

duties with respect to the appointment of the institution’s independent public accountant, the audit committee shall ensure that engagement letters and any related agreements with the independent public accountant for services to be performed under this part do not contain any limitation of liability provisions that:

- (i) Indemnify the independent public accountant against claims made by third parties;
- (ii) Hold harmless or release the independent public accountant from liability for claims or potential claims that might be asserted by the client insured depository institution, other than claims for punitive damages; or
- (iii) Limit the remedies available to the client insured depository institution.

(2) Alternative dispute resolution agreements and jury trial waiver provisions are not precluded from engagement letters provided that they do not incorporate any limitation of liability provisions set forth in paragraph (c)(1) of this section.

APPENDIX A TO PART 363—GUIDELINES AND INTERPRETATIONS

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INTRODUCTION

Congress added section 36, “Early Identification of Needed Improvements in Financial Management” (section 36), to the Federal Deposit Insurance Act (FDI Act) in 1991.

The FDIC Board of Directors adopted 12 CFR part 363 of its rules and regulations (the Rule) to implement those provisions of section 36 that require rulemaking. The FDIC also approved these “Guidelines and Interpretations” (the Guidelines) and directed that they be published with the Rule to facilitate a better understanding of, and full compliance with, the provisions of section 36.

Although not contained in the Rule itself, some of the guidance offered restates or refers to statutory requirements of section 36 and is therefore mandatory. If that is the case, the statutory provision is cited.

Furthermore, upon adopting the Rule, the FDIC reiterated its belief that every insured depository institution, regardless of its size or charter,

should have an annual audit of its financial statements performed by an independent public accountant, and should establish an audit committee comprised entirely of outside directors.

The following Guidelines reflect the views of the FDIC concerning the interpretation of section 36. The Guidelines are intended to assist insured depository institutions (institutions), their boards of directors, and their advisors, including their independent public accountants and legal counsel, and to clarify section 36 and the Rule. It is recognized that reliance on the Guidelines may result in compliance with section 36 and the Rule which may vary from institution to institution. Terms which are not explained in the Guidelines have the meanings given them in the Rule, the FDI Act, or professional accounting and auditing literature.

#### SCOPE OF RULE AND DEFINITIONS (§363.1)

1. *Measuring Total Assets.* To determine whether this part applies, an institution should use total assets as reported on its most recent Report of Condition (Call Report) or Thrift Financial Report (TFR), the date of which coincides with the end of its preceding fiscal year. If its fiscal year ends on a date other than the end of a calendar quarter, it should use its Call Report or TFR for the quarter end immediately preceding the end of its fiscal year.

2. *Insured Branches of Foreign Banks.* Unlike other institutions, insured branches of foreign banks are not separately incorporated or capitalized. To determine whether this part applies, an insured branch should measure claims on non-related parties reported on its Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (form FFIEC 002).

3. *Compliance by Holding Company Subsidiaries.* Audited consolidated financial statements and other reports or notices required by this part that are submitted by a holding company for any subsidiary institution should be accompanied by a cover letter identifying all subsidiary institutions subject to part 363 that are included in the holding company's submission. When submitting a Part 363 Annual Report,

the cover letter should identify all subsidiary institutions subject to part 363 included in the consolidated financial statements and state whether the other annual report requirements (*i.e.*, management's statement of responsibilities, management's assessment of compliance with designated safety and soundness laws and regulations, and, if applicable, management's assessment of the effectiveness of internal control over financial reporting and the independent public accountant's attestation report on management's internal control assessment) are being satisfied for these institutions at the holding company level or at the institution level. An institution filing holding company consolidated financial statements as permitted by §363.1(b)(1) also may report on changes in its independent public accountant on a holding company basis. An institution that does not meet the criteria in §363.1(b)(2) must satisfy the remaining provisions of this part on an individual institution basis and maintain its own audit committee. Subject to the criteria in §§363.1(b)(1) and (2), a multi-tiered holding company may satisfy all of the requirements of this part at the top-tier or any mid-tier holding company level.

4. *Comparable Services and Functions.* Services and functions will be considered "comparable" to those required by this part if the holding company:

(a) Prepares reports used by the subsidiary institution to meet the requirements of this part;

(b) Has an audit committee that meets the requirements of this part appropriate to its largest subsidiary institution; and

(c) Prepares and submits management's assessment of compliance with the Designated Laws and Regulations defined in guideline 7A and, if applicable, management's assessment of the effectiveness of internal control over financial reporting based on information concerning the relevant activities and operations of those subsidiary institutions within the scope of the Rule.

