

Traditional ratio and peer earnings analyses are not relevant at a branch because earnings are largely influenced by the role of the branch within the foreign banking organization (FBO).

Some FBOs maintain a U.S. presence to meet certain global portfolio considerations. As a result, their U.S. operations may likely engage in a wide range of activities similar to those of U.S. domestic banks. Other FBOs may have different objectives in establishing a U.S. presence, such as to provide funding and clearing services. A branch may also benefit from unique relationships that have a positive effect on its earnings, such as interest free funds, advances from the head office or managing assets not reflected on its books. Therefore, earnings should be evaluated primarily against budgeted numbers, which should be based on the branch's strategic plan. The examiner should also determine the role that the earnings and revenue structure plays in the context of the overall U.S. operations and objectives of the FBO. Comments may be warranted as to the adequacy of such results.

In establishing the budget, management should assess the broad range of financial and operational risk exposures, which are encompassed in the strategic plan. Projections should take into account not only the composition, quality, and risk structure of branch assets but also the internal control environment under which the assets are booked. Further, management's ability to prepare realistic budgets and meet budgeted projections would indicate some measure of effective planning and control over the branch's activities. To maximize effectiveness, budget projections should be periodically reviewed and updated as conditions change throughout the fiscal year. Actual results should be periodically compared to budget and material variances identified and reviewed by management.

GENERAL EXAMINATION APPROACH

Earnings are not a rated component of the branch rating system, although the level of earnings or absence of earnings may affect rating components. The review of earnings also

provides important information on the nature and efficiency of the branch's operations. The evaluation of earnings will consider, primarily, the effectiveness of a branch's comprehensive risk management procedures as it affects budgetary performance. Accordingly, variances to budgets should be reviewed. Persistent variances or exceptions may indicate poor planning or unrealistic projections, barring changes in economic and market conditions and other external factors or influences from the head office, which are beyond the branch's control.

The accuracy and integrity of earnings presented in risk management reports should be evaluated. For instance, reported earnings that do not properly reflect potential losses in the branch's credit risk exposures or accrued income on nonperforming loans may raise questions about the effectiveness of financial and accounting controls. The examiner should keep in mind, however, that the consolidated benefits derived by the FBO, as a result of maintaining a market presence to facilitate a global banking service network, may offset any earnings deficiencies or continued loss operations. Accordingly, the branch's strategic plan and function within the FBO and standards used by the head office to evaluate earnings performance must be ascertained and analyzed.

Examining the changes in earnings over time (a trend analysis) is a fundamental method for evaluating earnings. The trend in overall earnings and trends in earnings components should be reviewed to the extent that the branch's strategic plan has not changed significantly. Any significant changes or variances in profits or any of the components of income and expense should be investigated. Improving, deteriorating, and even flat earnings can be the result of not only changes in economic conditions but also of management's actions or influence over earnings through intrabank transactions. Some profitability ratios have been used, including net interest income/average assets (net interest margin) and net operating income/average assets, to make such an assessment. While providing a basis for analysis, particularly in year-to-year comparisons, earnings ratios can vary significantly among branches, depending on the nature of branch activity and the degree of support or influence exerted by head office.

PROFIT CENTERS AND COST CENTERS

Generally, branches will function as profit centers or cost centers. As an independent profit center, a branch will likely have a broad earning asset base and could have substantial off-balance-sheet activities. The branch would likely offer a broad array of products and services. Thus, earning assets and fee-based services would be primary sources of income. Examiners should consider the income distribution and the relative profitability and stability of the various sources of income.

As a cost center, the branch would serve a more narrowly defined central purpose of either providing a service to the head office or the FBO's customer network, such as a provider of funds to other bank offices. As such, the branch would likely offer only a limited number of products or services. Earnings at such offices will generally be less than robust.

Accordingly, profitability as a factor in evaluating the branch is diminished. In these instances traditional ratio and trend analysis is not relevant and alternate analysis techniques should be employed. The examiner should determine the standards that head office management uses in evaluating the branch's performance. This analysis will focus on the branch's strategic plan or primary function, for example, to serve as a source of liquidity for the head office or other branches, to service the FBO's trade-related business or to give the FBO a presence in a particular geographic location as part of its global banking network.

FACTORS AFFECTING EARNINGS

The Mission of the Office

The level of earnings would generally be driven by the branch's mission. In this context, internal factors could significantly influence earnings to the extent that a branch's earnings are essentially managed by the head office. To make this determination, examiners should carefully evaluate reported income for unusually high or low profit margins. For example, a branch may have ancillary functions from which it incurs additional expense or receives supplementary income, such as managing an offshore book or providing management or technical services to other offices

in a regional office function. If the fees for these services are not directly related to or based on the fair value of goods and services received, the branch's earnings can be affected. Services could include electronic data processing, audit and credit review, credit management, and foreign exchange and correspondent banking services.

Funding Sources

A branch that is funded through borrowings from related entities may have its cost of funds adjusted above or below market rates or even priced below the FBO's cost of funds. The head office might also provide an interest free capital allocation, or fund the branch's reserves at no cost. In these ways, the head office can either subsidize or reduce the branch's net interest income.

Transfer of Assets

The FBO may also transfer assets to or from a branch's books, which also will affect earnings. The transfer of nonperforming and other problem loans from the branch to the head office or another branch of the FBO will improve a branch's earnings and, conversely, negatively affect the earnings of any branch designated by the FBO as a workout branch. Low quality loans maintained on a branch's books would reduce interest income to the extent that full interest payments are not received. The transfer of such assets from the books of a branch would improve the quality of its assets, support its net interest income, and reduce its need for loan loss provisions and charge-offs. High quality earning assets may also be transferred to a branch's books from the head office. This may occur with start-up offices or branches that cannot otherwise generate earning assets at a level to sustain operations and fund the cost of doing business.

Accounting Considerations

Earnings at a branch may also be distorted to some extent because of the effect of home country accounting standards, administrative, tax, or other external influences. Accordingly, in reviewing earnings, the examiner should adjust branch income and expense statements to correspond with U.S. generally accepted accounting

principles. If statements cannot be adjusted, the examiner's written analysis must take into consideration major accounting aberrations. More commonly seen accounting exceptions may include:

- Recognizing interest income on loans, which, according to U.S. standards, should be placed on nonaccrual status.
- All U.S. offices of a foreign bank may be combined for income tax purposes; accordingly, taxes might be calculated by a regional office and the branch may not accrue for taxes.
- Failure to record unrecognized gains and losses on trading assets and certain off-balance sheet contracts in accordance with FASB 115 and FIN 39 can affect both asset valuations and earnings.

ANALYTICAL REVIEW

Interest Income

Recognizing that branch earnings are primarily evaluated against budgeted numbers, a comparison of detailed balances on a period-to-period basis also should be performed to assess trends in account balances. Such a review also would provide the examiner with an understanding of branch operations and help to identify potential problem situations. The analysis of net interest income will give an indication of management's ability to borrow at attractive rates and invest those funds with maximum profitable results. The level and trend of net interest income should be established and evaluated. As with any financial institution, the composition of net interest income should be reviewed for quality and stability.

