INTRODUCTION

The Federal Reserve shares supervisory and regulatory responsibility for federally insured banks with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation at the federal level, and with individual state banking departments at the state level. The Federal Reserve is the primary federal supervisor of state-chartered banks that have chosen to join the Federal Reserve System (which are referred to as “state member banks”).

Regulation and supervision are distinct, but complementary, activities. Regulation entails establishing the rules within which banks must operate—in other words, regulations govern the formation, operations, activities, and acquisitions of banks. Once the Federal Reserve Board or another government entity adopts a regulation, the Federal Reserve’s supervision process includes monitoring, inspecting, and examining banks to assess whether a bank is in compliance with banking laws and regulations, and whether it is operating in a safe and sound manner. Further, through the supervision process, examiners evaluate a bank’s idiosyncratic risks as well as the adequacy of a bank’s risk management to identify, manage, and control the risks arising from the bank’s business operations and activities.

New laws, regulations, supervisory policies, guidance, and interpretations result from emerging issues within the banking industry or are tied to specific risks and industry events. With the enactment of new laws and regulations and the issuance of additional guidance, the scope of supervisory activities and examinations are revised to ensure that a bank continues to operate in a safe and sound manner and in compliance with laws and regulations.

Section 10(d) of the Federal Deposit Insurance Act generally requires the appropriate federal banking agency for an insured depository institution (which includes state member banks) to conduct a full-scope examination at least once every 12 months, but permits a longer cycle—at least once every 18 months—for insured depository institutions that meet certain criteria. Examiners use the Uniform Financial Institutions Rating System (UFIRS), which is commonly referred to as the CAMELS rating system, to structure their assessment of a bank’s condition and to communicate their conclusions about the assessment of a bank’s condition.

PURPOSE OF THIS MANUAL

One of the main goals of the Commercial Bank Examination Manual is to explain the Federal Reserve’s examination process for state member banks. The state member bank examination process is the Federal Reserve’s fact-finding arm in discharging its regulatory and supervisory responsibilities. Further, the Federal Reserve supplements the information from examination activities with information from its off-site surveillance process that is based on banks’ financial regulatory reports (referred to as the “Call Reports”).

Objectives of an Examination

The essential objectives of an examination are to (1) provide an objective evaluation of a bank’s soundness; (2) determine the level of risk involved in the bank’s transactions and activities; (3) ascertain the extent of compliance with banking statutes and regulations; (4) evaluate the adequacy of corporate governance and to appraise the quality of the board of directors and management; and (5) identify areas where corrective action is required to strengthen the bank, to improve the quality of its performance, and to promote and demonstrate compliance with applicable statutes and regulations. Examiners should also evaluate and determine the prudence of the bank’s practices to manage risks arising from its business operations and activities.

The Commercial Bank Examination Manual organizes and formalizes examination objectives and procedures that provide guidance to examiners on conducting their work, and enhances the quality of examinations and consistent application of procedures across the Federal Reserve System. The manual provides specific guidelines for

- determining the scope of an examination;
- determining the procedures to be used in examining a bank, including those procedures that may lead to the early detection of trends and risks that, if continued, might result in a deterioration in the condition of a bank;

Commercial Bank Examination Manual

May 2021

Page 1
• evaluating the adequacy of the bank’s policies and procedures, the degree of compliance with them, and the adequacy of its internal controls;
• evaluating the work performed by internal and external auditors;
• evaluating the performance and activities of a bank’s board of directors and management;
• preparing workpapers that support examination reports and aid in evaluating the work of examiners; and
• using objective criteria as a basis for the overall conclusion, comments, and criticism, regarding the condition of the bank, compliance with banking laws and regulations, and the quality of the bank’s risk management.

The manual also provides background information on common banking activities and describes risk management practices for banks to support their safe and sound operations. More specifically, this manual describes loan and investment portfolio management as well as capital adequacy and liquidity analysis.

Although this manual is designed to provide guidance to examiners in planning and conducting bank examinations, it should not be considered a legal reference. Questions concerning the applicability of, and compliance with, banking laws and regulations should be referred to appropriate legal counsel at the Reserve Banks or the Board of Governors of the Federal Reserve System. As this manual provides background and references to regulations, a bank should refer to the Code of Federal Regulation for the Federal Reserve Board’s regulations.

In addition, the manual should not be viewed as a comprehensive training guide for examiners. Examiners should view the manual as a working tool and guide. The Federal Reserve has separate training and continuing professional development programs for its examiners and has examination modules that provide more detailed instructions than the material in this manual to assist examiners in conducting an examination.

HOW TO USE THIS MANUAL

Organization

The Commercial Bank Examination Manual is divided into the following major parts, which are generally organized based on the components of the CAMELS rating system:

• Part 1000—Supervisory Process
• Part 2000—Assets
• Part 3000—Capital, Earnings, Liquidity, and Sensitivity to Market Risk
• Part 4000—Management Activities and Internal Controls
• Part 5000—Other Examination Areas
• Part 6000—Bank Regulations
• Part 7000—International
• Part 8000—Statutes Administered by the Federal Reserve

Sections in each part are made up of four subsections, where applicable:

• supervisory policy and guidance by topic (e.g., section xxxx.1): These sections provide details on the respective topics. This information is expanded upon and reinforced through the Federal Reserve’s educational and training programs and the examiner’s experience on the job.
• examination objectives (e.g., section xxxx.2): If there are no corresponding Examination Documentation (ED) modules, these sections describe the goals that examiners should achieve in performing the examination for a particular bank activity or risk.
• examination procedures (e.g., section xxxx.3): These sections list procedures that examiners may scope into the review of a bank’s activity or risk. As applicable, the manual will incorporate or provide a link to the ED modules, which define common examination objectives and procedures for the review of state member banks in the community and regional bank supervision portfolios.
• internal control questionnaires (e.g., section xxxx.4): These sections set forth standards for a bank’s operational controls. The assessment of a bank’s internal controls is typically incorpo-
ICQ can be used in evaluating a bank’s operational audit techniques where the scope of internal auditing includes such considerations. The ICQ steps marked with an asterisk require substantiation by observation or testing.

UPDATES

Effective December 31, 2017, the Board ended the option of ordering print versions for the Commercial Bank Examination Manual. In May 2021, there was an administrative update to the manual. Many of the sections were reorganized to align the manual content with the bank rating system (CAMELS), rather than the structure of a bank’s balance sheet. For the May 2021 update, the revision dates in the footer of the manual pages did not change in most instances. Rather, the footer date changed if there were substantive changes to the content on that page.

The manual is updated periodically. The most recent version of the entire manual and major sections, as well as the ED modules, are available on the Board’s website at https://www.federalreserve.gov/publications/supmanual.htm.