4A. *Financial Statements Prepared for Regulatory Reporting Purposes.* (a) As

set forth in §363.3(c) of this part, “financial reporting,” at a minimum, includes both financial statements prepared in accordance with generally accepted accounting principles for the insured depository institution or its holding company and financial statements prepared for regulatory reporting purposes. More specifically, financial statements prepared for regulatory reporting purposes include the schedules equivalent to the basic financial statements that are included in an insured depository institution’s or its holding company’s appropriate regulatory report (for example, Schedules RC, RI, and RI-A in the Consolidated Reports of Condition and Income (Call Report) for an insured bank; and Schedules SC and SO, and the Summary of Changes in Equity Capital section in Schedule SI in the Thrift Financial Report (TFR) for an insured thrift institution). For recognition and measurement purposes, financial statements prepared for regulatory reporting purposes shall conform to generally accepted accounting principles and section 37 of the Federal Deposit Insurance Act.

(b) Financial statements prepared for regulatory reporting purposes do not include regulatory reports prepared by a non-bank subsidiary of a holding company or an institution. For example, if a bank holding company or an insured depository institution owns an insurance subsidiary, financial statements prepared for regulatory reporting purposes would not include any regulatory reports that the insurance subsidiary is required to submit to its appropriate insurance regulatory agency.

ANNUAL REPORTING REQUIREMENTS  
(§363.2)

5. *Annual Financial Statements.* Each institution (other than an insured branch of a foreign bank) should prepare comparative annual consolidated financial statements (balance sheets and statements of income, changes in equity capital, and cash flows, with accompanying footnote disclosures) in accordance with GAAP for each of its two most recent fiscal years. Statements for the earlier year may be presented on an unaudited basis if the in-

stitution was not subject to this part for that year and audited statements were not prepared.

5A. *Institutions Merged Out of Existence.* An institution that is merged out of existence after the end of its fiscal year, but before the deadline for filing its Part 363 Annual Report (120 days after the end of its fiscal year for an institution that is neither a public company nor a subsidiary of a public company that meets the criterion specified in §363.1(b)(1), and 90 days after the end of its fiscal year for an institution that is a public company or a subsidiary of a public company that meets the criterion specified in §363.1(b)(1)), is not required to file a Part 363 Annual Report for the last fiscal year of its existence.

6. *Holding Company Statements.* Subject to the criterion specified in §363.1(b)(1), subsidiary institutions may file copies of their holding company’s audited financial statements filed with the SEC or prepared for their FR Y-6 Annual Report under the Bank Holding Company Act of 1956 to satisfy the audited financial statements requirement of §363.2(a).

7. *Insured Branches of Foreign Banks.* An insured branch of a foreign bank should satisfy the financial statements requirement by filing one of the following for each of its two most recent fiscal years:

(a) Audited balance sheets, disclosing information about financial instruments with off-balance-sheet risk;

(b) Schedules RAL and L of form FFIEC 002, prepared and audited on the basis of the instructions for its preparation; or

(c) With written approval of the appropriate Federal banking agency, consolidated financial statements of the parent bank.

7A. *Compliance with Designated Laws and Regulations.* The designated laws and regulations are the Federal laws and regulations concerning loans to insiders and the Federal and, if applicable, State laws and regulations concerning dividend restrictions (the Designated Laws and Regulations). Table 1 to this Appendix A lists the designated Federal laws and regulations pertaining to insider loans and dividend restrictions (but not the State laws

and regulations pertaining to dividend restrictions) that are applicable to each type of institution.

8. *Management Report.* Management should perform its own investigation and review of compliance with the Designated Laws and Regulations and, if required, the effectiveness of internal control over financial reporting. Management should maintain records of its determinations and assessments until the next Federal safety and soundness examination, or such later date as specified by the FDIC or the appropriate Federal banking agency. Management should provide in its assessment of the effectiveness of internal control over financial reporting, or supplementally, sufficient information to enable the accountant to report on its assertions. The management report of an insured branch of a foreign bank should be signed by the branch's managing official if the branch does not have a chief executive officer or a chief accounting or financial officer.

8A. *Management's Reports on Internal Control over Financial Reporting under Part 363 and Section 404 of SOX.* An institution with \$1 billion or more in total assets as of the beginning of its fiscal year that is subject to both part 363 and the SEC's rules implementing section 404 of SOX (as well as a public holding company permitted under the holding company exception in §363.1(b)(2) to file an internal control report on behalf of one or more subsidiary institutions with \$1 billion or more in total assets) can choose either of the following two options for filing management's report on internal control over financial reporting.