In analyzing net interest income, the computation of net interest margin (interest income minus interest expense, divided by average earnings assets) is helpful, although the potential distortion of net interest income through interoffice transactions can limit the usefulness of the ratio. When discussing growth in earnings, the examiner should clearly differentiate between increases due to rates or yields versus volumes of earning assets. An improvement in net interest income, as a percentage of earning assets, may reflect favorably on management's ability to invest its funds at favorable yields or its ability to find less expensive sources of funds. However, it also may reflect changes in rates on

interoffice transactions. The management of interest rate risk also can affect earnings. An aggressive or speculative funding policy, whereby the branch is permitted to maintain large interest rate sensitivity gaps, could result in material increases or decreases in margins.

Asset Yields

An analysis of asset yields should provide a measure of the branch's ability to invest funds in earning assets that provide a rate of return over the cost of funds. The analysis of asset yields and cost of funds should include whether market rates are paid for funds borrowed from the interbank markets and the level and cost of interoffice funding activities. If market rates of interest are not charged on interoffice borrowings or paid on interoffice placements, net interest income can be materially distorted. For example, if a branch is a net user of head office or interoffice funds, rates on intrabank borrowings could be adjusted upward or downward to increase or reduce the branch's cost of funds, which would flow through to net interest income. A branch that is a net provider of funds to the bank may be required to charge below market rates to other offices of the FBO. This situation would have an adverse affect on gross interest income and apply downward pressure to the net interest margin.

The level of nonperforming assets would also adversely affect net interest income. Nonperforming and renegotiated credits either provide no income or provide a reduced rate of income to the extent that the assets are no longer profitable relative to the cost of funds and the cost of doing business.

Reserves

Regulatory agencies have long recognized that an allowance for loan loss reserves is only meaningful for the bank as a whole and not on a branch by branch basis. Accordingly, branches of FBOs are not required to establish separate loan loss reserves on the books of each branch, but may do so voluntarily, or to meet local requirements. Provisions for loan loss reserves may either be transferred to the branch from the head or regional office, or may be directly charged against the branch's earnings. However, unlike at stand-alone operations that are sepa-

rately capitalized, concerns arising from inadequate loan loss reserves are not key issues at a branch.

Other Income and Expenses

Examiners should analyze the composition, level, and trend of other income and expenses. Non-interest income would include trading commissions and fees, deposit service charges, and letter of credit fees, among other items. Noninterest expense includes personnel and occupancy expense, and other operating expenses that arise from the normal activities of the branch. An analysis of these components would be especially valuable when evaluating a limited purpose branch or a branch that is suffering operating losses. Fees for intrabank services provided or received from related entities should also be reviewed. Earnings can be materially distorted if market rates are not charged for these services.

Extraordinary Gains or Losses

Extraordinary gains or losses result from anything outside the normal operations of a branch and should be analyzed carefully for their effect on earnings. Generally, extraordinary gains or losses result from the sale or disposal of assets and because of accounting changes. Examiners

should note that “extraordinary” as used in the context of the examination report is not the same as defined in U.S. generally accepted accounting principles.

Offshore Shell Branches

Earnings for offshore shell branches should be maintained separately from those of the U.S. branch. As such, report comments should be limited to the income and expenses of the U.S. branch. Earnings for the offshore branch are frequently commingled in the U.S. branch’s management reports. The U.S. branch may absorb the offshore shell branch’s indirect expenses, such as personnel expenses, without charging a fee. The significance of these indirect expenses varies depending upon the relationship of the U.S. branch to the offshore shell branch. However, because the allocation of these expenses are ultimately under the direction of head office management, exception should not be taken to this practice. Also, examiners, generally should not question the tax implication to the U.S. branch if the branch and the offshore shell branch file a combined federal income tax return. However, expenses between a branch and a related U.S. banking subsidiary of the foreign banking organization should be properly allocated and in accordance with applicable laws and regulations.

Income and Expense

Examination Objectives

Effective date July 1997

Section 3400.2

1. To review and understand the branch's strategic plan and mission within the FBO, specifically the earnings objectives.
2. To assess management's ability to prepare realistic earnings projections and the effectiveness of the overall budgeting program for monitoring and controlling income and expense.
3. To evaluate the reasonableness of performance targets given the branch's strategic plan and mission objectives, particularly with respect to budget variances.
4. To determine whether budgets are reasonable.
5. To determine to what extent earnings are affected by such factors as above or below market interoffice funding, interoffice transfers, and interoffice expense allocations.
6. To analyze the level of significant trends in income and expense, particularly in terms of the branch's strategic plan, and current economic conditions.
7. To determine and comment on whether income reported to the head office, under the FBO's accounting procedures, accurately reflect true earnings, when adjusted for head office subsidies and the charges related to likely future loan losses.
8. To evaluate the adequacy of financial and accounting controls relating to income and expense.
9. To evaluate the effect on earnings of any unusual and extraordinary gains or losses.
10. To recommend corrective action when policies, practices, procedures, or internal controls are deficient.

Income And Expense

Examination Procedures

Effective date July 1997

Section 3400.3

1. Determine to what degree the branch is a profit center. If it is a profit center, calculate the net interest margin and review the trend. Consider the following:
 - a. To what degree does the agency raise its own funds and set its own cost of funds?
 - b. How is the pricing of loans and funds determined? Is it market driven or controlled by other factors?
 - c. Are transfer costs to affiliates reasonable, in relation to the services provided?
 - d. To what extent do transfer costs/benefits affect net earnings?
2. Determine if any significant changes have occurred in:
 - a. The branch's operations.
 - b. Accounting practices in U.S. or home country.
 - c. The branch's financial reporting.
 - d. General business conditions in U.S. or home country.
 - e. Tax codes in the U.S. or home country.
3. Obtain current financial statements, internal operating reports, interim financial statements, reports filed with the Federal Reserve, daily statements of assets and liabilities, and other available financial information. Look for the development or continuation of adverse trends and other significant or unusual trends or fluctuations. Primary considerations should include whether:
 - a. Significant structural changes are occurring in the branch that may affect the earnings stream.
 - b. The branch is making use of tax carry-backs or carryforwards.
 - c. Earnings are static or declining, as a percentage of total resources.
 - d. Income before securities gains and losses, is decreasing as a percentage of total revenues.
 - e. The ratio of operating expense to operating revenue is increasing.
 - f. Income and expense trends are inconsistent.
 - g. The spread between interest earned and interest paid is decreasing.
 - h. Loan losses are increasing.
 - i. Provisions for loan losses, if applicable, are sufficient to cover loan losses and whether overall reserves at an adequate level.
4. Obtain and review planning procedures, profit plans, budgets, mid-and long-range financial plans, economic advisory reports, and any related progress reports and:
 - a. Compare actual results to budgeted amounts.
 - b. Determine the impact of specific goals that have been set.
 - c. Determine the frequency of planning revisions.
 - d. Determine how planning revisions are triggered.
 - e. Determine who initiates plan revisions.
 - f. Determine whether explanations are required for significant variations and whether causes are ascertained to implement corrective action.
 - g. Determine the sources of input for forecasts, plans, and budgets.
5. Review ledger accounts for unusual entries. Examples of such items include:
 - a. Significant deviations from the normal amounts of recurring entries.
 - b. Unusual debit entries in income accounts or unusual credit entries in expense accounts.
 - c. Significant entries from an unusual source, such as a journal entry.
 - d. Significant entries in other income or other expense, which may indicate fees or service losses on an off-balance-sheet activity (i.e., financial advisory or underwriting services).
6. Investigate conditions of interest disclosed by the procedures in the preceding steps by:
 - a. Discussing exceptions or questionable findings with the examiner responsible for conducting those aspects of the examination that are most closely related to the item of interest to determine if a satisfactory explanation already has been obtained.
7. There is evidence that sources of interest and other revenues have changed since the prior examination.
8. There are any differences between branch accounting practices and U.S. regulatory accounting standards and generally accepted U.S. accounting principles.

