

International Banking

Examiners should evaluate the above-captioned function against the following control and performance standards. The Standards represent control and performance objectives that should be implemented to help ensure the bank operates in a safe and sound manner, and that the entity's objectives are carried out. Associated Risks represent potential threats to the bank if the standards are not achieved and maintained. The Standards are intended to assist examiners in analyzing important functions that may warrant additional review. All of the following Standards may NOT need to be considered at every bank. Conversely, these do NOT represent all of the control and performance standards needed for every bank. Examiners should continue to use their judgement when assessing risk.

| Standards | Associated Risks |
|---|---|
| MANAGEMENT AND CONTROL | |
| Management adequately maintains the financial risk of the bank's international activities. | Economic, social, legal, and political conditions of a foreign country may result in unfavorable consequences for borrowers in that country, including political or social upheaval, nationalization or expropriation, and government repudiation of external debts. Foreign exchange controls or shortfalls may preclude the timely completion of transactions. |
| The international department is adequately staffed, and personnel and senior management are knowledgeable and competent for the size and nature of the bank's international activities. | Inadequate understanding of the unique risks associated with international activities increases the likelihood of poor decision making, fraud, and loss. |
| Management provides for systems and personnel that are capable of controlling and reporting transactions. | The absence of an effective operations department may result in unanticipated losses. |
| A sufficient, independent audit of the bank's international activities is conducted, and results are clearly communicated to the board. | The board may be unaware of operational deficiencies that could result in losses. |
| The board has approved a formal statement of policy regarding international lending. The bank's policies enable management to determine borrower capacity and reputation by other than financial information. Management established appropriate aggregate country and currency limits. | Borrowers may be unable to comply with contractual credit terms. Variations in rates of currency exchange and currency conversion exposure may affect borrowers' ability to repay debt. Foreign financial statement quality and reliability may be poor. Bank may be exposed to excessive country risk. |
| The asset and liability accounts included in any International Banking Facility (IBF) are segregated on the bank's books. | Compliance with various restrictions and limitations on the types of business in which an IBF can engage may not be properly monitored. |
| Management establishes appropriate limits for trading positions in each currency. Management establishes appropriate limits on the volume of mismatches in its total foreign exchange (FX) positions. | Inappropriate trading limits expose the bank to increased exchange risk. Inappropriate mismatch limits expose the bank to increased interest rate risk. |
| Management conducts a careful evaluation of the | Customers may not be able to deliver the currency |

| Standards | Associated Risks |
|---|---|
| <p>creditworthiness of foreign exchange customers.</p> <p>Management establishes appropriate overall and daily limits for exchange contracts for each customer.</p> | <p>as promised in order to execute the contract.</p> <p>Customers may take delivery of funds from the bank but not deliver the counterparty funds.</p> |
| <p>Management establishes accounting systems and controls that provide current and accurate reports on FX trading activities.</p> | <p>Concealment of unauthorized transactions and misappropriation of funds may occur.</p> |
| <p>Management information systems (MIS) and the operations department are capable of reporting and supporting the current and expected FX trading volumes on a daily basis.</p> | <p>Ineffective information systems could lead to uninformed business decisions, inappropriate reaction to external influences or internal results of operations, and lost opportunities.</p> <p>Poor communication could result in inadequate accountability and oversight.</p> |
| PERFORMANCE | |
| <p>Duplicate records of certain offshore operations are maintained at the bank's head office.</p> <p>The bank complies with all applicable laws and regulations.</p> | <p>Failure to maintain duplicate records of certain offshore operations violates Part 347 of the FDIC Rules and Regulations and will not allow a centralized review of asset quality, funding operations, contingent liabilities, and internal controls.</p> <p>Violations of laws and regulations may subject the bank to increased regulatory supervision or enforcement actions.</p> |
| <p>Bank officers operate in conformance with board-established policies and procedures.</p> | <p>Officers may initiate unauthorized or inappropriate transactions.</p> |
| <p>The bank maintains sufficient financial information and documentation on international loans.</p> | <p>Country risk, foreign exchange risk, and the reliability of financial statements may influence repayment.</p> |
| <p>The bank considers foreign currency, extensions of credit, nostro accounts, and Eurodollar placements when determining total exposure to country or transfer risk.</p> | <p>Total exposure to country or transfer risk may be underestimated.</p> |
| <p>Accounting and other control documentation is maintained by each FX trading office.</p> | <p>Trading offices may not be aware of accounting and other control procedures.</p> |
| <p>The price and rate of the futures contract used correlates closely with the asset or liability hedged.</p> | <p>As characteristics of the futures contract become less similar to the account hedged, cross-hedging risk increases.</p> |
| <p>Appropriate internal controls are maintained regarding foreign notes and coins.</p> | <p>The bank may unknowingly accept counterfeit currency.</p> <p>The physical movement of notes and coins is expensive and time consuming.</p> |

International Banking

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

The following examination procedures are intended for domestically chartered banks conducting international activities. Procedures for branches and agencies of foreign banks may be found in the Federal Reserve's Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations.

