



ADVISORY BULLETIN 2005-AB-01

February 3, 2005

***Federal Housing Finance Board
Office of Supervision***

To: Federal Home Loan Bank Chairs, Presidents, and Directors of Internal Audit
Office of Finance Managing Director

From: Stephen M. Cross
Director
Office of Supervision

Subject: Examination Findings and Conclusions

Background:

Advisory Bulletin (AB) 03-11 defines five categories of findings used in our safety and soundness and affordable housing and community investment examinations and Reports of Examination. As a part of our ongoing assessment of the supervisory process, we are revising the definitions of “Unsafe or Unsound Practice or Condition,” “Recommendation,” and “Referral.” We also are changing the process by which the examiner-in-charge may communicate a Recommendation.

In addition to revising the definitions of examination findings and the process by which Recommendations are communicated to the Federal Home Loan Banks (Banks) and the Office of Finance (OF), we are introducing a way of communicating overall Conclusions about the level of supervisory concern presented by the practices, condition, or risk profile of a Bank or the OF. Conclusions will identify Banks and the OF as “Satisfactory,” “Fair,” “Marginal,” or “Unsatisfactory.” The examiner-in-charge will state a Conclusion and its basis, together with the appropriate supervisory response, in the Report Summary portion of the Report of Examination.

The Conclusion categories are composite categories that cover the examiners’ overall assessment of safety and soundness and affordable housing and community investment. The Report of Examination will include one Conclusion. That is, it will capture supervisory concerns presented or arising from the safety and soundness portion of the examination and those arising from the affordable housing and community investment portion of the examination.

Detailed below are the new “Endnotes” to our Report of Examination. These revised Findings categories, and the new Conclusions categories, will be incorporated into the examination process and Reports of Examination beginning in 2005.

Findings Categories:

A written finding will be prepared and included in the Report of Examination for all findings of Unsafe or Unsound Practice or Condition, Violation, Weakness, or Referral. In assigning a category to a particular finding, the examiner must consider the identified activity, operation, or policy, or lack thereof, in light of all relevant facts pertaining to the particular Bank or the OF and the situation. A Recommendation may be excluded as a finding in the Report of Examination. All Recommendations will be written and provided to the Chief Executive Officer of the Bank or the Managing Director of the OF and a copy maintained in the examination and supervision file.

Unsafe or Unsound Practice or Condition: Any action or inaction that is contrary to prudent operation that has resulted in, or if continued could result in, abnormal loss or risk or damage to the Bank or the OF. Immediate corrective action is required. A Bank's condition need not deteriorate to the brink of insolvency before a practice or condition may be found to be unsafe or unsound.

Violation: Non-compliance with statute, regulation, or agency rule. Corrective action is required.

Weakness: An inadequate or otherwise unacceptable policy, procedure, or practice, or a lack of sufficient internal controls or risk management. Corrective action is required.

Recommendation: A suggested change to a policy, procedure, practice, or control to improve performance or operations.

Referral: A matter that raises a legal or policy issue requiring guidance from or development of a position by Finance Board staff.

Conclusions Categories:

Conclusions will incorporate the level of supervisory concern presented by a Bank or the OF and the response of the Office of Supervision to that concern.

Satisfactory: Banks identified as "Satisfactory" have sound policies and practices. These Banks exhibit no material deficiencies in financial performance, governance, operations, risk management, and/or the administration of their affordable housing or community investment programs and are in substantial compliance with laws, regulations, and supervisory guidance. These Banks give no cause for supervisory concern.

Fair: Banks identified as "Fair" exhibit a moderate degree of concern in financial condition or performance, governance, operations, regulatory and supervisory compliance, risk management practices, and/or the administration of their affordable housing or community investment programs. The board of directors and management have demonstrated the ability and willingness to appropriately address deficiencies. The supervisory response is limited to monitoring correction of any identified deficiencies in the normal course of the supervisory process.

Marginal: Banks identified as “Marginal” exhibit a heightened degree of supervisory concern related to their financial condition or performance, governance, operations, risk management practices, and/or the administration of their affordable housing or community investment programs. Taken alone or in combination, these deficiencies are moderate to severe. In addition, Banks so identified may be in substantial noncompliance with laws, regulations, or supervisory guidance. The board of directors or management may lack the ability or willingness to appropriately address deficiencies. These Banks require more than normal supervision. The general policy for Banks identified as Marginal is that an informal supervisory action be undertaken.

Unsatisfactory: Banks identified as “Unsatisfactory” exhibit serious financial, governance, operations, risk management, and/or the administration of their affordable housing or community investment program deficiencies that are not being effectively addressed by the Bank’s board of directors or management. Close supervisory attention is required. The general policy with respect to Banks identified as Unsatisfactory is that a formal enforcement action be recommended to address the problem(s) or weakness(es).

Guidance:

This AB supersedes AB 03-11 and will be used in all safety and soundness and affordable housing and community investment examinations commencing after December 31, 2004.

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An Advisory Bulletin is a staff document through which the Office of Supervision provides guidance to the Federal Home Loan Banks and the Office of Finance regarding particular supervisory issues. Although an Advisory Bulletin does not have the force of a regulation or an order, it does reflect the position of the Office of Supervision on the particular issue and as such will be followed by examination staff. If non-compliance with an Advisory Bulletin is cited as the basis for a supervisory determination, any such determination will be subject to review by the Board of Directors pursuant to the procedures of 12 C.F.R. § 907.9. Advisory Bulletins are effective upon issuance.