(i) Management can prepare two separate reports on the institution's or the holding company's internal control over financial reporting to satisfy the FDIC's part 363 requirements and the SEC's section 404 requirements; or

(ii) Management can prepare a single report on internal control over financial reporting provided that it satisfies all of the FDIC's part 363 requirements and all of the SEC's section 404 requirements.

8B. *Internal Control Reports and Part 363 Annual Reports for Acquired Businesses.* Generally, the FDIC expects management's and the related inde-

pendent public accountant's report on an institution's internal control over financial reporting to include controls at an institution in its entirety, including all of its consolidated entities. However, it may not always be possible for management to conduct an assessment of the internal control over financial reporting of an acquired business in the period between the consummation date of the acquisition and the due date of management's internal control assessment.

(a) In such instances, the acquired business's internal control structure and procedures for financial reporting may be excluded from management's assessment report and the accountant's attestation report on internal control over financial reporting. However, the FDIC expects management's assessment report to identify the acquired business, state that the acquired business is excluded, and indicate the significance of this business to the institution's consolidated financial statements. Notwithstanding management's exclusion of the acquired business's internal control from its assessment, management should disclose any material change to the institution's internal control over financial reporting due to the acquisition of this business. Also, management may not omit the assessment of the acquired business's internal control from more than one annual part 363 assessment report on internal control over financial reporting. When the acquired business's internal control over financial reporting is excluded from management's assessment, the independent public accountant may likewise exclude this acquired business's internal control over financial reporting from the accountant's evaluation of internal control over financial reporting.

(b) If the acquired business is or has a consolidated subsidiary that is an insured depository institution subject to part 363 and the institution is not merged out of existence before the deadline for filing its Part 363 Annual Report (120 days after the end of its fiscal year for an institution that is neither a public company nor a subsidiary of a public company that meets the criterion specified in §363.1(b)(1), and 90 days after the end of its fiscal year for

an institution that is a public company or a subsidiary of public company that meets the criterion specified in §363.1(b)(1)), the acquired institution must continue to comply with all of the applicable requirements of part 363, including filing its Part 363 Annual Report.

8C. *Management’s Disclosure of Non-compliance with the Designated Laws and Regulations.* Management’s disclosure of noncompliance, if any, with the Designated Laws and Regulations should separately indicate the number of instances or frequency of noncompliance with the Federal laws and regulations pertaining to insider loans and the Federal (and, if applicable, State) laws and regulations pertaining to dividend restrictions. The disclosure is not required to specifically identify by name the individuals (*e.g.*, officers or directors) who were responsible for or were the subject of any such noncompliance. However, the disclosure should include appropriate qualitative and quantitative information to describe the nature, type, and severity of the non-compliance and the dollar amount of the insider loan(s) or dividend(s) involved. Similar instances of non-compliance may be aggregated as to number of instances and quantified as to the dollar amounts or the range of dollar amounts of insider loans and/or dividends for which noncompliance occurred. Management may also wish to describe any corrective actions taken in response to the instances of non-compliance as well any controls or procedures that are being developed or that have been developed and implemented to prevent or detect and correct future instances of noncompliance on a timely basis.

9. *Safeguarding of Assets.* “Safeguarding of assets,” as the term relates to internal control policies and procedures regarding financial reporting and which has precedent in accounting and auditing literature, should be encompassed in the management report and the independent public accountant’s attestation discussed in guideline 18. Testing the existence of and compliance with internal controls on the management of assets, including loan underwriting and documentation, represents a reasonable implementation of

section 36. The FDIC expects such internal controls to be encompassed by the assertion in the management report, but the term “safeguarding of assets” need not be specifically stated. The FDIC does not require the accountant to attest to the adequacy of safeguards, but does require the accountant to determine whether safeguarding policies exist.<sup>15</sup>

10. *Standards for Internal Control.* The management of each insured depository institution with \$1 billion or more in total assets as of the beginning of its fiscal year should base its assessment of the effectiveness of the institution’s internal control over financial reporting on a suitable, recognized control framework established by a body of experts that followed due-process procedures, including the broad distribution of the framework for public comment. In addition to being available to users of management’s reports, a framework is suitable only when it:

- Is free from bias;
- Permits reasonably consistent qualitative and quantitative measurements of an institution’s internal control over financial reporting;
- Is sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of an institution’s internal control over financial reporting are not omitted; and
- Is relevant to an evaluation of internal control over financial reporting.