- 1 Review the bank's most recent UBPR, Reports of Condition, examination reports, and correspondence for the existence of an international department, foreign branches or subsidiaries, the volume of international activity, and some indication as to the nature of the bank's international business.
 - 1 A Review remedial actions taken by management to correct examination identified deficiencies.
- 2 If the bank is part of a foreign banking organization (FBO), review the Strength of Support Assessment of the FBO and the Assessment of the Combined U.S. Operations of the FBO to determine if any weaknesses in the organization cause concern at the bank level. (Copies of these reports are available from the FDIC's regional office or the International Branch in Washington.)
- 3 Verify that the bank maintains, at its head office, a duplicate set of certain records (asset quality, funding operations, contingent liabilities, and internal controls) of offshore operations in accordance with Part 347 of the FDIC Rules and Regulations (FDIC), Section 211.7 of Regulation K (FRB).
- 4 Review the bank's compliance with any non-standard conditions associated with the approval of applications for foreign financial entities or foreign branches. (For example, a bank that operates an office in a secrecy jurisdiction may be required to keep duplicate records beyond those needed to comply with Part 347 (FDIC), Section 211.7 of Regulation K (FRB).)
- 5 Discuss the bank's current and future international activities with management.
- 6 Review board minutes for director review and approval of international activities. (Coordinate with Management and Internal Control Evaluation.)
- 7 Assess the adequacy of the bank's audit program relative to international activities. (Coordinate with Management and Internal Control Evaluation.)
 - 7 A Review internal and external audit reports prepared since the last examination.
 - 7 B Review the scope and findings of the internal audit function to ensure its sufficiency and determine what areas may warrant special review.
 - 7 C Review remedial action taken by management to correct internal and external audit deficiencies.
- 8 Determine whether there are sufficient staff and expertise to prudently manage the international activities of the bank.
- 9 Verify international activities are accurately reported in Call Report schedules RI, RI-D (Income from International Operations), RC, RC-E Part II, RC-I (Selected Assets and Liabilities of IBFs), and

RC-L (foreign exchange and other contingent liabilities including commercial documentary letters of credit) using bank prepared workpapers.

TRADE FINANCING

Letters of Credit

10 Review the bank's internal controls, policies, practices, and procedures for issuing and confirming letters of credit (L/C). (Note: Policies and procedures regarding L/Cs are often contained within the bank's loan policy. Coordinate with examiners responsible for loan review as necessary.) Pay particular attention to the following safeguards:

10 A Written policies that establish procedures, define customers, and establish minimum standards for documentation.

10 B Preparation and posting of subsidiary L/C records is performed or reviewed by appropriate personnel.

10 C Delinquencies are reviewed on a timely basis.

10 D Daily records of L/C transactions are maintained.

10 E Deferred payment L/Cs are recorded as direct liabilities of the bank after it has acknowledged receipt of the beneficiary's documents.

10 F Standby letters of credit (SLC) are segregated or made readily identifiable from other types of L/Cs or guarantees.

10 G Backing L/C is properly assigned as collateral to the bank issuing a back-to-back L/C.

Commercial Documentary Letters of Credit

11 Determine whether management ensures that commercial documentary letters of credit conform with the "Uniform Customs and Practice for Documentary Credits," publication Number 400 of the International Chamber of Commerce (ICC). (A copy is contained in the FFIEC Basic International Banking Self-Study handbook.) Review a sample of L/Cs to determine if they are issued with the following information:

11 A In favor of a definite beneficiary.

11 B For a fixed or determinate amount.

11 C In a form clearly stating how payment to the beneficiary is to be made and under what conditions.

11 D With a definite expiration date.

12 Determine whether management ensures that the bank's procedures conform with the "Uniform Rules for Collections" published by the ICC. (A copy is contained in the FFIEC Basic International Banking Self-Study handbook.)

13 Determine whether management adequately examines all documents to ensure that they conform to all the terms and conditions of the L/C.

14 Determine whether management controls the volume outstanding through a general ledger memorandum account or contra accounts.

Standby Letters of Credit

15 Determine whether management conducts sufficient credit analysis of account parties or customers for unsecured SLCs.

15 A Credit analysis should be equivalent to that applicable to a borrower in an ordinary unsecured loan situation.

15 B Unsecured SLCs are included in the bank's unsecured lending limit to one borrower.

16 Determine whether management ensures that SLCs conform with the "Uniform Customs and Practice for Documentary Credits" of the ICC.

17 Determine whether the bank issues guarantees.

17 A Determine whether insured nonmember banks only issue enforceable guarantees that serve a direct interest of the bank or are otherwise allowable by Part 347 of the FDIC Rules and Regulations.

17 B Verify that all guarantees are combined with standby letters of credit for determining a customer's legal lending limit (varies based on state law).

Bankers Acceptances

18 Determine if bankers acceptances (BAs) are eligible for discount or purchase by Federal Reserve Banks. (To be eligible, bankers acceptances must be created in accordance with Sections 12A, 13, and 14 of the Federal Reserve Act and Regulation A issued by the Board of Governors. Ineligible acceptances are subject to reserves.)