- b. Reviewing copies of workpapers prepared by internal auditors or management that explain account fluctuations from prior periods or from budgeted amounts.
 - c. Discussing unresolved items with management.
 - d. Reviewing underlying supporting data and records, as necessary, to substantiate explanations advanced by management.
 - e. Performing any other procedures considered necessary to substantiate the authenticity of the explanations given.
 - f. Reaching a conclusion as to the reasonableness of any explanations offered by other examiners or management, and deciding whether extensions of examination or verification procedures are necessary.
7. Review with officers and prepare, in appropriate report format, listings of deficiencies in and deviations from policies, practices, procedures, internal controls, and adverse trends.
 8. Prepare a complete set of workpapers to support examiner conclusions and discuss all material findings with management.

Management information systems (MIS) should gather, interpret, and communicate information regarding the branch's business activities and their inherent risks. Accurate, informative, and timely MIS are essential to the prudent operation of any branch office. In fact, the examiner's assessment of the quality of the MIS is an important factor in the overall evaluation of the risk management process, which is discussed in the ROCA Rating System section of this manual.

In the evaluation of MIS, examiners should determine the extent to which the risk management function monitors and reports the branch's risk exposures to local and head office management.¹ Risk exposure levels and other significant measures such as profit and loss statements should be reported to managers who supervise but do not, themselves, have operational responsibilities in the area of activity. Frequent reports should be made as warranted by the activity and type of risk. Reports to head office management may occur less frequently, but examiners should determine whether the frequency of reporting is sufficient for head office to maintain proper oversight over the branch's activities.

The form and content of the MIS will relate to the branch's operations and organization, policies and procedures, and management reporting lines. Examiners will find that the form of branch management information systems will vary substantially with no particular structure shown to be optimum. MIS, however, generally take two forms: computing systems with business applications and management reporting. For branches with extensive lending or trading operations, a computerized system should be in place. For branches with more limited operations in terms of risk and size, an elaborate computerized system may not be cost effective.

Not all management information systems are fully integrated within the branch or within the FBO. Generally, this aspect should be evaluated based on the complexity and degree of risk in the branch's activities.

Examiners should expect to see varying degrees of manual intervention and should determine whether the integrity of the data is preserved through proper controls, which will factor into the overall assessment of the branch's

operational controls. The examiner should review and evaluate the sophistication and capability of the branch's computer systems and software, which should be capable of supporting, processing, and monitoring the branch's changing risk profile. Generally, in evaluating the individual branch management information system, the examiner should focus on its overall effectiveness in monitoring the branch's level of risk within established parameters rather than its form.

Other considerations in evaluating the MIS include:

- Whether reports are presented in a format that is easily read and understood by senior management;
- Whether the branch has personnel with sufficient expertise to maintain MIS;
- Whether reports are updated and customized to reflect changes in the business environment or management's requirements;
- Whether an adequate reconciliation procedure is in place to ensure the integrity of data inputs; and
- Whether the system is independently audited by internal and external personnel with sufficient expertise to perform a comprehensive review of management reporting, financial applications, and systems capacity.

Management reporting summarizes the branch's day-to-day operations, including risk exposure. Reports also serve to provide management with an overall view of business activity for strategic planning. Reporting may be conducted via telephone, computer, correspondence, meetings, periodic management reports, audits, and examination reports. Examiners should evaluate the reporting process to determine whether it is sufficiently comprehensive for sound decision-making both on a day-to-day level and for future planning. To the extent that problems in specific areas of the branch may relate to inaccurate or inadequate reporting, the examiner also should review results and comments from other areas of the examination.

If the branch has extensive reporting requirements, it is not necessary to review each report. Instead the examiner should summarize the monitoring process in each area, giving only such information as is needed to justify the evaluation.

1. FBOs with multiple U.S. offices may establish an intermediate or regional U.S. reporting line. Such a reporting line should be evaluated to ensure that proper oversight by head office management is achieved.

Formal management reports will usually be generated by control personnel within the branch, independent from line management. Where line managers have input, the senior managers should be well aware of potential weaknesses in the data provided. Risk reporting should be assessed and performed independently of line management to ensure objectivity and accuracy and

to prevent manipulation or fraud. For branches operating in a less automated environment, report preparation should be evaluated in terms of timeliness and data accuracy. Cross checking and sign off by the report preparer and reviewer with appropriate authority promote a proper operational controls environment.

Management Information Systems

Examination Objectives

Effective date July 1997

Section 3410.2

RISK MANAGEMENT

1. To determine if the policies, practices, procedures, and internal controls regarding MIS are adequate.
2. To determine that risk management reporting summarizes the quantifiable and non-quantifiable risks of the branch to all appropriate management levels both at the local office and at the head office in a timely manner to ensure compliance with established risk parameters.
3. To determine whether management reporting provides adequate information for strategic planning to the extent conducted by local branch management.
4. To evaluate computer systems, communication networks, and software applications in terms of their ability to support and control the branch's activities.
5. To determine that the functions of automated systems and reporting processes are well understood by staff and are fully documented.

OPERATIONAL CONTROLS

6. To determine the scope and adequacy of the audit function for MIS and management reporting.
7. To verify that only authorized users have access to automated systems.
8. To determine that the software applications relating to risk reporting, pricing, and other applications are fully documented and subject to independent review.
9. To determine that the automated systems and manual processes are designed with sufficient audit trails to evaluate and ensure data integrity.

OTHER

10. To recommend corrective action when MIS policies, practices, procedures, or internal controls are deficient.

These procedures represent a comprehensive list of processes and activities to be reviewed during a full scope examination. The examiner-in-charge will establish the general scope of the examination and work with the examination staff to tailor specific areas for review as circumstances warrant. The procedures selected will be based on internal audit comments, previous examination workpapers, a general review of the activity to be examined, and the judgment of the examiner and examiner-in-charge.

