TEXAS DEPARTMENT OF BANKING

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SUPERVISORY MEMORANDUM – 1003

July 9, 2018

TO: All State-Chartered Banks
Bank and Trust Examining Personnel

FROM: Charles G. Cooper, Banking Commissioner

SUBJECT: Examination Frequency for State-chartered Banks[1]

BACKGROUND

Section 31.105 of the Texas Finance Code requires the banking commissioner to examine each state bank annually or on another periodic basis as may be required by rule or policy, or as the commissioner considers necessary to safeguard the interests of depositors, creditors, and shareholders, and efficiently enforce applicable law.

PURPOSE

The intent of this Supervisory Memorandum is to clearly communicate the Department of Banking's (Department) on-site examination timing requirements for state banks and trust departments of state banks and promote an efficient regulatory system. To promote competitive parity, the Department generally attempts to align its examination frequency policy for state-chartered banks with the examination frequency requirements applied by the federal bank supervisory agencies, as set forth in 12 U.S.C. 1820(d)(4) and implemented by 12 C.F.R. §208.64 (for member banks) or §337.12 (for nonmember banks), subject to safety and soundness considerations. This Supervisory Memorandum does not limit the authority of the banking commissioner to examine any state bank as frequently as deemed necessary.

BANK EXAMINATION FREQUENCY POLICY

The Department, in cooperation with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of Dallas (FRB), has committed to coordinating examination efforts to reduce regulatory burden. The general practice of the agencies is to alternate examinations between the Department and the FDIC or, if the institution is a member bank, with the FRB. However, the

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[1] This policy was revised to reflect a change to an 18-month examination frequency for banks with total assets of $3 Billion or Less. Previously, the 18-month examination frequency applied to banks with total assets of $1 Billion or Less. This change is part of the Economic Growth, Regulatory Relief, and Consumer Protection Act which became effective on May 24, 2018.

Department will conduct an independent examination or a joint examination with the appropriate federal supervisory agency whenever deemed appropriate.

Banks which meet certain qualifying criteria (outlined below) may have the examination frequency extended to a maximum of 18 months. While the examination frequency for banks may change based on the criteria in the table below, the general practice of alternating examinations between the state and appropriate federal agency will continue.

EXAMINATION SCOPE

The scope of each examination is based upon circumstances of the individual financial institution. The Department utilizes five types of examination scopes: Level I Full Scope, Level II Full Scope, Continuous, Visitation, and Interim Risk Examination and Assessment.

- A Level I Full Scope Examination (Level I) is the most comprehensive with the Department's examiners completing procedures that are designed to assess the safety and soundness of the bank's operations and activities, resulting in the assignment of an appropriate CAMELS (Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk) rating. A Report of Examination is produced for the bank to review.

- A Level II Full Scope Examination (Level II) allows examiners to focus on the highest risk areas of the bank while excluding certain assignments determined to be of lower risk due to the nature of the bank's activities. Examiners complete risk-focused procedures and review all critical aspects of the bank's operations to the extent considered necessary to assign CAMELS ratings. Supervisory Memorandum 1025 details the requirements of a Level II Full Scope examination program. A Report of Examination is produced for the bank to review.

- A Visitation is a narrowly scoped examination which may focus on one or more CAMELS components, a specific risk area, or compliance with an enforcement action. The results of a Visitation will be documented with a Letter of Findings to the bank. The FDIC's use of a visitation may be different in scope than the visitation performed by the Department. The Department may accept risk assessment rating changes from a federal agency Visitation review conducted between annual Full Scope examinations.

- An Interim Risk Examination and Assessment Program (IREAP) is an examination that consists of risk-focused reviews of the CAMELS components, an assessment of compliance with enforcement actions, and a review of any significant criticisms noted at the last examination which affects a CAMELS component. At the conclusion of an IREAP, a CAMELS component or the overall CAMELS rating may be changed. Findings are documented in a Report of Examination when a CAMELS component or the overall CAMELS rating is changed. If no CAMELS component or overall rating is changed, then a Letter of Findings will be provided to the bank instead of a Report of Examination.

- A Continuous Examination Program (CEP) is primarily utilized in larger institutions, generally $10 billion and greater or as determined by the Commissioner or Deputy Commissioner and includes a series of targeted reviews conducted over an examination cycle generally covering a 12-month period. The targeted reviews focus on one or more specific risk areas of an institution's operations. Under the CEP, all CAMELS components are evaluated during the examination cycle. The results of targeted reviews are documented in a Letter of Findings. The results of targeted reviews performed during the examination cycle are utilized to assign a composite CAMELS rating for the institution which is documented in a formal Report of Examination.

The Level I and Level II examinations as well as the CEP meet the examination priorities of the Department and federal regulators. If at any time it becomes apparent that the planned scope of supervisory activity should be expanded, the Department will not hesitate to do so.

EXAMINATION SCOPE AND FREQUENCY SCHEDULE

The following chart details the *general* criteria for determining examination frequency of state-chartered banks for Safety and Soundness examinations. The frequency and scope outlined in the Examination Scope and Frequency Schedule meet the examination priorities of the Department. Examinations started 30 days or less after the due date are considered to meet the Department's performance measures. Examinations started 60 days or more before the due date or more than 30 days after the due date require approval by the Director of Bank and Trust Supervision and the Deputy Commissioner, or the Commissioner.