19 Determine compliance with lending limits and reserve requirements affecting BAs.

19 A State banking laws for nonmember banks (but most states have adopted appropriate sections of Federal statutes).

19 B Section 13 of the Federal Reserve Act.

20 Determine whether the following controls are in place:

20 A Acceptances of other banks that have been purchased in the open market are segregated on the bank's books from acceptances created by the bank itself.

20 B Prepayments on outstanding BAs are netted against the appropriate asset account.

20 C BA policies are reviewed at least annually to determine if they are compatible with changing market conditions.

20 D Record copies and liability ledger trial balances relating to acceptances issued by the bank are prepared and reconciled monthly with control accounts by employees who do not process or record acceptance transactions.

Other

21 Determine if the bank participates in other forms of trade financing such as current account advances, foreign receivable financing, or discounting trade acceptances.

LOANS

Policy and Portfolio Considerations

22 Review the bank's policies regarding international lending. Content will vary based on the size of the bank and the extent of its international activities. (Note: This information is often contained in the bank's general loan policy. Therefore, coordinate with examiners responsible for loan review.) The policy should include the following items:

22 A Basic credit standards.

22 B International lending objectives.

22 C Credit approval system.

22 D Loan processing procedures.

22 E Lending authorities.

22 F Provisions for periodic reporting to the board regarding the condition of the international loan portfolio.

22 G Country exposure guidelines.

- 22 G1 1. Country exposure limitations or aggregate limitations such as geographic area, income level, or common commodity.
2. Limits or sub-limits on loans by category such as trade credits, term-loans, etc.
3. Maximum maturities for various categories of loans.

23 Determine whether international loan portfolio management objectives and policies are reviewed at least annually to determine compatibility with changing market conditions.

24 Review bank reports on the general distribution and characteristics of the international loan portfolio to determine adherence with board established guidelines.

25 Consider discussing the bank's international lending philosophy with management.

Credit Standards and Information

26 Determine if bank management cautiously reviews financial statements prepared in other countries. (Accounting practices vary widely and even some highly developed countries have surprisingly lax auditing standards.)

26 A Ensure that financial analysis completed in a foreign currency is also converted into U.S. dollar equivalents with the applicable exchange rate indicated.

27 Determine how management establishes borrower capacity and reputation. (One of the most effective methods is a program of regular visitations to borrowers' countries by bank account officers followed by preparation of candid reports that become significant parts of credit files.)

28 Determine if management considers the following issues when evaluating loans to foreign banks:

- 28 A An accurate appraisal of the foreign bank's management.
 - 28 C The condition of the country.
 - 28 B The country's banking structure.
 - 28 D The position of comparable banks.
- 29 Determine whether the bank's credit analysis considers direct or indirect borrower support by a party of substantial strength such as a domestic parent or affiliate, a foreign correspondent bank guarantor, or a foreign government.
- 30 Determine whether lending personnel compare outstanding balances to appropriate country limits prior to granting additional advances or commitments.
- 31 Determine whether the bank is properly recording interest payments on debt obligations of financially troubled foreign sovereign borrowers. (FDIC: Refer to RD Memo #88-116, Recording Interest Payments on Certain Sovereign Debt.)

Geographic Limits

- 32 Determine whether management establishes maximum credit lines for each individual borrower, and maximum aggregate lines for each political entity where credit is advanced, based on country risk analysis. (Aggregate country loan limits should include a currency sublimit in order to control currency loss exposure.)
- 33 Determine whether lending officers are cognizant of specific country limits.

COUNTRY RISK

COUNTRY RISK: political, economic, and social conditions of countries in which a bank has exposure.

TRANSFER RISK: relevant whenever a bank extends credit across international borders and the extension of credit is denominated in a currency external to the country of residence of the obligor.

- 34 Review the bank's written policies regarding country risk.
- 35 Determine the name and composition of the committee responsible for the administration of country risk, and review committee meeting minutes, if applicable.
- 36 Review the latest country risk exposure reports given to the board of directors, and determine whether the information provided is comprehensive, accurate, and timely.
- 37 Review for accuracy any Country Exposure Reports (FFIEC 009) filed by the bank since the last examination. (These reports are filed quarterly by banks meeting certain conditions per Part 351 of the FDIC Rules and Regulations.)
- 38 Evaluate the bank's country exposure management system including the following items:

38 A Procedures for measuring exposure including economic trends, political developments, and the social fabric within countries where bank funds are at risk. This information can be derived from the following sources:

- 38 A1 1. Economic data supplied by the borrower or published by institutional lenders.
2. Social-political commentaries.
3. On-site reports from bank branches, subsidiaries, or affiliates.
4. Bank officer visits to the country.

38 B System for establishing country limits including aggregate outstandings, maturities, and categories of risk by country. (Note: Country limits should be updated at least annually.)

38 C Capacity for analyzing countries.

38 D Internal reporting system used to monitor and control country exposure. The system should provide the following information or controls:

- 38 E 1. Accurate assignment of risk assets to the country of risk.
2. Assure adherence to the policy directives of the board.
3. Review of portfolio composition in individual countries at least annually.
4. Clear-cut method for reporting exceptions to established limits.
5. Ability to accurately recognize country exposure on the basis of legally binding guarantees, collateral, or reallocation by office of responsibility.
6. Quickly provide complete exposure data in sufficient detail to assess risk.