RISK MANAGEMENT

1. Obtain a flowchart of management reports and system flows, and review information to identify important risk points.
2. Review the policies and procedures for MIS and management reporting, including the scope, quality, and frequency of management reports. Determine whether head office management is receiving adequate and timely information to effectively monitor branch operations.
3. Review the functional applications such as credit administration, risk monitoring, liquidity and funds management, trade settlement, accounting, revaluation, etc., to determine the combination of automation and manual intervention for management reporting. Compare findings with examiners reviewing specific products or business lines.
4. Determine whether the range of risk management reports is adequately documented in terms of inputs (data bases, data feeds external to the branch, economic and market assumptions), computational features, and outputs (report formats, definitions). Evaluate the documentation for thoroughness and comprehensiveness.
5. Determine whether the range of reports (risk management, past due and nonperforming loans, financial performance, and operational controls) provides valid results to evaluate business activities and for strategic planning.
6. Comment on the branch's automated communications with the head office and/or U.S.

regional management, if applicable. Can branch data be accessed directly by them?

7. Review lists of ongoing or planned information systems projects. Determine whether the priority of projects is justified given branch management's strategic goals and the recent mix of business activity.
8. Review, for frequency, the branch manager's attendance at periodic meetings with head office to report on branch activities.

OPERATIONAL CONTROLS

9. Obtain copies of internal and external audits for MIS and management reporting. Review findings and management's responses to determine whether appropriate corrective action is taken by management.
10. Obtain an overview of the system's functional features with the financial institution's systems administrator. Browse the system with the administrator. Determine whether passwords are used and access to the automated system is restricted to approved users.
11. If the branch has a number of independent data bases for credit administration, risk monitoring, etc., determine the types of reconciliations performed, the frequency of data base reconciliation, and the tolerance for variance. Generally, independent data bases have more potential for data error.
12. Determine the usage of financial applications on terminals that are not part of the mainframe, minicomputer, or local area network. For example, traders may use their own written spreadsheet to monitor risk exposure or for reconciliation.
13. Determine whether the processing and production of reports is segregated from line management and staff. Where line management has influence, how does the branch validate summary data and findings?

OTHER

14. Ensure that the branch has considered the impact of the century date change (year 2000) on its computer systems, and has

taken steps to correct any problems. Determine the extent of management's:

- a. awareness and due diligence
- b. risk assessment
- c. solution implementation and testing
- d. contingency planning

15. Recommend corrective action when policies, practices, procedures, internal controls or MIS are deficient.

RISK MANAGEMENT

1. Is management reporting adequate for the volume and complexity of the branch's range of activities? Are reports complete? Do they have clear formats? Are exceptions highlighted?
2. Does local and head office management have adequate information to monitor the changing risk profile of the branch? Does the branch have written policies regarding the type and frequency of reports to be submitted to a regional or head office level? Do the reports accurately convey the condition of the branch and the information required in accordance with written policies? How often does branch management communicate with its regional and head offices on an informal basis?
3. Is the risk measurement and management system sufficiently flexible to stress test the range of portfolios managed by the branch? Does the system provide usable and accurate output? If the branch does not perform automated stress testing, what process is used to minimize quantifiable risks in adverse markets?
4. Do reports provide information on the branch's activities that is adequate for sound planning? Are profitable and unprofitable activities clearly identified?
5. Do reports segregate positions by legal entity when appropriate?
6. Do policies and procedures address the range of system development and technical maintenance at the branch, including the use of outside vendors and consultants? Does the branch or FBO have a comprehensive computer policy? If the branch uses personal computers, there should be a written policy to address access, development, maintenance, and other relevant issues.
7. Are there functional specifications for the system? Are they adequate for the current range of automated systems at the branch? Do they address both automated and manual input and intervention?
8. Does the branch have flowcharts or narratives that indicate the data flow from input through reporting? Is this information comprehensive for the level of reporting necessary for the branch?
9. Are third party vendors provided with adequate lead time to make changes to existing programs? Is sufficient testing performed before system upgrades are implemented?
10. Are planned enhancements or development projects given appropriate priority based on management's stated goals?
11. Does the system design account for the different pricing conventions and accrual methods across the range of products in use at the branch? Evaluate the range of system limitations for processing and valuation across the range of products utilized by the branch. Assess the possible impact on accuracy of management reporting.

OPERATIONAL CONTROLS

12. Is management reporting prepared on a sufficiently independent basis from line management? Are appropriate segregation of duties in place for report preparation? Is the data accurate?
13. Is the scope of the audit coverage comprehensive? Are audits for MIS and reporting available? Are findings discussed with management? Has management implemented corrective action for deficiencies in a timely manner?
14. Is access to the automated systems adequately protected?
 - a. Do access rights, passwords, and logon IDs protect key data bases from corruption?
 - b. Are "write or edit" commands restricted to a limited set of individuals?
 - c. Are specific functions assigned to a limited set of individuals? Are access rights reviewed periodically?
 - d. Does the system have an audit report for monitoring user access?
 - e. Is access logon information stored in records for audit trail support?
15. Is management information provided from mainframe, minicomputers, local area networks, a single user personal computer, or a combination of the above?

16. Identify the key data bases used for the range of management reports.
- Are direct electronic feeds from external services, such as Reuters, Telerate, and Bloomberg employed? How are incomplete data feeds identified? Can market data be overridden by users? How does the branch ensure the data integrity of data feeds or manually input rates, yields, or prices from market sources?
 - Are standard instructions set within the automated systems? Can these be overridden? Under what circumstances?
 - For merging and combining data bases, how does the branch ensure accurate output?
 - What periodic reconciliations are performed to ensure data integrity? Are reconciliation personnel sufficiently familiar with the information to identify "contaminated" data?
17. Is the branch's computer system capable of handling year 2000 calculations?

CONCLUSION

- Is the information covered by this ICQ adequate for evaluating internal controls in this area? If not, indicate any additional examination procedures deemed necessary.
- Based on the information gathered, evaluate internal controls in this area (i.e. strong, satisfactory, fair, marginal, unsatisfactory).

OTHER ASSETS

The term "other assets," as used in this section, includes all balance sheet asset accounts not covered specifically in other areas of the examination. Such accounts often may be quite insignificant to the overall size of the branch. However, significant subquality assets may be discovered in accounts of some branches lacking proper internal controls and procedures.

Types of Accounts

Types of other assets frequently found in branches include the various temporary holding accounts such as suspense, teller, transit, and bookkeeping differences having debit balances. Those accounts should be used only for temporary recording, until the offsetting entry is received or fully identified and posted to the appropriate account. Branches will also have more permanent accounts recorded in other assets such as premises and furniture, leasehold improvements, purchased computer software, and deferred payment letters of credit. Nothing should be allowed to remain in the temporary holding accounts ("difference accounts") for any significant length of time, usually no more than a few business days. Branches should have written procedures to ensure that difference accounts are reconciled and closed out on a timely basis. In any event, all difference accounts should be closed out at least monthly.

General categories of other assets common to branches on the accrual system are prepaid expenses and income earned not collected. Prepaid expenses represent cash outlay for goods and services, the benefits of which will be realized in future periods. Income earned and not collected results from the differences between accrual and cash-basis accounting.