In the United States, *Internal Control—Integrated Framework*, including its addendum on safeguarding assets, which was published by the Committee of Sponsoring Organizations of the Treadway Commission, and is known as the COSO report, provides a suitable and recognized framework for purposes of management’s assessment. Other

<sup>15</sup>It is management’s responsibility to establish policies concerning underwriting and asset management and to make credit decisions. The auditor’s role is to test compliance with management’s policies relating to financial reporting.

suitable frameworks have been published in other countries or may be developed in the future. Such other suitable frameworks may be used by management and the institution's independent public accountant in assessments, attestations, and audits of internal control over financial reporting.

11. *Service Organizations.* Although service organizations should be considered in determining if internal control over financial reporting is effective, an institution's independent public accountant, its management, and its audit committee should exercise independent judgment concerning that determination. Onsite reviews of service organizations may not be necessary to prepare the report required by the Rule, and the FDIC does not intend that the Rule establish any such requirement.

12. [Reserved]

#### ROLE OF INDEPENDENT PUBLIC ACCOUNTANT (§363.3)

13. *General Qualifications.* To provide audit and attest services to insured depository institutions, an independent public accountant should be registered or licensed to practice as a public accountant, and be in good standing, under the laws of the State or other political subdivision of the United States in which the home office of the institution (or the insured branch of a foreign bank) is located. As required by section 36(g)(3)(A)(i), the accountant must agree to provide copies of any working papers, policies, and procedures relating to services performed under this part.

14. [Reserved]

15. *Peer Review Guidelines.* The following peer review guidelines are acceptable:

(a) The external peer review should be conducted by an organization independent of the accountant or firm being reviewed, as frequently as is consistent with professional accounting practices;

(b) The peer review (other than a PCAOB inspection) should be generally consistent with AICPA Peer Review Standards; and

(c) The review should include, if available, at least one audit on an insured depository institution or consoli-

dated depository institution holding company.

16. [Reserved]

17. *Information to be Provided to the Independent Public Accountant.* Attention is directed to section 36(h) which requires institutions to provide specified information to their accountants. An institution also should provide its accountant with copies of any notice that the institution's capital category is being changed or reclassified under section 38 of the FDI Act, and any correspondence from the appropriate Federal banking agency concerning compliance with this part.

18. *Attestation Report and Management Letters.* The independent public accountant should provide the institution with any management letter and, if applicable, an internal control attestation report (as required by section 36(c)(1)) at the conclusion of the audit. The independent public accountant's attestation report on internal control over financial reporting must specifically include a statement as to regulatory reporting. If a holding company subsidiary relies on its holding company's management report to satisfy the Part 363 Annual Report requirements, the accountant may attest to and report on the management's assertions in one report, without reporting separately on each subsidiary covered by the Rule. The FDIC has determined that management letters are exempt from public disclosure.

18A. *Internal Control Attestation Standards for Independent Auditors.* (a) §363.3(b) provides that the independent public accountant's attestation and report on management's assertion concerning the effectiveness of an institution's internal control structure and procedures for financial reporting shall be made in accordance with generally accepted standards for attestation engagements or the PCAOB's auditing standards, if applicable. The standards that should be followed by the institution's independent public accountant concerning internal control over financial reporting for institutions with \$1 billion or more in total assets can be summarized as follows:

(1) For an insured institution that is neither a public company nor a subsidiary of a public company, its independent public accountant need only follow the AICPA's attestation standards.

(2) For an insured institution that is a public company that is required to comply with the auditor attestation requirement of section 404 of SOX, its independent public accountant should follow the PCAOB's auditing standards.

(3) For an insured institution that is a public company but is not required to comply with the auditor attestation requirement of section 404 of SOX, its independent public accountant is not required to follow the PCAOB's auditing standards. In this case, the accountant need only follow the AICPA's attestation standards.

(4) For an insured institution that is a subsidiary of a public company that is required to comply with the auditor attestation requirement of section 404 of SOX, but is not itself a public company, the institution and its independent public accountant have flexibility in complying with the internal control requirements of part 363. If the conditions specified in §363.1(b)(2) are met, management and the independent public accountant may choose to report on internal control over financial reporting at the consolidated holding company level. In this situation, the independent public accountant's work would be performed for the public company in accordance with the PCAOB's auditing standards. Alternatively, the institution may choose to comply with the internal control reporting requirements of part 363 at the institution level and its independent public accountant could follow the AICPA's attestation standards.

(b) If an independent public accountant need only follow the AICPA's attestation standards, the accountant and the insured institution may instead agree to have the internal control attestation performed under the PCAOB's auditing standards.

19. *Reviews with Audit Committee and Management.* The independent public accountant should meet with the institution's audit committee to review the accountant's reports required by this part before they are filed. It also may

be appropriate for the accountant to review its findings with the institution's board of directors and management.