39 Review a sample of the bank's formal and informal analyses of individual country conditions (pay particular attention to those countries with significant exposure). Determine how frequently they are performed.

40 Determine whether management adequately diversifies risk.

40 A Compare individual country exposure to the bank's capital funds.

40B Review the Results of the Interagency Country Exposure Review Committee Meeting, for appropriate comments on or classification of country exposures. (FDIC: Refer to latest RD memo.)

- 40 B1 1. Amount extended for adverse classification or comment should be the balance as of the asset review date, if possible.
2. Contingent liabilities that will result in a concomitant increase in bank assets if converted to an actual liability should also be extended for comment or classification, as applicable.
3. Use the standard narrative prepared by the Interagency Country Exposure Review Committee in the report of examination.

40C Consider the following factors when determining whether certain countries warrant comment:

- 40 C1 1. The composition of the bank's portfolio in the country.
2. The capabilities of bank management.
3. The bank's capital position.

41 Consider country risk factors when evaluating the bank's capital adequacy in accordance with the International Lending Supervision Act of 1983 (ILSA). (In addition to countries adversely classified due to transfer risk, large exposures to countries that are not adversely classified may

warrant comment on the Examiner's Comments and Conclusions page if the exposure is large relative to the bank's capital position. Coordinate with Capital Analysis.)

42 Review compliance with ILSA and Part 351 of the FDIC Rules and Regulations that, in part, set forth requirements on the following items:

42 A Maintaining Allocated Transfer Risk Reserves (ATRR) as determined by the Interagency Country Exposure Review Committee (ICERC).

42 B Establishing special reserves through a charge against current income and segregating the balance from the bank's general allowance for loan and lease losses (ALLL) when the value of international loans or quality of bank assets are impaired. Impairment can be caused by a protracted inability of the borrowers in a country to make payments on external indebtedness.

42 C Accounting for fees on international loans. (Fees in excess of administrative costs must be amortized over the life of the loan.)

42 D Reporting and public disclosure of international assets in relation to total assets and capital.

43 Review outstanding FDIC Regional Director memoranda for examination guidance regarding specific country exposures.

INTERNATIONAL BANKING FACILITIES

General

44 Review IBF ledgers to verify that IBF accounts are clearly segregated from the bank's books. (IBF assets need not balance with IBF liabilities.)

45 Determine whether all deposits and extensions of credit are accepted from or extended only to foreign residents, other IBFs, and offices of the institution establishing the IBF. (Federal Reserve Board Regulation D. IBF deposits are not insured by the FDIC.)

46 Determine whether customers are provided written notice at the time the deposit or credit relationship is first established advising of the requirement regarding the non-U.S. use of deposits and credit extensions, and whether a confirmation is obtained from foreign affiliates of U.S. residents acknowledging receipt of the notice.

47 Determine whether procedures exist to ensure the following conditions:

47 A Nonbank deposits are used only to support the non-U.S. operations of the customer.

47 B Nonbank extensions of credit are used only to finance the non-U.S. operations of the customer.

48 Determine whether management is thoroughly familiar with the provisions of Federal Reserve Board Regulations D and Q and other applicable laws and regulations.

49 Review all IBF-related regulatory reports (FFIEC-002 and FR 2951, if applicable) prepared since the last examination to determine their accuracy and submission in a timely manner.

FOREIGN EXCHANGE

FOREIGN EXCHANGE RISK: sensitivity of the real domestic currency value of assets, liabilities, or revenues to unanticipated changes in exchange rates.

CREDIT RISK: exposure a trader is willing to extend to a counterparty and controlled through the use of credit lines.

SETTLEMENT RISK: risk of not receiving a payment and controlled through the use of Daily Settlement Limits.

MARKET RISK: risk of unfavorable movements in foreign exchange rates and controlled through the use of limits on currency and trader positions.

50 Determine the type of FX activities and risks in which the bank is engaged (spot, forward, swaps, options, and futures) and whether transactions are for customers or the bank's own account.

Audit Documentation

51 Review internal audit reports of the bank's foreign exchange trading. Audit procedures should be documented through the following minimum standards:

51 A Audit reports, workpapers, and related files maintained at the head office or other centralized location.

51 B Files that indicate the extent to which the auditor tested the control and accounting entries as well as compliance with bank policy.

51 C A determination of whether the bank's controls are adequate and recommendations for additional controls, the deletion of existing controls, and the underlying rationale.

51 D Material deficiencies are promptly reported in writing to the board of directors or appropriate board committee.

51 E Evidence of steps taken to identify changed conditions since previous reviews of control adequacy.

52 Review external audit reports, management letters, engagement letters, and other descriptions of audit scope, procedures, or findings since the last examination.

Policy and Procedure Considerations

53 Review the bank's foreign exchange policies and procedures. At a minimum, they should address the following issues:

53 A Scope of trading activity authorized and types of services offered.

53 B Reporting requirements.

53 C Trading limits as well as exception approval and reporting process.

- 53 C1 1. Net positions by currency and in the aggregate.
2. Maturity distribution of foreign currency assets, liabilities, and contracts.
3. Individual customers and bank lines.
4. Daily settlements with customers and banks.