There are an unlimited number of account titles that could be included in the other assets category, from bond coupons to art objects, antiques, and coin and bullion. The examiner must design specific procedures for review and testing to fit the particular account and situation and must document the scope of the review in the workpapers.

Scope of other assets review

Examiners assigned to review other assets must obtain a detailed breakdown of such accounts, with a description of each account and the date each item was posted. Certain accounts, such as Other Real Estate Owned, may be reviewed by examiners assigned to other areas of the branch. Refer to Section 3090 for information on other real estate owned. The remaining accounts should be reviewed and evaluated by examiners assigned to this section.

The major factor in deciding which accounts are to be reviewed is materiality; however, even accounts with small balances may require attention. Net balance accounts must be grossed up. The examiner should then evaluate whether to analyze the nature and quality of each individual item based upon its impact on the overall soundness or risk standing of the branch. In this regard, it is important that the examiner verify the existence of the asset, the proper valuation of the asset, the adequacy of the accounting and disposition controls, and the quality of the asset.

An examiner should verify the existence of the assets selected by ensuring adequate supporting documentation. The examiner should also verify that ownership of the asset rests with the branch. The date the asset was acquired or first posted also is important. Temporary accounts such as suspense, should be cleared of stale items.

Proper valuation and reporting of other asset accounts is another potential area of concern for the examiner. Assets are generally acquired through purchase, trade, repossession, prepayment of expenses, or accrual of income. Generally, assets purchased, traded, or repossessed are transferred at their fair market value. Prepaid expenses and income accrued are booked at cost. An examiner should be particularly alert in identifying those assets that lose value over time to ensure that they are appropriately depreciated or amortized. All intangible assets should be regularly amortized, and management should have a system in place to confirm the valuation of the remaining book balance of the intangible assets. The examiner should ensure that the book balance of key personnel life insurance policies owned by the branch value the surrender charge, if any.

The examiner should assess the quality of the asset. Refer to Section 6010.1, *Asset Quality Classifications*, for information on the classification of assets.

The examiner should ensure that the controls concerning other assets protect the branch's ownership rights, that the accounts are properly valued and accurately reported, and that activity is monitored regularly by management. A branch with good controls and review procedures will periodically charge off all uncollectible or unreconcilable items. However, the examiner must frequently go beyond the general ledger control accounts and scan the underlying subsidiary ledgers to determine that posting errors and/or the common practice of netting certain accounts against each other do not cause significant balances to go unnoticed because of the lack of proper detail.

OTHER LIABILITIES

"Other liabilities," as used in this section, include all balance sheet liability accounts not covered in other specific liability categories or in other areas of the examination. The accounts often may be quite insignificant to the overall size of a branch. In some branches, specific accounts are established for control purposes and appear on the balance sheet as other liabilities. For reporting, however, these accounts must be assigned to specific liability categories or netted from related asset categories, as appropriate.

Types of Accounts

A general category of other liabilities common to branches using accrual systems is expenses accrued and unpaid. These accounts represent periodic charges to income based on anticipated or contractual payments of funds to be made at a later date. The accounts include items such as interest on deposits, taxes, and expenses incurred in the normal course of business. There should be a correlation between the amount being accrued on a daily or monthly basis and the amount due on the stated or anticipated payment date.

The examiner should review other liability accounts to determine that accounts, such as deferred taxes (credit balance), are being prop-

erly recognized. This review should also determine that matters, such as pending tax litigation, equipment contracts, and accounts payable, have been recorded properly and are being discharged in accordance with their terms and requirements.

Various miscellaneous liabilities may be found within the accounts, such as deferred credits, suspense, and other titles denoting pending status. The number of possible items that could be included are unlimited and the accounts should be reviewed to determine that they are used properly and that all such items are clearing in the normal course of business. Because of the variety of such accounts, the examiner must develop specific examination procedures to fit the particular account and situation.

Scope of other liabilities review

Examiners assigned to review other liabilities are responsible for obtaining the branch's breakdown of those accounts and determining when they are to be reviewed under other sections of this manual. They must ensure that examiners in charge of those other sections receive the necessary information. The remaining accounts should be reviewed and evaluated by examiners assigned to this section.

The major emphasis in examining this area should be on the adequacy of the controls and procedures employed by the branch in promptly recording the proper amount of liability. Without proper management attention, these accounts may be misstated, either advertently or inadvertently. For instance, fraudulent entries in suspense or interbranch accounts could be rolled over every other day to avoid stale dates causing shortages to be effectively concealed for indefinite periods of time.

Like other assets, other liability accounts with small balances may be significant and net balance accounts should be grossed up. Scanning account balances may disclose a recorded liability but it does not aid in determining whether liability figures are accurate. Therefore, it is important to review information obtained from branch counsel handling litigation because these documents might reveal a major understatement of liabilities. Determining accurate balances in other liability accounts requires an in-depth review of source documents or other accounts from which the liability arose.

Other Assets and Other Liabilities

Examination Objectives

Effective date July 1997

Section 3420.2

1. To determine if policies, practices, procedures, and internal controls regarding other assets and other liabilities are adequate.
2. To determine that branch officers and employees are operating in conformance with established guidelines.
3. To evaluate the validity and quality of all other assets.
4. To determine that other liabilities are properly recorded.
5. To evaluate the scope and adequacy of the audit function.
6. To determine compliance with laws and regulations.
7. To recommend corrective action when policies, practices, procedures, or internal controls are deficient or when violations of laws or regulations have been noted.

Other Assets and Other Liabilities

Examination Procedures

Effective date July 1997

Section 3420.3

1. Complete or update the Internal Control Questionnaire, if selected for implementation.
2. Based on the evaluation of internal controls and the work performed by internal/external auditors, determine the scope of the examination.
3. Test for compliance with policies, practices, procedures, and internal controls in conjunction with performing the remaining examination procedures. Obtain a listing of any deficiencies noted in the latest review by internal/external auditors from the examiner assigned to Internal and External Audits, and determine if appropriate corrections have been made.
4. Obtain a trial balance of other asset and other liability accounts and:
 - a. Verify or reconcile balances to departmental controls and general ledger.
 - b. Review reconciling items for reasonableness.
5. Scan the trial balances for:
 - a. Obvious misclassifications of accounts and, if any are noted, discuss reclassification with appropriate branch personnel and furnish a list to appropriate examining personnel.
 - b. Large, old, or unusual items and, if any are noted, perform additional procedures as deemed appropriate being certain to appraise the quality of other assets.
 - c. Other asset items that represent advances to related organizations, officers, employees or their interests, and, if any are noted inform the examiner assigned to Credit Risk Management.
6. Determine that amortizing other asset accounts are being amortized over a reasonable period relative to their economic life.
7. If the branch has outstanding customer liabilities under deferred payment letters of credit, obtain and forward a list of names and amounts to the examiner assigned to Credit Risk Management.
8. Review the balance of any other liabilities owed to officers or their interests and investigate, by examining applicable supporting documentation, whether they have been used to record unjustified amounts or amounts for items unrelated to branch operations.
9. Develop and note in the workpapers any special programs considered necessary to properly analyze any remaining other assets or other liabilities account.
10. Test for compliance with applicable federal and state laws and regulations.
11. For other asset items that are determined to be stale, abandoned, uncollectible, or carried in excess of estimated values and for other liability items that are determined to be improperly stated, request management to make the appropriate entries on the branch's books after consulting with the examiner-in-charge.
12. Prepare in appropriate report form and discuss with appropriate officer(s):
 - a. Violations of laws and regulations.
 - b. Criticized other assets.
 - c. The adequacy of written policies relating to other assets and other liabilities.
 - d. Recommended corrective action when policies, practices, or procedures are deficient.
13. Update the workpapers with any information that will facilitate future examinations.