20. *Notice of Termination.* The notice of termination required by §363.3(c) should state whether the independent public accountant agrees with the assertions contained in any notice filed by the institution under §363.4(d), and whether the institution's notice discloses all relevant reasons for the accountant's termination. Subject to the criterion specified in §363.1(b)(1) regarding compliance with the independent financial statements requirement at the holding company level, the independent public accountant for an insured depository institution that is a public company and files reports with its appropriate Federal banking agency, or is a subsidiary of a public company that files reports with the SEC, may submit the letter it furnished to management to be filed with the institution's or the holding company's current report (*e.g.*, SEC Form 8-K) concerning a change in accountant to satisfy the notice requirements of §363.3(c). Alternatively, if the independent public accountant confirms that management has filed a current report (*e.g.*, SEC Form 8-K) concerning a change in accountant that satisfies the notice requirements of §363.4(d) and includes an independent public accountant's letter that satisfies the requirements of §363.3(c), the independent public accountant may rely on the current report (*e.g.*, SEC Form 8-K) filed with the FDIC by management concerning a change in accountant to satisfy the notice requirements of §363.3(c).

21. *Reliance on Internal Auditors.* Nothing in this part or this Appendix is intended to preclude the ability of the independent public accountant to rely on the work of an institution's internal auditor.

#### FILING AND NOTICE REQUIREMENTS (§363.4)

22. [Reserved]

23. *Notification of Late Filing.* (a) An institution's submission of a written notice of late filing does not cure the requirement to timely file the Part 363

Annual Report or other reports or notices required by §363.4. An institution's failure to timely file is considered an apparent violation of part 363.

(b) If the late filing notice submitted pursuant to §363.4(e) relates only to a portion of a Part 363 Annual Report or any other report or notice, the insured depository institution should file the other components of the report or notice within the prescribed filing period together with a cover letter that indicates which components of its Part 363 Annual Report or other report or notice are omitted. An institution may combine the written late filing notice and the cover letter into a single notice that is submitted together with the other components of the report or notice that are being timely filed.

24. *Public Availability.* Each institution's Part 363 Annual Report should be available for public inspection at its main and branch offices no later than 15 days after it is filed with the FDIC. Alternatively, an institution may elect to mail one copy of its Part 363 Annual Report to any person who requests it. The Part 363 Annual Report should remain available to the public until the Part 363 Annual Report for the next year is available. An institution may use its Part 363 Annual Report under this part to meet the annual disclosure statement required by 12 CFR 350.3, if the institution satisfies all other requirements of 12 CFR Part 350.

25. [Reserved]

26. *Notices Concerning Accountants.* With respect to any selection, change, or termination of an independent public accountant, an institution's management and audit committee should be familiar with the notice requirements in §363.4(d) and guideline 20, and management should send a copy of any notice required under §363.4(d) to the independent public accountant when it is filed with the FDIC. An insured depository institution that is a public company and files reports required under the Federal securities laws with its appropriate Federal banking agency, or is a subsidiary of a public company that files such reports with the SEC, may use its current report (e.g., SEC Form 8-K) concerning a change in accountant to satisfy the notice requirements of §363.4(d) subject to the

criterion of §363.1(b)(1) regarding compliance with the audited financial statements requirement at the holding company level.

#### AUDIT COMMITTEES (§ 363.5)

27. *Composition.* The board of directors of each institution should determine whether each existing or potential audit committee member meets the requirements of section 36 and this part. To do so, the board of directors should maintain an approved set of written criteria for determining whether a director who is to serve on the audit committee is an outside director (as defined in §363.5(a)(3)) and is independent of management. At least annually, the board of each institution should determine whether each existing or potential audit committee member is an outside director. In addition, at least annually, the board of an institution with \$1 billion or more in total assets as of the beginning of its fiscal year should determine whether all existing and potential audit committee members are "independent of management of the institution" and the board of an institution with total assets of \$500 million or more but less than \$1 billion as of the beginning of its fiscal year should determine whether the majority of all existing and potential audit committee members are "independent of management of the institution." The minutes of the board of directors should contain the results of and the basis for its determinations with respect to each existing and potential audit committee member. Because an insured branch of a foreign bank does not have a separate board of directors, the FDIC will not apply the audit committee requirements to such branch. However, any such branch is encouraged to make a reasonable good faith effort to see that similar duties are performed by persons whose experience is generally consistent with the Rule's requirements for an institution the size of the insured branch.

