

BANKING
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF BANKING

Safe And Sound Methods Of Banking – Examination of Banks and Savings Banks Under Director of Board of Directors, Board Managers or Board of Trustees; Audit Requirements of State Associations – Time of Audit

Proposed Amendments: N.J.A.C 3:7-3.1, 3.2, 3.7, and 3.9; and 3:29-1.7

Proposed New Rule: N.J.A.C. 3:7-3.10

Authorized By: Steven M. Goldman, Commissioner, Department of Banking and Insurance.

Authority: N.J.S.A. 17:1-8, 8.1 and 15e; 17:9A-253: and 17:12B-176.

Calendar Reference: See Summary below for explanation of exception to calendar requirement.

Proposal Number: PRN 2008-225

Submit comments by September 5, 2008 to:

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The agency proposal follows:

Summary

The Department of Banking and Insurance (Department) proposes to amend its rules governing directors' examinations, also known as an internal audit, of New Jersey banks and savings banks. The existing rules at N.J.A.C. 3:7-3.3 to 3.9 provide specific requirements and standards for director's examinations.

The proposal would amend N.J.A.C. 3:7-3 to add new section N.J.A.C. 3:7-3.10, which would authorize an alternate type of report that will be accepted by the Department in lieu of a directors' examination. In addition, the Department proposes to add a definition of "financial statement audit report," a term used in proposed N.J.A.C. 3:7-3.10, to the definitions in N.J.A.C. 3:7-3.1. Proposed N.J.A.C. 3:7-3.10 sets forth what must be provided to the Department by a bank or savings bank intending to use the alternative method. Currently, some banks and savings banks undertake a financial statement audit although they are not required to do so. Others undertake them because the Federal Deposit Insurance Corporation (FDIC) requires them. The effect of proposed N.J.A.C. 3:7-3.10 would be to reduce the regulatory burden on banks and savings banks that undertake such financial statement audits by providing that if such institutions submit the financial statement audit report to the Department they would not also need to perform a directors' examination in accordance with the requirements in N.J.A.C. 3:7-3.3 through 3.9. Through the submission of such audit reports, the supervisory needs of the Department for current financial information would be satisfied.

The Department is also proposing amendments to relocate the audit requirements for State associations set forth at N.J.A.C. 3:7-3 to N.J.A.C. 3:29, which contains audit requirements specifically for State associations. The Department also proposes to amend the heading of N.J.A.C. 3:7-3 to eliminate the reference therein to State associations, amend N.J.A.C. 3:7-3.1 to delete the definition of State association, amend N.J.A.C. 3:7-3.2 to eliminate two statutory references to State associations and amend N.J.A.C. 3:7-3.7(c) to delete the term State associations. Consistent with its intention to separately codify the audit requirements for banks and savings banks and those for State associations, the Department proposes to amend N.J.A.C. 3:29 to change the chapter heading from "Audit Requirements" to "Audit Requirements for State

Associations” and amend N.J.A.C. 3:29-1.7, Time of Audit, to codify therein all of the substantive timing requirements for State association audits, some of which are currently codified at N.J.A.C. 3:7-3.2.

In addition, the Department proposes to amend N.J.A.C. 3:7-3.9(a) to delete the reference to “savings banks” because the use of the term “banks,” pursuant to the definitions at N.J.A.C. 3:7-3.1, incorporates both banks and savings banks. Lastly, the term “institutions” in N.J.A.C. 3:7-3.9(a)26i(1) is proposed to be deleted and the term “banks” substituted so the terms used in the subchapter are consistent.

A 60-day comment period is provided and, therefore, pursuant to N.J.A.C. 1:30-3.3(a) 5, the proposal is not subject to the provisions of N.J.A.C. 1:30-3.1 and 3.2 governing rulemaking calendars.

Social Impact

The proposed amendments and new rule regarding alternatives to a director’s examination apply to all New Jersey banks and savings banks. They set forth the requirements for use of the alternative method to directors’ examinations. These alternative examinations will fully meet the supervisory needs of the Department. These proposed amendments and new rule will avoid duplication of effort by banks and savings banks. In addition, separating the examination requirements of banks and savings banks from those of State associations, together with adjusting the necessary chapter and subchapter names and language, will make the rules clearer and more easily understood. Therefore, the proposed amendments and new rule will have a beneficial social impact.

Economic Impact

It is expected that the proposed amendments and new rule will have a positive economic impact on New Jersey banks and savings banks. A second examination, with its attendant cost to the institution, will not need to be conducted if a financial statement audit is initially undertaken and the report of it is filed with the Department as set forth in the proposed amendments and new rule. This will save the bank or savings bank the cost of conducting the second examination and having a report of its findings prepared. The relocation of the provisions applicable to savings associations from Subchapter 7 to Chapter 29 should have a neutral economic impact on such associations.