Other Assets and Other Liabilities

Internal Control Questionnaire

Effective date July 1997

Section 3420.4

Review the branch's internal controls, policies, practices, and procedures concerning other assets and other liabilities. The branch's systems should be documented in a complete and concise manner and should include, where appropriate, narrative descriptions, flow charts, copies of forms used, and other pertinent information.

1. Has the branch formulated written policies and procedures governing both other asset and other liability accounts?
2. Does the branch maintain subsidiary records and supporting documentation of items comprising other assets and other liabilities?
3. Is the preparation of entries and posting of subsidiary other asset and other liability records performed or tested by persons who do not also have direct control, either physical or accounting, of the supporting data or related assets?
4. Are the subsidiary records balanced at least monthly to the appropriate general ledger accounts by persons who do not also have direct control, either physical or accounting, of the supporting data or related assets?
5. Are the items included in suspense accounts aged and regularly reviewed for propriety by responsible personnel?
6. Are receivables reviewed at least monthly for collectibility by someone other than the originator of the entry?
7. Is approval required to pay credit balances in receivable accounts?
8. Do credit entries to receivables accounts, other than payments, require the approval of an officer independent of the entry preparation?
9. Does charge off of a nonamortizing other asset initiate review of the item by a person not connected with entry authorization or posting?
10. Are invoices and bills proved for accuracy, prior to payment? Who has the authority to pay the invoices and up to what amount?
11. Are all payroll tax liabilities verified to appropriate tax returns and reviewed by an officer to ensure accuracy?

CONCLUSION

12. Is the information covered by this ICQ adequate for evaluating internal controls in this area? If not, indicate any additional examination procedures deemed necessary.
13. Based on the information gathered, evaluate internal controls in this area (i.e. strong, satisfactory, fair, marginal, unsatisfactory).

Other Assets and Other Liabilities

Audit Guidelines

Effective date July 1997

Section 3420.5

1. Obtain or prepare detailed lists of other assets and other liabilities, including a breakdown of subsidiary ledgers.
2. Within each category of other assets, use an appropriate sampling technique to select specific items and:
 - a. Where appropriate, verify the original balance of the item from an invoice or other supporting document.
 - b. Examine documentation for additions to any given item since the previous audit.
 - c. Where amortization is applied to a given item, review the computations for the period since the previous audit to determine mathematical accuracy and the reasonableness of estimated life.
 - d. Determine the reasonableness of the current balance by reviewing the remaining estimated life, collectibility, etc.
 - e. Prepare any special programs considered necessary to properly analyze and test specific accounts.
3. Determine that interbranch and affiliate transactions clear in the normal course of business by actually reviewing the entries to the account for several days and examining the debit and credit tickets. Special attention should be given to entry dates, authorizing initials, and validity or reasonableness of the item.
4. If a branch is on an accrual basis of accounting:
 - a. Review the branch's system of recording liabilities for interest, taxes, and other expenses.
 - b. Review the balance of interest accrued to outstanding interest-bearing liabilities for reasonableness.
 - c. Review the balance of the reserve for both current and deferred taxes for reasonableness by examining the worksheets and computations.
 - d. Review the reasonableness and completeness of the balance reflected for reserves for other expenses.
5. Within each general category of other liabilities, use an appropriate sampling technique to select specific items for further review. For each item selected, determine that the balance is reasonably stated by examining supporting documentation.
6. Review accounts not sampled, for items that appear unusual in nature or amount and examine supporting documentation.
7. Using an appropriate sampling technique, select expense checks issued since the examination date and:
 - a. Determine whether the expense was incurred before or after the examination date by examining the vendor's invoice or other supporting documentation.
 - b. For expenses incurred prior to the examination, trace the amount to the detail list of other liabilities.
 - c. Discuss with appropriate branch officials, any significant items incurred prior to and recorded after the examination date.

This section describes the activities of private banking services and provides insight into adequate safeguards. The portions concerning hold mail, dormant accounts, and overdrafts are also applicable to the Deposit Accounts section of this manual because they can affect all types of accounts and account holders.

Private banking departments may offer a wide array of products and services to their clients, including, but not limited to, trust services (by referral to or in association with an affiliated trust entity), investment advisory services, foreign exchange trading, lending, letters of credit, bill paying, credit cards, and deposit services. Private banking generally markets its services to high net worth individuals and, if the client has a business, may entice them to develop a corporate banking relationship. Private banking accounts may be opened in the name of an individual, a commercial business, a trust, or a private investment corporation (PIC) registered in offshore havens.

The relationship between the private banker and the client is carefully cultivated by the banker; therefore, it is common for clients to follow private bankers to different financial institutions because of the level of trust that has been developed. As a result, private banking clients may delegate a significant amount of discretionary financial authority to private bankers. Some private banking departments have small staffs that make the segregation of duties normally found in banking activities difficult to maintain. This combination of trust in the private banker and difficulty in segregating duties exposes private banking activities to possible account manipulation. As a result, the private banking area must have compensating internal controls to ensure proper supervision and safeguarding of client accounts.

Examiners should understand the nature and scope of the private banking activities. Additionally, examiners should carefully evaluate the policies, procedures, internal controls, credit reviews, and audits surrounding private banking to ensure that internal controls exist to detect fraud and prevent losses to both the branch and/or customers. Internal and external audits should provide an excellent source of information concerning the adequacy of policies, procedures and controls of private banking. The lack of an internal audit of the private banking

department should be viewed as a serious weakness and criticized in the examination report.

REVIEW OF DEPOSIT ACCOUNTS AND REVIEW OF ACCOUNT DOCUMENTATION

Private banks often assist clients in forming shell corporations of PICs. PICs are generally incorporated in bank secrecy (tax haven) countries such as the Cayman Islands, Bahamas, British Virgin Islands, and Netherlands Antilles to maintain the clients' confidentiality, and/or for tax or trust related reasons. The beneficial owners of the shell corporations are typically foreign residents.