28. *"Independent of Management" Considerations.* It is not possible to anticipate, or explicitly provide for, all circumstances that might signal potential conflicts of interest in, or that might

bear on, an outside director's relationship to an insured depository institution and whether the outside director should be deemed "independent of management." When assessing an outside director's relationship with an institution, the board of directors should consider the issue not merely from the standpoint of the director himself or herself, but also from the standpoint of persons or organizations with which the director has an affiliation. These relationships can include, but are not limited to, commercial, banking, consulting, charitable, and family relationships. To assist boards of directors in fulfilling their responsibility to determine whether existing and potential members of the audit committee are "independent of management," paragraphs (a) through (d) of this guideline provide guidance for making this determination.

(a) If an outside director, either directly or indirectly, owns or controls, or has owned or controlled within the preceding fiscal year, 10 percent or more of any outstanding class of voting securities of the institution, the institution's board of directors should determine, and document its basis and rationale for such determination, whether such ownership of voting securities would interfere with the outside director's exercise of independent judgment in carrying out the responsibilities of an audit committee member, including the ability to evaluate objectively the propriety of management's accounting, internal control, and reporting policies and practices. Notwithstanding the criteria set forth in paragraphs (b), (c), and (d) of this guideline, if the board of directors determines that such ownership of voting securities would interfere with the outside director's exercise of independent judgment, the outside director will not be considered "independent of management."

(b) The following list sets forth additional criteria that, at a minimum, a board of directors should consider when determining whether an outside director is "independent of management." The board of directors may conclude that additional criteria are also relevant to this determination in light of the particular circumstances of its in-

stitution. Accordingly, an outside director will not be considered "independent of management" if: (1) The director serves, or has served within the last three years, as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of or to the institution or its affiliates.

(2) The director has been, within the last three years, an employee of the institution or any of its affiliates or an immediate family member is, or has been within the last three years, an executive officer of the institution or any of its affiliates.

(3) The director has participated in the preparation of the financial statements of the institution or any of its affiliates at any time during the last three years.

(4) The director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$100,000 in direct and indirect compensation from the institution, its subsidiaries, and its affiliates for consulting, advisory, or other services other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service). Direct compensation also would not include compensation received by the director for former service as an interim chairman or interim chief executive officer.

(5) The director or an immediate family member is a current partner of a firm that performs internal or external auditing services for the institution or any of its affiliates; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance, or tax compliance practice; or the director or an immediate family member was within the last three years (but no longer is) a partner or employee of such a firm and personally worked on the audit of the insured depository institution or any of its affiliates within that time.

(6) The director or an immediate family member is, or has been within the last three years, employed as an

executive officer of another entity where any of the present executive officers of the institution or any of its affiliates at the same time serves or served on that entity's compensation committee.

(7) The director is a current employee, or an immediate family member is a current executive officer, of an entity that has made payments to, or received payments from, the institution or any of its affiliates for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$200 thousand, or 5 percent of such entity's consolidated gross revenues. This would include payments made by the institution or any of its affiliates to not-for-profit entities where the director is an executive officer or where an immediate family member of the director is an executive officer.

(8) For purposes of paragraph (b) of this guideline:

(i) An "immediate family member" includes a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home.

(ii) The term affiliate of, or a person affiliated with, a specified person, means a person or entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

(iii) The term indirect compensation for consulting, advisory, or other services includes the acceptance of a fee for such services by a director's immediate family member or by an organization in which the director is a partner or principal that provides accounting, consulting, legal, investment banking, or financial advisory services to the institution, any of its subsidiaries, or any of its affiliates.

(iv) The terms direct and indirect compensation and payments do not include payments such as dividends arising solely from investments in the institution's equity securities, provided the same per share amounts are paid to all shareholders of that class; interest income from investments in the institution's deposit accounts and debt se-

curities; loans from the institution that conform to all regulatory requirements applicable to such loans except that interest payments or other fees paid in association with such loans would be considered payments; and payments under non-discretionary charitable contribution matching programs.

(c) An insured depository institution that is a public company and a listed issuer (as defined in Rule 10A-3 of the Securities Exchange Act of 1934 (Exchange Act)), or is a subsidiary of a public company that meets the criterion specified in §363.1(b)(1) and is a listed issuer, may choose to use the definition of audit committee member independence set forth in the listing standards applicable to the public institution or its public company parent for purposes of determining whether an outside director is "independent of management."

(d) All other insured depository institutions may choose to use the definition of audit committee member independence set forth in the listing standards of a national securities exchange that is registered with the SEC pursuant to section 6 of the Exchange Act or a national securities association that is registered with the SEC pursuant to section 15A(a) of the Exchange Act for purposes of determining whether an outside director is "independent of management."

