



# ***TEXAS DEPARTMENT OF BANKING***

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## **SUPERVISORY MEMORANDUM – 1025**

**November 25, 2019 (rev.)**

**TO:** Chief Executive Officers of State-Chartered Banks  
All Bank and Trust Examining Personnel

**FROM:** Charles G. Cooper, Banking Commissioner

**SUBJECT:** Level II Full Scope Examinations

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### **PURPOSE**

The purpose of this Supervisory Memorandum is to provide written guidelines under which a Level II Full Scope Examination (Level II) utilizing risk focused examination procedures may be conducted and considered acceptable to meet the Texas Department of Banking's (Department) examination requirements of Texas Finance Code §31.105 and Supervisory Memorandum 1003 - Examination Frequency for State-Chartered Banks.

Under a Level II program, qualifying institutions that are determined to present a low risk profile based on specific criteria, may receive an examination focusing on the highest risk areas in lieu of the more comprehensive, Level I Full Scope Examination (Level I). The Department has determined that this program can be implemented without materially jeopardizing the agency's mission to ensure that Texas state-chartered banks are operating in a safe and sound manner and in compliance with applicable banking statutes and supervisory guidelines.

The Memorandum is being revised to modify the eligibility requirements for a Level II examination. Specifically, an institution with total assets of \$3 billion or less may be eligible for a Level II examination.

### **OVERVIEW**

The Level II examination program was implemented to help ensure that Department resources are appropriately allocated to focus on the highest risk institutions and that supervisory priorities and requirements continue to be met.

On-site examinations in combination with the agency's off-site monitoring program and the in-between examination call program ensure that the inherent risks in the banking system and individual institutions are assessed and monitored. These supervisory methods have also allowed the Department to identify institutions that present a low risk profile. These institutions have historically been rated a composite CAMELS rating of 1 and exhibit management practices that

are risk adverse and which consistently adhere to safe and sound banking practices and procedures. The Department has reviewed and considered other factors such as an institution's, longevity and quality of leadership, current business plan and regulatory history in determining characteristics conducive to an institution receiving a Level II examination.

### **ELIGIBILITY**

Institutions that generally meet the below criteria are eligible to receive a Level II examination as determined by the Regional Directors.

- 1) The institution has received a composite CAMELS rating of 1 at the last two examinations and is not subject to an administrative or enforcement action of any type;
- 2) There has been no change in the ownership or executive officers, or a significant change in board composition within the last 12 months;
- 3) The institution does not exceed \$3 billion in total assets as of its last call report;
- 4) The institution is not a de novo bank and has been operating for at least seven years; and
- 5) The institution is not under any type of special monitoring or has become a concern to the Department through its off-site monitoring program, a substantial change in its business plan, or other factor as determined by the Commissioner; and
- 6) The previous examination performed by the Department was a Level I examination.

### **WHAT TO EXPECT**

Institutions selected for a Level II examination will be informed by the Examiner-in-Charge (EIC) before the examination begins and will receive a reduced list of required examination documents. The length of the on-site portion of the examination should be reduced as well as the number of Department personnel participating in the examination. The examination will follow the Department's pattern of regular communication including a management exit meeting to review the findings in detail and a Board meeting to review the overall conclusions of the examination. A written examination report will be issued as usual. No adjustments in assessments will be implemented.

### **EXAMINATION SCOPE**

The Level I examination is the Department's most comprehensive examination program conducted. The Level I examination follows the Department's standard risk-focused procedures. Under the Level II program, examiners follow the standard risk-focused procedures but will focus on the highest risk areas of the bank while excluding certain operational assignments determined to be of lower risk to the safety and soundness of the institution. Examiners will continue to review all critical aspects of the bank's operations to the extent needed to assign an appropriate CAMELS rating.

Areas that will receive a thorough and comprehensive review under the Level I and Level II examination programs include:

- Audit
- Credit Review, including the adequacy of the internal and external Loan Review and Allowance for Loan and Lease Losses;
- Investment Activities;
- Capital;
- Earnings;
- Liquidity;
- Sensitivity to Market Risk;
- Management and Board Supervision; and
- Other Supervisory Issues – Unclaimed Property

During the planning and risk assessment process for a Level II exam, the EIC may determine that the following operational areas should receive a review focusing on specific, higher-risk areas or activities within the functions listed below. In a Level I exam, these functions would receive a more thorough and comprehensive review.

- BSA/AML Compliance<sup>1</sup>;
- Other Real Estate Owned; and
- Overdrafts, Kite Suspect, and Cuts.

The following areas may be omitted from the scope or review at the discretion of the EIC under the Level II examination, if determined to be of low risk:

- Cash and Cash Items;
- Collections, Consigned Items, Safekeeping, and Safe Deposit;
- Insurance and Risk Management;
- Interbank Liabilities;
- Other Assets;
- Other Liabilities;
- Premises and Equipment;
- Related Organizations;
- Retail Sale of Nondeposit Investment Products;
- Temporary Mortgage Purchase Program; and
- Other Supervisory Issues – other than Unclaimed Property.

<sup>1</sup> Refer to Examiner Bulletin on Risk Focused BSA/AML Examinations. May perform the minimum procedures in a lower-risk bank that is well managed, otherwise expanded sections may need to be performed.

**If at any point during a Level II examination, the Department's review findings indicate increased risk, less than satisfactory compliance or additional exposure, the scope of the examination will be expanded to thoroughly assess the areas of concern.**

Questions regarding this guidance may be directed to the Director of Bank & Trust Supervision, at (512) 475-1300.