



Maximum Efficiency, Risk-Focused, Institution Targeted (MERIT) Examinations

FIL-13-2004
February 4, 2004

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: Expanded Use of FDIC's Streamlined Examination Program Called "MERIT" – Maximum Efficiency, Risk-Focused, Institution Targeted Examinations

Summary: *As part of the FDIC's continuing efforts to refine its risk-focused examination process and use resources efficiently, the FDIC has expanded the use of a streamlined examination program called MERIT. The MERIT program, originally implemented in April 2002, was applicable to banks that met basic eligibility criteria, such as total assets of \$250 million or less and satisfactory regulatory ratings. Successful implementation of the MERIT program has led the FDIC to expand the program to eligible, well-rated banks with total assets of \$1 billion or less.*

The Federal Deposit Insurance Corporation (FDIC) has expanded the use of its streamlined examination program begun in April 2002. The "MERIT" program – for **Maximum Efficiency, Risk-Focused, Institution Targeted Examinations** – applied to banks that met basic eligibility criteria, which included having total assets of \$250 million or less and satisfactory regulatory ratings. Under the expanded MERIT program, well-rated banks with total assets of \$1 billion or less will now be eligible.

The success of the MERIT program, implemented as part of the FDIC's ongoing efforts to refine its risk-focused examination process, led the FDIC to broaden the program's use. The program's expansion is one component of a multi-faceted corporate-wide process redesign effort initiated by FDIC Chairman Don Powell. The way the FDIC examines banks will continue to evolve to ensure that the Corporation's resources are focused on the greatest areas of risk, while preserving the integrity of the examination process.

MERIT Eligibility Criteria

Under the expanded MERIT program, the FDIC has targeted well-capitalized institutions with component and composite ratings of "1" or "2" and total assets of \$1 billion or less. To be eligible, institutions must also have been found at the previous examination to have:

- Stable management and
- Effective formal or informal loan grading systems.

Ineligible institutions include those that:

- Have recently experienced a change in control;

- Have significant adverse external factors, such as a poor local economy;
- Are recently chartered banks, niche banks, or institutions with higher-risk lending or securitization programs;
- Have a significant change in risk profile, as indicated by off-site analysis or monitoring systems; or
- Have significant new business lines.

While the FDIC's intent is to maximize the use of MERIT examinations, the FDIC reserves the right to remove a bank from the MERIT program at its discretion. The FDIC would normally base such a decision on adverse findings or "red flags" revealed during the pre-examination planning process or the examination.

MERIT Examination Procedures

During a MERIT examination, the examiners will use procedures that focus on determining the adequacy of an insured depository institution's internal control systems, and that focus on reviewing the internal and external audit programs. In analyzing loan portfolios, examiners will continue to include substantial transaction testing, but at a reduced level. For example, if an institution maintains an effective internal asset review program, examiners will significantly reduce the time spent reviewing individual credits. Examiners will devote significant attention to an overall assessment of the institution's risk-management processes. They will review an institution's lower-risk activities primarily through discussions with management and by monitoring the activities through various off-site analytical programs.

Effect of Streamlined Procedures

The MERIT program's overall benefits are improved efficiencies and less examiner time spent on-site in examinations of well-rated insured depository institutions. The program also provides an opportunity for the FDIC to redirect examination resources to institutions that pose higher risks. Similar programs have been developed for information technology examinations in banks without complex computer systems or significant external connectivity, and for examinations of trust departments with total trust assets of \$50 million or less.

For more information about the MERIT program, please contact your FDIC Regional Office. For your reference, FDIC Financial Institution Letters may be accessed on the FDIC's Web site at <http://www.fdic.gov/news/news/financial/2004/index.html>.

Michael J. Zamorski
Director
Division of Supervision and Consumer Protection

#

Distribution: FDIC-Supervised Banks (Commercial and Savings)

NOTE: Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 801 17th Street, NW, Room 100, Washington, DC 20434 (1-877-275-3342 or (703) 562-2200)