Reviewing the list of accounts for private banking clients may provide insight into some of the activities conducted by private banking. For instance, the review may reveal that the branch allows accounts that disguise the true identity of the client through the use of fictitious or code name accounts, accounts in the name of a PIC, or blind/numbered trust accounts. Management must be able to provide documented files on the identity of the ultimate account holder and details on the account relationship. Examiners should carefully scrutinize the reasons for these types of accounts and ensure that they do not compromise the institution's compliance with the Financial Recordkeeping and Reporting regulations, and the Federal Reserve's "Know Your Customer" guidelines.

Reviewing account documentation should reveal that the branch has an adequate quality control program in place for opening accounts that includes a follow-up system for obtaining missing or date-sensitive documents. Additionally, account documentation reviews should show how the branch documents its client relationships and implements its "Know Your Customer" policy.

An integral part of an effective "Know Your Customer" policy is a comprehensive knowledge of both the customer and the types of transactions carried out by the customer. As a general rule, a financial institution should never establish a business relationship until the identity of a potential customer is satisfactorily verified. Accordingly, the "Know Your Customer" policy should clearly identify the type of documentation needed before a relationship can

be formerly established. If a potential customer refuses to produce any of the requested information, the relationship should not be established. Likewise, if requested follow-up information is not forthcoming, any relationship already begun should be terminated.

The purpose of the business relationship should also be identified. Incoming client funds may be used for various purposes such as establishing deposits, funding investments, securitizing loans, paying bills, or establishing PICs or trusts. The “Know Your Customer” procedures established by the institution allow for the collection of sufficient information to develop a “transaction profile” for each customer. The primary objective of such procedures is to enable the institution to predict with relative certainty the types of transactions in which a customer is likely to engage. Internal systems should then be developed for monitoring transactions which are inconsistent with the customer’s transaction profile. The level, detail and documentation of “Know Your Customer” information should be greater for customers with larger balances and transaction volumes. (Examiners may refer to the Federal Reserve’s Bank Secrecy Act Manual and other similar examination material for more information).

HOLD MAIL

Private banking clients and in particular, international private banking clients, are often provided hold mail service. Hold mail clients elect to have bank statements and other documents maintained at the institution rather than mailed to their home address. In most cases, this service is provided because the client’s country of residence has an unreliable or limited postal system or for security reasons. Controls over hold mail accounts should be carefully reviewed because the clients do not receive their statements promptly, and therefore, relinquished their ability to detect unauthorized transactions in a timely manner. One of the key controls that should be part of any hold mail operation is to have a process for ensuring that the back office receives customer account statements.

DORMANT ACCOUNTS

Accounts that are inactive for a prolonged period of time could be subject to manipulation and

abuse by branch personnel. Examiners should carefully review the policies, procedures, and controls over dormant accounts. Effective controls over dormant accounts should include:

- A specified period of time between the last customer-originated activity and its classification as dormant.
- Segregation of signature cards for dormant accounts.
- Blocking of the account so that entries cannot be posted to the account without review by more than one member of senior management outside of private banking.

OVERDRAFTS/EXTENSIONS OF CREDIT

Private banking clients often pledge their assets, including cash, mortgages, marketable securities, land, and/or buildings to securitize loans. Loan proceeds are used for a variety of purposes, including, but not limited to, recapitalizing the client’s business(s) or providing working capital. Branch management should demonstrate understanding of each specialty business and should know what would affect the value of any collateral or business being financed. Loans to private banking clients may not be of sufficient size to be covered during the review of asset quality. However, it is important to ensure that a sampling of private banking loans and contingent liabilities are reviewed. In many instances, loans and other credit-related activities for private banking clients are collateralized by cash or marketable securities; therefore, credit underwriting standards and procedures may not be as complete or stringent as prudent banking practice would dictate.

Loans backed by cash or negotiable collateral are common in private banking. An extension of credit based solely on collateral, even if the collateral is cash, does not guarantee repayment. There are at least three ways in which a branch can lose its collateral: forfeiture through the seizure of assets by a government agency; theft or manipulation by a dishonest employee; and errors such as the inadvertent release of collateral by an employee. While the collateral enhances the branch’s position, it should not be used as a substitute for regular credit analyses and prudent lending practices unless the branch makes a separate determination of the creditwor-

thiness of the client. A client may be considered creditworthy if the branch performs its due diligence by adequately documenting that its client's funds were derived from legitimate means and can verify that the use of the loan proceeds are for legitimate purposes.

Examiners should ensure that policies and procedures for extending credit to private banking clients are in place and are being followed. The branch's credit review function should also sample private banking loans and ensure compliance with established policies. Loan files should contain sufficient information to assess the quality of the credit, the proper approvals, and the purpose and source of repayment. During the review of private banking loans, examiners should ensure that loan files include documented background information on the client's source of wealth and occupation, the purpose of the loan, and the source of repayment (other than collateral). Ambiguous purposes such as personal investments or working capital, and liquidation of cash collateral for source of repayment, are generally not acceptable. Weaknesses in this area could result in noncompliance with the Financial Recordkeeping and Reporting regulations (See the Federal Reserve's Bank Secrecy Act Manual and other similar examination material for details).

Loans secured by cash or marketable securities should have files containing pledge/assignment documents, which serve to perfect the branch's security interest. In addition, procedures should be implemented to monitor and document the value of the collateral. Documentary exceptions should be listed as technical exceptions.

Documented financial statements that support credit decisions and guarantees may be present. Financial statements should never be waived merely because the loan is secured by cash or marketable securities.

BILL PAYING SERVICES

Private banking departments often provide bill paying services for their clients. If this service is provided, examiners should ensure that an agreement between the customer and the client exists for this service and that it has been reviewed by legal counsel. Typically, a client might request that the branch debit a deposit account for credit card bills, utilities, rent, mortgage payments, or

other monthly consumer charges. Policies, procedures, and controls over this area should be reviewed to ensure that they are adequate and protect the customer and the branch from fraud or abuse.

SALE OF NON-DEPOSIT INVESTMENT PRODUCTS

Private banking departments are increasingly offering investment products to their clients under discretionary or nondiscretionary arrangements. In addition, private banking departments may also offer treasury services, portfolio management, financial planning advice and offshore services.

Although fiduciary and agency activities are circumscribed by formal trust laws, clients may delegate varying degrees of authority (discretionary versus nondiscretionary) over assets under management to the institution. In all cases, the terms under which the assets are managed are fully described in a formal agreement, also known as the "governing instrument", between the customer and the institution. The agreement should address the duties that a fiduciary is obliged to perform for its beneficiaries or customers, keeping the assets of the customers separate and distinct from those of the branch, and avoiding any circumstances that may conflict with the branch's fiduciary obligations. A client's portfolio may consist of a mixture of instruments bearing varying degrees of market and credit risk which should be appropriate to the client. Assets under management may include deposits, securities, loans, items held in safekeeping, and other products.

Examiners should determine, through discussions with private banking personnel, the types of products being offered to clients. Clients may be offered a wide range of products. Examiners should also determine the level of discretionary authority delegated to private banking personnel in the management of these activities and the documentation required from customers to execute transactions on their behalf. Private banking personnel should not be able to execute transactions on behalf of their clients without proper documentation from clients or independent verification of client instructions.