Federal Standards Statement

The proposed amendments and new rule are consistent with and do not exceed the requirements of 12 CFR §363. They provide an option to banks and savings banks. Therefore, no Federal standards analysis is required.

Jobs Impact

The Department does not anticipate that any jobs will be generated or lost as a result of the proposed amendments and new rule.

The Department invites commenters to submit any data or studies concerning the jobs impact of the proposed amendments and new rule together with their written comments on other aspects of this proposal.

Agriculture Industry Impact

The Department does not expect any agriculture industry impact from the proposed amendments and new rule.

Regulatory Flexibility Analysis

Some New Jersey banks, savings banks or State associations may be small businesses as defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. The proposed amendments and new rule impose no new compliance requirements on these entities. The requirements permit an alternate form of audit, sometimes required by Federal regulators, to be substituted in place of the specific New Jersey directors' examination currently required for banks and savings banks. The recordkeeping involved is minimal and consists of retaining a copy of the report of the alternate audit and providing a copy of that report to the Department. No professional services are required in order to comply with the amendments and new rule. In addition, allowing the substitution eliminates the burden on the institution of conducting the directors' examination.

The purpose of these requirements does not vary based upon business size. Accordingly, no differentiation in compliance requirements based on business size is provided.

Smart Growth Impact

The proposed amendments and new rule will have no impact on the achievement of growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

CHAPTER 7

SAFE AND SOUND METHODS OF BANKING

SUBCHAPTER 3. EXAMINATION OF BANKS[,] **AND** SAVINGS BANKS [AND STATE ASSOCIATIONS] UNDER DIRECTION OF BOARD OF DIRECTORS, BOARD OF MANAGERS OR BOARD OF TRUSTEES

3:7-3.1 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise.

. . .

“Financial statement audit report” means an audit report as defined in 12 CFR 363.

[“State association” means a State association as defined in N.J.S.A. 17:12B-5.]

. . .

3:7-3.2 Date of examination

The examination shall be commenced within the time period specified in N.J.S.A. 17:9A-253B [or 17:12B-176(l)]. Prior to commencing the examination, the person scheduled to conduct the examination shall notify the Department so as to avoid conflict with an examination pursuant to N.J.S.A. 17:9A-260 [or 17:12B-172]. In the transmittal or report to the bank, the person conducting the examination shall specify the date of completion of the examination.

. . .

3:7-3.7 Review of internal controls and audit program

(a) - (b) (No change.)

(c) In addition, the public accountant or other approved person shall review the scope, frequency of performance and testing done under the internal audit program of the bank

[or State association] to determine if they are considered adequate for the institution under examination. If the internal audit program is deemed inadequate, he or she shall make suggestions for expansion and shall indicate in his or her report any conditions disclosed in the review which are deemed to reflect a material weakness in internal controls and offer any suggestions believed to strengthen them.

(d) - (e) (No change.)

3:7-3.9 Audit program

(a) The minimum audit scope to be performed in banks [or savings banks, as applicable,] includes the following:

1. - 25. (No change.)

26. Electronic data processing services:

i. The review of internal operating procedures and controls as they relate to data processing servicers shall encompass at least the following items, or analogous items, but not necessarily be limited to the specific areas outlined:

(1) Review the [institution's] **bank's** own insurance and obtain the review coverages of the servicers;

(2) - (7) (No change.)

3:7-3.10 Substitute examination

A bank that undergoes a financial statement audit and submits a copy of the report of such audit to the Department may do so in lieu of undergoing a directors' examination and submitting the report as required by N.J.A.C. 3:7-3.3 to 3.9.

CHAPTER 29

AUDIT REQUIREMENTS **OF STATE ASSOCIATIONS**

SUBCHAPTER 1. GENERAL PROVISIONS

3:29-1.7 Time of audit

(a) At least one such audit shall be made in each calendar year, and it is not necessary that the audit coincide with a fiscal year. The audit may be made on a “surprise” basis so that preliminary or interim work, such as branch audits, may be accomplished at any time. The auditor shall cover the period from the previous audit to the date the present audit is started.

(b) **The examination shall be commenced within the time period specified in N.J.S.A. 17:12B-176(1). Prior to commencing the examination, the person scheduled to conduct the examination shall notify the Department so as to avoid a conflict with an examination conducted pursuant to N.J.S.A. 17:12B-172. In the transmittal or report to the association, the person conducting the examination shall specify the date of completion of the examination.**