
Sampling Program

Examination Objectives

To select a sample of homogeneous assets that will enable the examiner to evaluate the institution's underwriting and draw conclusions about asset quality.

To assess the IAR program to draw a conclusion about the reliability of the institution's IAR program and, for nonhomogeneous assets, to determine if the assets reviewed under the IAR program can be included in the examination asset review sample.

To select a sample of nonhomogeneous assets that will enable the examiner to draw conclusions about the institution's underwriting and asset quality.

Examination Procedures

Wkp. Ref.

Reviewing the Institution's Underwriting Policies

1. Review the general ledger to ascertain the overall characteristics of the loan portfolio. Determine the number of loans held in portfolio for each of the different loan types, i.e., one- to four-family residential loans, consumer loans, etc. Ensure that adequate records are readily available to facilitate the loan sampling review.

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2. Review the adequacy of the institution's policies for underwriting and acquiring assets pursuant to the other sections of Chapter 200 of this Handbook.
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Testing the Internal Asset Review (IAR) Program

3. Review the preceding report of examination and all IAR-related exceptions noted and determine if management has taken appropriate corrective action.

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4. Review the institution's IAR program pursuant to Section 210, Lending Risk Assessment and Appendix A to Section 261, Adequacy of Valuation Allowances. Review IAR program sampling methodology and obtain schedules of internally reviewed nonhomogeneous assets.

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For homogeneous assets reviewed under the institution's IAR program, determine whether the institution's classifications are based primarily on delinquency status. Proceed with step 7 for reviewing homogeneous assets.

If the policies and procedures of the IAR program are deemed sufficient, select a representative sample of nonhomogeneous assets reviewed in the IAR program and proceed with step 5.

If the IAR program is insufficient, then proceed to step 17 and the procedures that follow for independent review of nonhomogeneous assets or consider postponing the examination asset review, if necessary.

Note: If the IAR program is simply incomplete, e.g., it does not include reviews of a particular category of assets, and the rest of the IAR program is considered acceptable, then the examiner may still proceed with step 5 to determine if the internal classifications of the acceptable portion of the IAR program may be included in the minimum examination sampling coverage standards. The examiner should conduct an independent sampling and review of those categories of assets for which the IAR program is not acceptable.

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5. Review the selected assets for classification. If no more than an acceptable number of exceptions in classifications are found, then all assets reviewed in the IAR program and their internal classifications should be included in the minimum examination sampling coverage standards. If an unacceptable number of exceptions in classifications are found, then only assets actually reviewed by examiners should be included in calculating the examination sampling coverage.
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6. Document your conclusions regarding the reliability of the IAR program for reporting and monitoring purposes between examinations and comment in the ROE, if necessary. Discuss IAR program deficiencies noted with management and initiate appropriate corrective action.
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Examination Asset Review

Homogeneous Assets (Refer to Exhibits 1 and 2 of this Section)

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| 7. Systematically sample homogeneous assets. If necessary to ensure coverage of significant subcategories of homogeneous assets, judgmentally sample additional assets, such as a wider sample of those assets underwritten or acquired since the previous examination. | |
| 8. Review the sample for compliance with prudent underwriting, safety and soundness regulations, internal policies, and possible classification according to instructions in Section 260, Classification of Assets. | |
| 9. List all "slow loans" and "slow consumer credit" and tentatively classify them in accordance with Section 260, Classification of Assets. | |
| 10. Allow management to review the tentative adverse classifications to identify any that may be controversial. Review files on disputed classifications and revise classifications if appropriate. | |
| 11. Scan records of homogeneous assets to identify unusually large assets and verify that any unusually large assets are properly designated by purpose. Include any improperly designated homogeneous assets with nonhomogeneous assets for sampling and review. | |
| 12. Review exceptions from prudent underwriting practices, and determine if additional sampling or other examination procedures are needed to determine the cause for the exceptions and the corrective action needed. If appropriate, undertake additional sampling. | |

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13. If necessary, expand samples of any groups of assets suspected to contain material amounts of assets that may warrant classification.

14. Review expanded samples to determine if any assets from the expanded samples should be adversely classified.

15. If the sample review indicates possible material risk of loss in a subcategory of homogeneous assets, include that subcategory with nonhomogeneous assets for additional sampling and review.

16. Document your conclusions regarding the underwriting and asset quality of homogeneous assets and comment in the ROE. Discuss any underwriting deficiencies noted with management and initiate appropriate corrective action.

Independent Sampling of Nonhomogeneous Assets (Refer to Exhibit 3 of this Section)

17. Use either the minimum cut-off or dollar-proportional method to select a sample of nonhomogeneous assets. (Refer to Exhibit 1 of Appendix B.) Select an additional sample using the judgmental method.

18. Add all nonhomogeneous asset balances included in the samples (including the assets reviewed by the institution under its IAR program if the examiner finds the IAR program to be acceptable for the purpose of including the results of the IAR program in meeting minimum examination sampling coverage standards). Divide the total of the samples by the total of nonhomogeneous assets. If the percent selected is between 30% and 50%, use the initial samples for review. If not, raise or lower the cut-off amount and make additional judgmental selections to achieve the intended percent.

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19. Review the sampled assets for possible classification and exceptions.

20. After any necessary classifications have been made, if adverse classifications exceed 50% of GAAP equity capital or if any asset group has significant problems, lower the cut-off for that group or make additional judgmental selections of assets for review.

21. If additional review increases classifications by a material amount, increase the sample size for the type of assets in which the problems were found.

22. When severe asset quality problems are known or suspected, it may be necessary to increase the sample size even further to 65% (or higher) of total nonhomogeneous assets to adequately determine the extent of asset quality problems, the need for valuation allowances, and the effect on capital.

23. Document your conclusions regarding the underwriting and asset quality of nonhomogeneous assets and comment in the ROE. Discuss any underwriting deficiencies noted with management and initiate appropriate corrective action.

Conclusion

24. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as recommendations for any necessary corrective measures, on the appropriate work papers and ROE pages.

Examiner's Summary, Recommendations, and Comments

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