

REPORT OF EXAMINATION RECOMMENDATIONS BEING TREATED AS MANDATORY

All financial institutions, whether state or federally-chartered, are subject to regulatory examinations by one or more of the banking regulatory agencies (collectively, the “Supervisory Authorities”). Each examination is followed by a Report of Examination that summarizes the Supervisory Authorities’ findings and specifies whether the financial institution is operating in a safe and sound manner.

In recent Supervisory Authorities’ Reports, there are “*recommendations*” or “*suggestions*” based on best practices that the Supervisory Authorities would like to see completed by the next examination date. These recommendations and suggestions do not come in the form of criticisms nor violations of laws or regulations, they are merely recommendations or suggested best practices that the Supervisory Authorities believe will help the financial institution operate in a more safe and sound manner. These recommendations and best practices suggestions generally follow neutral language, such as the financial institution being “*adequate*” or “*satisfactory*.”

To an ordinary reader, a recommendation or a suggestion based upon best practice is simply that – a recommendation or suggestion. With no additional language criticizing the institution, citing any violations of laws or regulations, or mandating that the financial institution implement a new policy or plan, management may overlook some of the minor recommendations or best practice suggestions to focus on directives such as “*Matters Requiring Board Attention*,” or in the case of the Federal Reserve, “*Matters Requiring Immediate Board Attention*.”

When the Supervisory Authorities return for the next examination, however, we are now seeing bank’s being heavily criticized for “*failing to incorporate the recommendations or best practices suggestions*,” and have even seen some situations in which the Supervisory Authorities use this as a justification to downgrade the institutions individual CAMELS ratings, or overall Composite Rating. It would seem that, although they are titled “*recommendations*” or “*suggestions*,” they are being treated as mandatory directives that the financial institution must follow, or be penalized for omitting to do so.

Our firm will often see financial institutions, especially those with a 1 or 2 Composite Rating, sign and “*accept*” the Report of Examination as prepared and presented by the Supervisory Authorities without responding or requesting a modification of the language therein. It may also be the case that some financial institutions and management are unaware that they have the ability to do so. We assist our clients in the reading, interpreting and modifying of Reports of Examination, as well as appealing the findings therein. What may be only a recommendation or suggestion now may turn into a repeat violation in the next examination. At that point, most financial institutions are now behind the “*eight ball*” paying catch-up, as they have to either appeal an unjustified CAMELS downgrade, or present a case as to why there has been no repeat violation.

Know your options. Our firm can assist and walk you through the potentially hazardous language in the Reports of Examination so that you are not facing repeat violations for simply ignoring a recommendation or suggestion.

Before the Board and management sign the next Report “*accepting*” the findings therein, think about how these statements we have encountered may be harmful to the bank:

- *Not in Compliance. Several violations and contraventions of statements of policy, as well as repeat violations and contraventions were noted in the prior Report. No violations or nonconformance of statements of policy were cited at this exam.*
- *Not in Compliance. As noted in the prior Report, the Bank was in violation of Part 337.6 FDIC Rules and Regulations. Brokered deposits have rolled-off or have been redeemed early in an effort to reduce the level. No additional brokered deposits have been identified.*
- *Not in Compliance. The Board approved the revised Policy, which addresses the concerns noted at the prior examination. The policy is consistent with the FFIEC Examination Manual. However, recommendations to enhance several areas of the program were discussed during the examination.*
- *Not in Compliance. SARs, while filed, lacked specific details of the nature of the report activities. SAR’s completed since the prior examination were filed in a timely manner and contained sufficient details.*

These are just a few examples where a financial institution was criticized for failing to adhere to recommendations or best practice suggestions, or for reasons that are

clearly contradictory. If this language is accepted and the Report of Examination is signed, the next examination team can easily criticize the financial institution for repeat violations in some areas that have never been violated.

Another commonly overlooked section is the *Risk Management Assessment*. Directors and Management do not view this section as priority, as there are generally not any directives involved. However, the findings in this section are very important to support the position that proper oversight and risk management was in place at the time of examination, should the bank find itself in an administrative hearing at a later date. The *Risk Management Assessment’s* are very specific to the bank’s operations and often times do not correlate to the question being asked. This section should be carefully read and modified prior to “*accepting*” the Report.

To provide an example, in responding to the question of whether internal controls are adequate, a financial institution received this response: “*No. Though prior examination deficiencies in the internal audit function were adequately addressed, and compliance with laws and regulations has improved, the BSA/AML program requires further attention.*” Compliance has improved and the deficiencies were addressed, yet these positives are heavily outweighed by the single word “*No.*” The Board and management should press the Supervisory Authorities to change the responses to Risk Management Assessment questions when the explanations clearly provide evidence to the contrary.

A bank typically has 30 – 45 days to respond or accept the language in the Report, [contact us](#) for a second opinion before you do.



Nicholas A. Colella

Attorney with Iglar | Pearlman, P.A.
2075 Centre Pointe Blvd., Suite 100
Tallahassee, FL 32308
(850) 878-2411
Nick.Colella@IglarLaw.com