29. [Reserved]

30. *Holding Company Audit Committees.*

(a) When an insured depository institution satisfies the requirements for the holding company exception specified in §§363.1(b)(1) and (2), the audit committee requirement of this part may be satisfied by the audit committee of the top-tier or any mid-tier holding company. Members of the audit committee of the holding company should meet all the membership requirements applicable to the largest subsidiary depository institution subject to part 363 and should perform all the duties of the audit committee of a subsidiary institution subject to part 363, even if the holding company directors are not directors of the institution.

(b) When an insured depository institution subsidiary with total assets of \$1 billion or more as of the beginning of

its fiscal year does not meet the requirements for the holding company exception specified in §§363.1(b)(1) and (2) or maintains its own separate audit committee to satisfy the requirements of this part, the members of the audit committee of the top-tier or any mid-tier holding company may serve on the audit committee of the subsidiary institution if they are otherwise independent of management of the subsidiary institution, and, if applicable, meet any other requirements for a large subsidiary institution covered by this part.

(c) When an insured depository institution with total assets of \$500 million or more but less than \$1 billion as of the beginning of its fiscal year does not meet the requirements for the holding company exception specified in §§363.1(b)(1) and (2) or maintains its own separate audit committee to satisfy the requirements of this part, the members of the audit committee of the top-tier or any mid-tier holding company may serve on the audit committee of the subsidiary institution provided a majority of the institution's audit committee members are independent of management of the subsidiary institution.

(d) Officers and employees of a top-tier or any mid-tier holding company may not serve on the audit committee of a subsidiary institution subject to part 363.

31. *Duties.* The audit committee should perform all duties determined by the institution's board of directors and it should maintain minutes and other relevant records of its meetings and decisions. The duties of the audit committee should be appropriate to the size of the institution and the complexity of its operations, and, at a minimum, should include the appointment, compensation, and oversight of the independent public accountant; reviewing with management and the independent public accountant the basis for their respective reports issued under §§363.2(a) and (b) and §§363.3(a) and (b); reviewing and satisfying itself as to the independent public accountant's compliance with the required qualifications for independent public accountants set forth in §§363.3(f) and (g) and guidelines 13 through 16; ensuring that

audit engagement letters comply with the provisions of §363.5(c) before engaging an independent public accountant; being familiar with the notice requirements in §363.4(d) and guideline 20 regarding the selection, change, or termination of an independent public accountant; and ensuring that management sends a copy of any notice required under §363.4(d) to the independent public accountant when it is filed with the FDIC. Appropriate additional duties could include:

(a) Reviewing with management and the independent public accountant the scope of services required by the audit, significant accounting policies, and audit conclusions regarding significant accounting estimates;

(b) Reviewing with management and the accountant their assessments of the effectiveness of internal control over financial reporting, and the resolution of identified material weaknesses and significant deficiencies in internal control over financial reporting, including the prevention or detection of management override or compromise of the internal control system;

(c) Reviewing with management the institution's compliance with the Designated Laws and Regulations identified in guideline 7A;

(d) Discussing with management and the independent public accountant any significant disagreements between management and the independent public accountant; and

(e) Overseeing the internal audit function.

32. *Banking or Related Financial Management Expertise.* At least two members of the audit committee of a large institution shall have "banking or related financial management expertise" as required by section 36(g)(1)(C)(i). This determination is to be made by the board of directors of the insured depository institution. A person will be considered to have such required expertise if the person has significant executive, professional, educational, or regulatory experience in financial, auditing, accounting, or banking matters as determined by the board of directors. Significant experience as an officer or member of the board of directors or audit committee of a financial services company would satisfy these criteria.

A person who has the attributes of an "audit committee financial expert" as set forth in the SEC's rules would also satisfy these criteria.

33. *Large Customers.* Any individual or entity (including a controlling person of any such entity) which, in the determination of the board of directors, has such significant direct or indirect credit or other relationships with the institution, the termination of which likely would materially and adversely affect the institution's financial condition or results of operations, should be considered a "large customer" for purposes of §363.5(b).

34. *Access to Counsel.* The audit committee should be able to retain counsel at its discretion without prior permission of the institution's board of directors or its management. Section 36 does not preclude advice from the institution's internal counsel or regular outside counsel. It also does not require retaining or consulting counsel, but if the committee elects to do either, it also may elect to consider issues affecting the counsel's independence. Such issues would include whether to retain or consult only counsel not concurrently representing the institution or any affiliate, and whether to place limitations on any counsel representing the institution concerning matters in which such counsel previously participated personally and substantially as outside counsel to the committee.