5. Total FX contracts outstanding.
6. Overnight net FX positions by currency and in the aggregate.
7. Maximum loss by trader, desk, and branch.

53 D Stop-loss amounts by trader and by currency, beyond which positions should be liquidated and trading stopped until senior management reviews the situation.

53 E Credit limits (spot and forward) as well as exception approval and reporting process.

53 F Clear standards for trading with affiliated entities, members of the board of directors, and employees. (Conflicts of interest.)

53 G Lines and delegation of authority and responsibility including specific officer responsibility for and authority over functional trading desks (spot, forward, and futures). Specific types of trading activity, currencies, and positions should be limited by individual trader.

53 H Holdovers and after-hours transactions. (These transactions should be included in the position report and general ledger accounts as of the day they were transacted.)

53 I Accounting controls and methods.

53 J Guidelines for disputed contracts and prohibitions regarding the use of "Points." (FDIC: Refer to RD Memo #90-087, Use of "Points" in Settling Foreign Exchange Contracts.)

53 K Settlement procedures.

53 L Operational procedures.

54 Determine whether traders periodically assess the impact of economic developments in the countries whose currencies they trade (need not be formal).

Trading Limits

55 Evaluate trading limits in light of current strategies, liquidity and volatility of individual currencies, trader qualifications, and loss exposure.

56 Review the process by which limits are allocated to branches and the process through which branches may borrow limits from other branches.

57 Evaluate policies governing the extension of limits and approval and reporting procedures.

Credit Limits

58 Review the list of approved credit limits noting any unusual concentrations or lines to banks with known market problems.

59 Review the allocation and monitoring of credit limits. Ensure that the following controls exist:

59 A FX counterparty and settlement limits, approved by a credit review process, are established independently of other credit lines within the bank.

59 B Documentation of individuals authorized by counterparties or customers to initiate trades.

59 C Daily reports generated by FX operations indicate those customers or banks that have exceeded their limits (sometimes called an over-limit or exceptions report).

59 D Daily report of limit excesses including written approvals for excesses are prepared by an officer not in the trading area.

59 E Determination of when a trade ceases to be a forward trade and becomes a spot trade (should have daily adjustments for banks active in FX markets).

59 F More risk is allocated to counterparties with long maturity positions.

59 G On-line systems that detail credit line status are available to traders.

59 H Bilateral netting contracts (these are optional). (For additional information refer to FDIC Part 325, Appendix A: Statement of Policy on Risk-Based Capital, and FIL-6-95, Risk-Based Capital Standards: Bilateral Netting Requirements, dated 1-6-95.)

Maturity Mismatch Limits

60 Verify that the bank has established limits on the sizes of mismatches in the foreign exchange book.

61 Review the bank's foreign exchange position and associated risks from exchange rate movements.

61A Evaluate the mismatch size limits relative to the bank's capital, potential losses, and management of the maturity mismatch.

61 B Review projected cash flows from transactions to determine if the bank can control the risk involved in taking interest rate positions.

Hedging

62 Determine whether the bank uses currency futures or options to hedge FX risk resulting from commercial transactions.

Management Information Systems (MIS) and Operational Support

63 Review MIS reports to determine if they enable management to complete the following tasks:

63 A Evaluate ability to monitor all FX positions.

63 B Ensure that daily net position reports for each currency traded contain the following information:

- 63 B1 1. Foreign currency balance sheet and off-balance sheet items.
2. Afterhour and holdover transactions.
3. US dollar equivalent position.
4. Daily profit and loss.

63 C Ensure that position reports are prepared by the FX and money market bookkeeping section and reconciled daily to the trader's blotter.

63 D If formal position reports cannot be submitted at the end of the business day, management should be apprised of the traders' estimated position at the end of each day.

- 63 E Review compliance with trading and credit limits.
- 63 F Determine whether gap or maturity reports show daily gaps for the first two to four weeks. Beyond this time, gap periods of a maximum of two weeks are preferred.
- 63 G Determine the frequency of report distribution (should be at least daily).
- 63 H Determine whether the system is periodically tested for accuracy.
- 64 Review the operations department and determine if the following controls are in place:
- 64 A Operations department personnel report to someone other than a member of the trading staff.
- 64 B There is adequate staff to support the volume of transactions.
- 64 C Duties of the department are segregated (confirmations, trader positions, counterparty positions).
- 64 D There is sufficient documentation to ensure a proper audit trail of transactions.
- 64 E Operations department personnel review all trader and counterparty position reports and identify and report all excesses to the operations manager daily.
- 64 F Documentation for the approval of excesses is obtained and reviewed daily.
- 65 Determine whether the bank establishes contingency plans should one or more of its systems become unavailable.
- 66 Review mark-to-market revaluations for accuracy and adherence to bank policy.
- 66 A Review prices used by operations personnel and verify they are from sources other than the bank's traders.
- 66 A1 1. Net asset and liability positions in foreign currencies are revalued at spot rates. (Institutions that carry substantial open positions must have access to real-time price information.)
2. Foreign exchange positions in foreign currencies are revalued on the mark-to-market basis or cost-to-cover basis.
3. Forward positions are revalued with forward rates consistent with the days to value date. (A forward position with 60 days to value date is revalued using the 60 day forward rate.)
- 66 B Determine if revaluations are recorded at least monthly and profits or losses are recognized accordingly.
- 66 C Determine if the revaluation date is consistent each month (for example, the 20th or 21st each month).
- 67 Determine whether confirmation discrepancies are recorded in a log and promptly corrected.
- 68 Review the status of nostro (correspondent asset account denominated in a foreign currency) and vostro (demand deposit account maintained by a bank for a foreign correspondent) accounts to identify any outstanding items which may indicate settlement errors.

