

# AuditOne Regulatory Advisory

From Bud Genovese, Chairman

## Understanding the New Statement on Correspondent Concentration Risk

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FIL-18-2010 (<http://www.fdic.gov/news/news/financial/2010/fil10018.html>) addressing Correspondent Concentration Risk (CCR) was released April 30th. There was additional detail provided in a concurrent Guidance Statement (<http://www.fdic.gov/news/news/press/2010/pr10093a.pdf>).

CCR has both an asset and a liability component. The asset side relates to credit risk considerations in the event of unduly large exposure to a correspondent counterparty that defaults on amounts owing (loan, Fed Funds sold position, due-from account, etc.). The essentials here are already addressed in Reg F, but the Guidance talks of the need for due diligence, monitoring and reporting that go beyond the Reg F minimum requirements. CCR issues come in for correspondent exposures (direct and indirect, on a consolidated basis) that exceed 25% of a bank's Risk-Based Capital.

The liability side of CCR relates to insufficient diversity in wholesale funding sources. There isn't as firm a threshold; the Guidance indicates that CCR concerns may kick in where one correspondent represents as little as 5% of a bank's total liabilities. It also notes the possible interplay between asset and liability exposure, where problems on one side can feed problems on the other.

What's expected of an institution in managing its CCR? Four aspects are discussed:

1. Management should conduct (and report to the Board) comprehensive assessments of correspondent concentrations. This could be done together with the Reg F reporting.
2. Set concentration limits on correspondent exposure, on both the asset and liability side.
3. Establish early-warning trigger levels for a correspondent's capital trends, loan quality ratios, volatile liability dependence, etc. There's a fuller list on pg. 17 of the Guidance. These triggers should be part of the ongoing monitoring and should be reviewed independently of the concentration limits. If a correspondent's condition is deteriorating, action should be taken even if exposure is below the limit established. Which brings in:
4. Contingency planning, to spell out actions to be taken. On the liability side, this dovetails with April's FIL-13-202 on Funding and Liquidity Risk Management, with its attention to liquidity planning, including Contingent Funding Plans.

We at AuditOne are happy to talk with you about any of the Statement's provisions and how to best implement recommended action steps. Please contact me ([jeremy.taylor@audit-one.com](mailto:jeremy.taylor@audit-one.com)) or Kevin Watson ([kevin.watson@audit-one.com](mailto:kevin.watson@audit-one.com)) at 562-802-3581

*Bud Genovese is Chairman of AuditOne LLC, a California-based internal audit firm that focuses only on banks and their service providers. Mr. Genovese pioneered the concept of providing comprehensive, affordable, independent internal audit and credit review services by gathering wide-ranging, extraordinary expertise within one firm. AuditOne now serves over 160 clients throughout the Western United States, and **nationally**. Contact Bud Genovese at 408-980-8099 or [bud.genovese@audit-one.com](mailto:bud.genovese@audit-one.com)*