EXAMINATION SCOPE AND FREQUENCY SCHEDULE

ASSET SIZE	COMPOSITE AND CAPITAL CRITERIA	EXAMINATION SCOPE AND FREQUENCY
$10 Billion or Greater	1,2,3,4 or 5 Composite	Continuous Examination Program. A composite risk rating will be assigned no less frequently than every 12 months.
Greater Than $3 Billion But Less Than $10 Billion	1 or 2 Composite	Level I examination every 12 months.

ASSET SIZE	COMPOSITE AND CAPITAL CRITERIA	EXAMINATION SCOPE AND FREQUENCY
$3 Billion or Less	“Well capitalized” as defined by 12 C.F.R. 325.103 (b)(1) (member bank) or §325.103(b)(1) (nonmember bank) AND 1 or 2 Composite Rating with 1 or 2-Rated Management	Level I examination every 18 months; however, may be eligible for the Level II examination.
$3 Billion or Less	1 or 2 Composite With Management Rating >2 OR Not "well capitalized" as defined by 12 C.F.R. 325.103(b)(2) and 1 or 2 Composite	Level I examination every 12 months.
Any Size	De Novo and 1 or 2 Composite	Visitation within first six months of opening. Level I examination 12 months after opening and annually thereafter for the first five years of operation. Commissioner may alter this schedule to align with the applicable federal regulatory agency or Division policy.
Less than $10 Billion	3, 4 or 5 Composite	Level I examination every 12 Months. FDIC Visitation or Interim Risk Examination and Assessment to be performed approximately six months after the Level I examination.

Generally, Full Scope examinations of banks with total assets greater than $1 billion will be conducted jointly with the appropriate federal regulator. Full Scope examinations of 3, 4, and 5 rated institutions should be conducted jointly with the appropriate federal regulator. The examinations for 1 or 2 rated de novo institutions will be conducted jointly with the appropriate federal regulator for the first three years and then continue on an alternating basis.

An Information Technology (IT) review should be performed to coincide with the Full Scope examination as outlined in Supervisory Memorandum 1020.

EXCEPTIONS TO BANK EXAMINATION FREQUENCY SCHEDULE

Exceptions may be made to the examination frequency schedule of a bank depending upon the circumstances as determined by the Director of Bank and Trust Supervision and the Deputy Commissioner, or the Commissioner. The following addresses when an examination schedule may be shortened or lengthened temporarily, and the authorization required.

Shortened Examination Frequency

Banks that qualify for an 18-month examination frequency cycle *may* be subject to a 12-month examination cycle as determined by the Director of Bank and Trust Supervision and the Deputy Commissioner, or the Commissioner. A shortened examination cycle may be necessary for institutions operating under certain circumstances which include but are not limited to the following:

a. a change of control during the preceding 12-month period;

b. a Capital, Asset Quality, Earnings, Liquidity or Sensitivity to Market Risk component rating of “3”, “4”, or “5” as defined by the Uniform Financial Institutions Rating System; or

c. a formal or informal enforcement action.

Extended Examination Frequency

An extension to the examination frequency schedule for banks is permitted under certain circumstances. The reason(s) for the extension must be in writing, maintained with the institution’s records at the Department, and be approved by the Deputy Commissioner or Commissioner.

The Deputy Commissioner has authority to extend the date of any type of examination (Safety and Soundness, Information Technology, or Trust Department) up to six months predicated on extenuating circumstances including, but not limited to:

a. an anticipated merger or acquisition with another institution;

b. an anticipated change in charter;

c. a disruption in normal operations due a natural disaster or state of emergency; or

d. other significant reasons as determined by the Commissioner or Deputy Commissioner.

Authority to extend an examination beyond six months requires approval of the Commissioner.

TRUST DEPARTMENT EXAMINATION FREQUENCY POLICY

For banks with Trust departments, Trust examinations generally will be scheduled within 120 days prior to, or on the same day as, the start date of the safety and soundness examination. In certain circumstances, trust examinations may be delayed up to 60 days after the safety and soundness examination start date, with the concurrence of the Director of Bank and Trust Supervision. The flexible due date allows coordination with the bank to reduce the regulatory burden and preclude conflicts with safety and soundness examination procedures. Generally, banks eligible for an 18-month or subject to a 12-month safety and soundness examination cycle will require Trust Department examinations of a like frequency. However, banks subject to a 6-month safety and soundness examination cycle are eligible to have a Trust Department examination waived if the most recent Trust examination occurred within the last 12 months and the Trust composite risk rating is a “1” or “2”. In situations where the most recent composite risk rating is "3", "4" or "5", the scope and frequency of the next Trust Department review will be established by the Chief Trust Examiner and the Director of Bank and Trust Supervision.

The findings of the Trust examination may be embedded into the bank safety and soundness Report of Examination or delivered separately as an independent Report of Examination, as determined by the Chief Trust Examiner and applicable Regional Director. The examination frequency policy for Trust Companies is addressed in Supervisory Memorandum 1004.

CONTACT INFORMATION

Questions about this Supervisory Memorandum may be directed to the Director of Bank and Trust Supervision at 512-475-1300.