Internal Accounting Controls

69 Review the bank's internal accounting controls of foreign exchange trading. Consider the following minimum standards:

69 A Description of accounting systems and procedures. (Transaction day, value day, revaluation, spot and forward transactions, contingent accounts, dual or multi-currency accounting, etc.)

69 B Procedures to reconstruct the date and time of transactions.

69 C Control of contract forms.

69 D Reconciliation of trading positions.

69 E Reporting of exceptions.

69 F Descriptions and accounting procedures for each type of interest arbitrage transaction.

69 G Recordkeeping requirements. (FX telex tapes or copies for at least 90 days.)

69 H Limit approval documentation that evidences consideration of actual and projected trading activity.

69 I Use of recorded phone lines, where possible.

70 Review the bank's method to confirm FX contracts (should be independent of the trading function).

70 A Outgoing confirmations should include the following information:

- 70 A1 1. Transaction date, preparation date (if different from the transaction date), and maturity date.
2. Amount of currency traded, accepted, or placed, and the applicable rate.
3. Name of counterparty.
4. Liquidation instruction (if known) and reference number.

70 B Incoming confirmations should be verified by comparison with contracts.

OTHER INTERNATIONAL BANKING ACTIVITIES

Cash Accounts

71 Determine whether adequate physical controls and accounting systems and controls exist regarding foreign cash accounts.

72 Verify that accounting reports include the U.S. dollar equivalent of foreign currency balances.

73 Determine whether separate controls exist for cash items maintained on the general ledger and if cash items are supported by subsidiary records.

74 Verify that foreign currency is included in position reports.

Due-From or Nostro Accounts

Core Analysis

(May be used for trading for the bank's own account.)

75 Review nostro accounts similarly to domestic correspondent bank accounts.

76 Determine whether in-coming confirmations are carefully reviewed by management and whether timely follow-up procedures are in place for non-receipt of confirmations.

77 Review the bank's credit evaluation of foreign banks with whom demand deposit accounts are maintained.

Due-From Time Deposits

(Also known as placements, interbank placements, or redeposits.)

78 Review the bank's policies and procedures regarding placement activity (usually Eurodollars). Policies should be similar to those used for Federal funds transactions and define the following items:

78 A Terms.

78 B Acceptable levels of concentration in relation to credit and country risks.

78 C Acceptable banks for placement activity.

79 Determine whether management conducts a thorough investigation of the creditworthiness of banks with which due-from time deposits are placed.

80 Determine whether credit officers regularly review acceptable depositories.

81 Determine whether lists of acceptable depositories with prescribed limits are provided to traders.

82 Determine whether management considers the effect of changes in interest rates on Eurodollar activity.

Investments

83 Evaluate the bank's international investment activities. (Coordinate with examiner(s) completing the Securities Analysis.)

84 Determine whether management analyzes the following factors prior to purchasing a foreign security and retains supporting documentation of conclusions.

84 A Legal implications.

- 84A1 1. Governing law.
2. Disclosure.
3. Contract or fraud provisions.
4. Capacity to enter financial contracts.
5. Netting enforceability.
6. Extradition.
7. Resolution.

84 B Credit soundness. Credit risk can be identified through the following sources:

- 84 B1 1. Country risk rating.
2. Issuer's financial reports.

3. Credit rating.
4. Bond yield (spread off Treasury curve, spread off floating rate index).
5. Quality of credit enhancement.

84 C Marketability.

84 D Exchange rate risk.

84 E Country risk.

84 F Transfer risk.

84 G Settlement risk. Securities transactions are commonly settled through one of the following clearing systems:

- 84 G1 1. Cedal - (Luxembourg) holds securities for its participating organizations and facilitates the clearance and settlement of securities transactions between participants through electronic book-entries.
2. Euroclear - (Belgium) holds securities for its participants and clears and settles transactions between participants through simultaneous electronic book-entry against payment. Also provides securities lending and borrowing services.

85 Verify that the international investment portfolio is reviewed by the board at least annually to monitor adherence to written policies and procedures.

86 Review compliance with investment limitations outlined in the Federal Reserve Board's Regulation K and FDIC Rules and Regulations Part 347.

87 Review outstanding Regional Director memoranda for examination guidance regarding securities issued by certain countries. (FDIC: RD Memo #93-015.)

88 Determine whether the bank participates in debt and equity swaps involving countries with allocated transfer risk reserves. (FDIC: RD Memo #93-014, Call Report Treatment for Debt and Equity Swaps Involving Countries with Allocated Transfer Risk Reserves.)