On February 16, 1994, federal and thrift regulatory agencies released a joint statement on

retail sales of mutual fund and other non-deposit investment products by federally insured institutions. It reaffirms the agencies belief that retail customers must be fully informed about risks associated with non-deposit investment products. Branches recommending or selling such products should ensure that customers are fully informed that the products: (1) are not FDIC-insured; (2) are not deposits or other obligations of the institution and are not guaranteed by the institution; and (3) involve investment risks, including possible loss of principal. Examiners should refer to this statement for further guidance. While this statement addresses insured

branches, the premises in this statement are applicable to uninsured branches.

Examiners should ensure that the branch has agreements with customers covering the terms of any asset management or other services provided, and that the agreements are on file. An evaluation of private banking personnel's ability and competence to provide the services offered should also be assessed. If the branch executes transactions or performs back-office functions, the examiner should refer to the Securities Activities section of this manual for further guidance.

Private Banking

Examination Objectives

Effective date July 1997

Section 3430.2

1. To determine if policies, practices, procedures, and internal controls covering private banking activities are adequate and are being followed by branch personnel.
2. To determine the scope and adequacy of the audit function.
3. To recommend corrective action when policies, procedures, practices, or internal controls are deficient or when violations of laws or regulations have been noted.

Private Banking

Examination Procedures

Effective date July 1997

Section 3430.3

The examiner should refer to the sections of this manual listed below as well as other applicable supervisory agency manuals for further information on examination procedures:

- Deposit Accounts section for examination procedures covering deposit accounts, hold mail, dormant accounts and overdrafts.
- Credit Risk Management section for examination procedures for extensions of credit.
- Federal Reserve's Bank Secrecy Act Manual or other similar examination material for examination procedures to check private banking activities for compliance with the Financial Recordkeeping and Reporting regulations.

The various state and federal agencies may differ in terms of specific practices and methodologies used to implement the following guidelines. For further guidance in this area, examiners should consult with their respective agencies.

1. If selected for implementation, complete or update the internal control questionnaire.
2. Review policies and procedural manuals, and internal control activities to determine their adequacy.
3. Assess the adequacy of the internal audit function as it relates to private banking.
4. Determine, through a discussion with management, what types of products are offered to private banking clients.
5. Review the agreements covering the products offered by private banking to determine that they adequately protect the branch and the customer.
6. Assess private banking personnel's level of competency to provide the services being offered to clients, i.e., education, experience, licenses, and the branch's training program.

POLICIES AND PROCEDURES

1. Does the branch have up-to-date policies and procedures regarding private banking activities?
2. Do the policies and procedures cover the following:
 - a. Definition of the products offered.
 - b. Client account opening procedures.
 - c. Client background checking procedures.
 - d. Account monitoring procedures.
 - e. Token name account requirements.
 - f. Account officer's responsibilities.
 - g. Documentation requirements.
 - h. Segregation of duties.

OFFICE OF FOREIGN ASSETS CONTROL AND REGULATION

3. Are private banking customers reviewed against the Office of Foreign Assets Control and Regulation's (OFAC) listing of blocked accounts of foreign individuals and countries? (Refer to the Other Compliance Matters section of this manual for more information on OFAC).

TOKEN NAMES

4. Does the branch maintain a listing of all token name accounts and is there sufficient documentation to ascertain the customer's "true" identity?
5. Does management periodically review all accounts?
6. Are there agreements on file that adequately outline the branch's powers and limits of liability?

MANAGEMENT INFORMATION SYSTEMS

7. Are complete and accurate management reports received by private banking administrators and senior management on a timely basis?

8. Do the management reports cover the following:
 - a. Credit.
 - b. Overdrafts.
 - c. Cash and deposit activity.
 - d. Limit exceptions.
 - e. Past-due accounts.
 - f. Missing documents.
 - g. Daily activity.
 - h. Off-balance-sheet exposure (e.g., letters of credit).
 - i. Sale of non-deposit investment products.

AUDIT COVERAGE

9. Does the audit report provide management with an adequate appraisal of the private banking function?
10. Does the audit report cover all of the necessary control concerns and procedures listed in this internal control questionnaire?
11. Do management responses indicate that prompt and appropriate corrective action is taken when exceptions are noted?

DEPOSIT ACCOUNTS

Refer to the Deposit Accounts section of this manual when reviewing deposit account activities managed by the private banking staff.

HOLD MAIL

12. Does the branch have a "hold harmless" statement for hold mail accounts? Are hold mail accounts tested to ensure hold harmless statements are on file and are signed by customers?
13. Are hold mail statements kept in a secured area and segregated from the private banking area?
14. How is hold mail released to customers? (It should not be given to private bankers to deliver to the customer).
15. Are customers required to sign a form acknowledging receipt of their hold mail? Is the signature verified against signature

cards? Does the form list what mail was received?

16. What items are kept in hold mail files?
17. Are hold mail customers required to pickup hold mail within a specified period? What procedures are followed if hold mail is not picked up within specified periods?
18. Does an adequate audit trail exist in the hold mail area?
19. Does the internal audit function adequately review the hold mail function?

Refer to the Deposit Account section of this manual for more questions.

DORMANT ACCOUNTS

20. Over what time period does an account become dormant? Are dormant accounts blocked on the computer system or are all transactions on dormant accounts reviewed for authenticity?
21. If the appropriate time defining a dormant account has elapsed and the account is not placed on dormant status, is the reason documented?
22. Are signature cards for dormant accounts segregated and under dual control?
23. Who maintains the list of dormant accounts and is there dual control/segregation of duties in place to reactivate dormant accounts? Does the reactivation require approval from an officer outside the private banking department?
24. Does the branch comply with the escheating State requirements for dormant accounts?
25. Does the internal audit function review for compliance with dormant account procedures?

Refer to the Deposit Account section of this manual for more questions.

OVERDRAFTS

26. Is there an overdraft approval schedule with limits for each officer? Are the limits reasonable?

27. Is the overdraft report reviewed and signed by management on a daily basis? If not, when is it reviewed? Are approvals within established limits?
28. Is there an overdraft aging report and is it reviewed by management?

Refer to the Deposit Accounts section of this manual for further questions.

BILL PAYING SERVICES

29. Is there an agreement between the customer and the branch covering bill paying services? Does it specify what bills are to be paid?
30. What support documents are required as back-up for bill payments?
31. Are there adequate dual controls and review of the bill paying function?
32. Is confidential bill paying information, such as credit card numbers with expiration dates, safeguarded?
33. Are official checks used for bill paying properly controlled and inventoried?

CREDIT CARDS

34. Does the branch provide credit cards to its customers?
35. Are there adequate procedures to safeguard the cards while they are in the branch's custody?
36. Does the customer acknowledge receipt of the card upon delivery?

CONCLUSION

37. Is the information covered by this ICQ adequate for evaluating internal controls in this area? If not, indicate any additional examination procedures deemed necessary.
38. Based on the information gathered, evaluate internal controls in this area (i.e. strong, satisfactory, fair, marginal, unsatisfactory).