility in this respect will result in examinations that are tailored to fit the condition, nature, and scope of operations, i.e., a risk focus approach.

If, for example, serious deficiencies surface or issues are raised during an examination, all relevant examination procedures set forth in the manual are generally expected to be followed. Additional procedures may also be required from other supervisory manuals and materials. When modifying the procedures, the examiner-in-charge is responsible for determining that the examination objectives are met and that the scope of the examination is consistent with the condition of the individual branch.

### Internal Control Questionnaire

The evaluation of a branch's internal control environment should encompass a review of the

internal audit activities and the implementation of selected Internal Control Questionnaires (ICQs), which set forth standards for operational control. Due to the inherent differences between an examination and an audit, it is not contemplated that all ICQs will necessarily be implemented on every examination. The ICQs employed during the course of the examination should include: (1) those selected by the examiner-in-charge based upon his/her experience, knowledge of problems within the branch, and perception of risk; and (2) those that focus on areas where on-site evaluation of operational control seems warranted in light of the results of the examination of internal audit activities. In addition to serving as a guide for on-site evaluations, the ICQs can be used in the appraisal of operational audit techniques.

## Audit Guidelines

The Audit Guidelines under selected sections are included as an additional source of information relative to special situations where serious issues are raised with respect to the internal audit program or the general internal control environment. Audit Guidelines set forth traditional audit techniques that ideally should be employed by the local staff, head office, internal or external auditors, or a combination thereof. Audit guidelines should not be routinely included in the scope of every examination.

## NUMBERING SYSTEM

The manual is arranged using a numbering system based on the manual's sections and subsections. For example, the Overview subsection of the Credit Risk Management section is numbered 3010.1., 3010 is the section number for Credit Risk Management, and .1 is the subsection number for the Overview. The Examination Objectives subsection for that section is numbered 3010.2, and so on. Subsections are always numbered consecutively regardless of the number of subsections within a particular section.

The manual was initially published in January 1995, and subsequently revised July 1997. Since the entire manual was updated and reprinted at that time, all pages are dated as of the July 1997 revision date. Supplemental pages will be periodically published and distributed by the Federal Reserve Board and appropriately dated.

## USE OF MANUAL

The manual should serve as a working tool as well as a reference manual. It is organized to provide flexibility to the examiner in planning and conducting a branch examination and identifying the key areas of concern as presented in the ROCA rating system.

As discussed earlier, examination procedures may be modified, depending upon the size, range of activities, and condition of the branch. State laws and local characteristics may also necessitate a review of additional factors and supplemental procedures. For example, specific procedures relating to highly sophisticated trading activities have not been included in this manual. Examination procedures for those activities may be found in the *Trading Activities Manual* of the Board of Governors of the Federal Reserve System. Similarly, applicable State, FDIC, and OCC banking rules and regulations must be considered in various areas, such as those relating to asset maintenance requirements or asset pledge/capital equivalency deposits.

Although the manual discusses selected branch activities in general terms, it is primarily oriented toward describing examination procedures covering those activities. *Therefore, the manual should not be viewed as a comprehensive training guide or a legal reference.* Separate training programs will provide more detailed instructions to assist the examiner in better understanding branch activities and applying examination procedures. In addition, questions concerning applicability and compliance with federal and state laws and regulations should be referred to the legal staff of the appropriate regulatory agency.