35. *Transition Period for Forming and Restructuring Audit Committees.*

(a) When an insured depository institution's total assets as of the beginning of its fiscal year are \$500 million or more for the first time and it thereby becomes subject to part 363, no regulatory action will be taken if the institution (1) develops and approves a set of written criteria for determining whether a director who is to serve on the audit committee is an outside director and is independent of management and (2) forms or restructures its

audit committee to comply with §363.5(a)(2) by the end of that fiscal year.

(b) When an insured depository institution's total assets as of the beginning of its fiscal year are \$1 billion or more for the first time, no regulatory action will be taken if the institution forms or restructures its audit committee to comply with §363.5(a)(1) by the end of that fiscal year, provided that the composition of its audit committee meets the requirements specified in §363.5(a)(2) at the beginning of that fiscal year, if such requirements were applicable.

(c) When an insured depository institution's total assets as of the beginning of its fiscal year are \$3 billion or more for the first time, no regulatory action will be taken if the institution forms or restructures its audit committee to comply with §363.5(b) by the end of that fiscal year, provided that the composition of its audit committee meets the requirements specified in §363.5(a)(1) at the beginning of that fiscal year, if such requirements were applicable.

#### OTHER

36. *Modifications of Guidelines.* The FDIC's Board of Directors has delegated to the Director of the FDIC's Division of Supervision and Consumer Protection authority to make and publish in the FEDERAL REGISTER minor technical amendments to the Guidelines in this Appendix and the guidance and illustrative reports in Appendix B, in consultation with the other appropriate Federal banking agencies, to reflect the practical experience gained from implementation of this part. It is not anticipated any such modification would be effective until affected institutions have been given reasonable advance notice of the modification. Any material modification or amendment will be subject to review and approval of the FDIC Board of Directors.

TABLE 1 TO APPENDIX A—DESIGNATED FEDERAL LAWS AND REGULATIONS APPLICABLE TO:

		National banks	State member banks	State non-member banks	Savings associations
<b>Insider Loans—Parts and/or Sections of Title 12 of the United States Code</b>					
375a .....	Loans to Executive Officers of Banks	√	√	(A)	(A)
375b .....	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Banks.	√	√	(A)	(A)
1468(b) .....	Extensions of Credit to Executive Officers, Directors, and Principal Shareholders.	√			
1828(j)(2) .....	Extensions of Credit to Officers, Directors, and Principal Shareholders.	√			
1828(j)(3)(B) .....	Extensions of Credit to Officers, Directors, and Principal Shareholders.	(B)	(C)		
<b>Parts and/or Sections of Title 12 of the Code of Federal Regulations</b>					
31 .....	Extensions of Credit to Insiders .....	√			
32 .....	Lending Limits .....	√			
215 .....	Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks.	√	√	(D)	(E)
337.3 .....	Limits on Extensions of Credit to Executive Officers, Directors, and Principal Shareholders of Insured Nonmember Banks.	√			
563.43 .....	Loans by Savings Associations to Their Executive Officers, Directors, and Principal Shareholders.	√			
<b>Dividend Restrictions—Parts and/or Sections of Title 12 of the United States Code</b>					
56 .....	Prohibition on Withdrawal of Capital and Unearned Dividends.	√	√		
60 .....	Dividends and Surplus Fund .....	√	√		
1467a(f) .....	Declaration of Dividend .....	√			
1831o(d)(1) .....	Prompt Corrective Action—Capital Distributions Restricted.	√	√	√	√
<b>Parts and/or Sections of Title 12 of the Code of Federal Regulations</b>					
5 Subpart E .....	Payment of Dividends .....	√			
6.6 .....	Prompt Corrective Action—Restrictions on Undercapitalized Institutions.	√			
208.5 .....	Dividends and Other Distributions .....	√			
208.45 .....	Prompt Corrective Action—Restrictions on Undercapitalized Institutions.	√			
325.105 .....	Prompt Corrective Action—Restrictions on Undercapitalized Institutions.	√			
563 Subpart E .....	Capital Distributions .....	√			
565.6 .....	Prompt Corrective Action—Restrictions on Undercapitalized Institutions.	√			

- A. Subsections (g) and (h) of section 22 of the Federal Reserve Act [12 U.S.C. 375a, 375b]
- B. Applies only to insured Federal branches of foreign banks.
- C. Applies only to insured State branches of foreign banks.
- D. See 12 CFR 337.3.
- E. See 12 CFR 563.43.

APPENDIX B TO PART 363—ILLUSTRATIVE MANAGEMENT REPORTS

TABLE OF CONTENTS

1. General

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- 3. Illustrative Statements of Management’s Responsibilities