88 A Review each swap to assure that the carrying value is recorded in accordance with GAAP and regulatory reporting requirements.

88 B Determine whether the initial valuation is supported by evidence of fair value.

88 C Assess the transfer risk associated with each swap.

88 D Determine whether each swap should be classified for reasons of commercial risk in evaluating the bank's asset quality.

Borrowings

89 Evaluate the bank's borrowing practices and accounting procedures.

90 Determine whether management considers the following factors when funding operations through international markets:

90 A Cost.

- 90 A1 1. Interest.

Core Analysis

2. Fees for issuance.
3. Expenses for issuance.

90 B Risk.

- 90 B1 1. Liquidity.
2. Capital adequacy.

90C Control.

- 90 C1 1. Covenants.
2. Collateral.

Hedging Activities

91 Determine whether the bank participates in hedging activities associated with its international operations. (Additional guidance regarding hedging instruments can be found in the Capital Markets Examination Handbook.)

CABLE DEPARTMENT

General

92 Review the results of the Electronic Funds Transfer module for conditions that affect international banking activities.

International Banking

REPORT OF EXAMINATION PRESENTATION:

1 Discuss analysis, conclusions, and recommendations with EIC and management prior to completing the following pages as needed:

1 A International Operations: International Loans, Acceptances, and Letters of Credit.

1 B International Operations: Eurocurrency Operations.

1 C Transfer Risks Subject to Adverse Classification or Comment.

1 D Analysis of the Country Exposure Management System. (Discuss the following topics, if applicable.)

1 D1 1. The quality of internal policies, practices, procedures, and controls over the international lending function.

2. The general level of adherence to internal policies, practices, procedures, and controls.

3. The scope and adequacy of the internal loan review system as it pertains to country risk.

4. The scope and adequacy of the bank's analysis of country conditions.

5. Causes of existing problems.

6. Expectation for continued sound international lending or correction of existing deficiencies.

7. Promises made by management for correction of deficiencies.

8. The quality of management with respect to the monitoring and controlling of country risk.

1 E Selected Concentrations of Country Exposure.

1 F Foreign Exchange Activities.

1 G Foreign Exchange Questionnaire: Position Analysis.

1 H Foreign Exchange Questionnaire: Maturity Distribution (GAP) Analysis.

1 I Foreign Exchange Questionnaire: Revaluation and Income/Loss Analysis.

1 J Foreign Exchange Questionnaire: Income/Loss Schedule.

1 K Foreign Exchange Questionnaire: Policy and Procedures.

1 L Audit and Internal Controls.

International Banking

Generally, procedures used in the Expanded Analysis should target concerns identified in the Core Analysis and Decision Factors. Expanded procedures associated with Core Analysis and Decision Factors of no concern need not be used. The flexible guidelines specified for the Core Analysis also apply here.

Policies and Procedures

1 Investigate why the policy and procedures deficiencies identified in the Core Analysis exist. Discuss with management its response to examiner recommendations. (Note: The Core Analysis reveals what the deficiencies are, whereas the Expanded Analysis is focused on the circumstances causing the deficiencies and management's ability and willingness to implement corrective action.) Possible reasons for policy deficiencies may include the following circumstances:

1 A Management overlooked these issues.

1 B Management is unfamiliar with prudent guidelines and procedures for international banking activities.

1 C Management is unwilling to create or enhance policies and procedures.

2 If poor compliance with policies and procedures exist, determine the reasons. Possible reasons are detailed below:

2 A Unaware of policies' existence.

2 B Disregard for established policies.

2 C Misunderstanding the intent of policy guidelines.

2 D Poor communication of policies and procedures or subsequent changes.

3 Determine if management commits to and supports proper controls and monitoring to ensure policy guidelines are followed in the future. Ensure proposed controls, if any, are reasonable.

Laws and Regulations

4 Restrictive Trade Practices

4 A Department of Commerce Part 369, Restrictive Trade Practices or Boycotts.

4 A1 1. Review the documentation of a sample of international transactions (especially letters of credit) for any indication of restrictive trade or boycott requests or provisions, expressed or implied.

2. Through discussions with bank management, determine whether any such stipulations or provisions were agreed to verbally.

3. Investigate apparent violations of Department of Commerce Part 369 and report under Group B.

5 Foreign Corrupt Practices

5 A Foreign Corrupt Practices Act of 1977.

5 A1 1. Banks subject to the Securities and Exchange Act of 1934 must maintain strict accounting standards and management control over their assets.

2. Banks may not bribe foreign officials or foreign political candidates or parties for the purpose of acquiring or retaining business. (Facilitating or "grease" payments are not prohibited.)
3. Prepare and submit a Suspicious Activity Report on all apparent violations of the Foreign Corrupt Practices Act.

Controls

International Banking Facilities

- 6 Determine whether all assets and liabilities of the IBF qualify under the definitions in Regulations D and Q and other regulatory provisions applicable to IBFs.
- 7 Review intrabank transactions for the following conditions:
 - 7 A All transactions with U.S. offices of the institution establishing the IBF or other IBFs are clearly identifiable.
 - 7 B Eurocurrency liabilities to the IBF are properly reported by the U.S. offices of the institution establishing the IBF.
- 8 Verify that no banker's acceptances, certificates of deposit, or other liabilities have been issued in negotiable bearer form.
- 9 Determine whether all foreign nonbank deposits meet the minimum maturity or notice period to withdraw of two business days.
- 10 Determine whether nonbank time deposit or withdrawal transactions (except closeouts) meet the minimum size requirement of \$100,000.

Foreign Exchange

- 11 Verify the accuracy of exception reports by comparing a current report of all outstanding FX contracts with credit approval limits.
- 12 Consider creating FX transaction flowcharts and tracing several FX transactions to ensure the bank is not at risk.

Offshore Operations

- 13 If the main office maintains inadequate information or there are unusual features concerning the activities of foreign branches, consider whether an on-site examination of foreign branches is necessary.
- 14 There are specific procedures that must be followed prior to and during official travel to a foreign country. (FDIC: RD Memo #97-063, Procedures for Travel to Foreign Countries for Examination Matters.)
 - 14 A The Regional Office should contact the appropriate desk officer of the U.S Department of State and request that they notify the U.S. Ambassador of the country to be visited.
 - 14 B FDIC personnel should maintain notification documentation at all times while visiting the foreign country. Personnel should also have the name of the U.S. Ambassador and the telephone number of the U.S. Embassy.

International Banking

REPORT OF EXAMINATION PRESENTATION:

NOTE: Only prepare supplemental pages that support examination comments and conclusions.

1 Discuss analysis, conclusions, and recommendations with the EIC and management prior to completing the following pages as needed:

- 1 A Those pages listed in the Core Analysis Decision Factor section.
- 1 B Violations of Laws and Regulations.
- 1 C Examiner's Comments and Conclusions.
- 1 D If restrictive trade practices (agreed or not agreed to by the bank) are discovered, the Examiner's Comments and Conclusions page should include the following comments:
 - 1 D1 1. The nature of the transaction giving rise to the request or practice.
 - 2. A description of the restrictive trade practice or boycott requested or agreed to.
 - 3. Whether it involves a violation of Part 369.
 - 4. An indication of the attitude of bank management with respect to the request or practice, including whether management has or will refrain from honoring such requests or discontinuing such practices.
- 1 E Risk Management page comments (FDIC).
- 1 F Management/Administration page comments.
- 1 G Earnings page comments.
- 1 H Internal Routine and Controls page comments.

International Banking

Impact Analysis reviews the impact that deficiencies identified in the Core and Expanded Analysis and Decision Factors have on the bank's overall condition. Impact Analysis also directs the examiner to consider possible supervisory options.

- 1 Determine the effect of international banking activities on the bank's capital, asset quality, earnings, and sensitivity to market risk positions.
- 2 Determine the need for administrative and enforcement actions, formulate specific recommendations, and advise the appropriate supervisory officials on the nature of the concerns. (FDIC: Field Office Supervisor, Regional Office)
- 3 Discuss the possibility of administrative and enforcement actions with executive management and the board of directors.
- 4 Investigate potential recommendations for civil money penalties or removal actions.

International Banking

REPORT OF EXAMINATION PRESENTATION:

NOTE: Only prepare supplemental pages that support examination comments and conclusions.

1 Discuss analysis, conclusions, and recommendations with the EIC and management prior to completing the following pages as needed:

1 A Those pages listed in the Expanded Analysis Decision Factor section.

1 B Prepare appropriate recommendations for administrative and enforcement actions, and associated memoranda.

International Banking

Core Analysis Decision Factors

Examiners should evaluate Core Analysis in this section for significance and to determine if an Expanded Analysis is necessary. Negative responses to Core Analysis Decision Factors may not require proceeding to the Expanded Analysis. Conversely, positive responses to Core Analysis Decision factors do not preclude examiners from proceeding to the Expanded Analysis if deemed appropriate.

Do Core Analysis and Decision Factors indicate that risks are adequately managed?

General Comment:(If any)

Core Analysis Decision Factors

C.1. Are policies, practices, and procedures adequate regarding current and anticipated international activities?

C.2. Do bank officers comply with established policies and procedures?

C.3. Does management comply with all applicable laws and regulations?

C.4. Does management demonstrate sufficient expertise to prudently manage international activities?

C.5. Do management reports provide sufficient information to assure board members that the bank is in compliance with approved policies?

C.6. Is the audit function adequate?

C.7. Are controls adequate?

C.8. Is country risk adequately managed?

C.9. Is the foreign exchange function adequately managed?

C.10. Are records and activities of off-shore operations adequate and properly managed?

International Banking

Expanded Analysis Decision Factors

This section evaluates the significance and materiality of deficiencies or other specific concerns identified in the Core and Expanded Analyses.

Do Expanded Analysis and Decision Factors indicate that risks are adequately managed?

General Comment:(If any)

Expanded Analysis Decision Factors

E.1. Are management deficiencies immaterial to the oversight of international banking activities?

E.2. Are performance deficiencies immaterial to the bank's condition?