

HAWAII ADMINISTRATIVE RULES

TITLE 16

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

CHAPTER 26

EXAMINATION AND OFF-SITE MONITORING OF  
HAWAII FINANCIAL INSTITUTIONS

Subchapter 1 General Provisions

- §16-26-1 Objectives
- §16-26-2 Definitions
- §16-26-3 Repealed
- §16-26-4 Purpose of examination
- §16-26-5 Purpose of visitation
- §16-26-6 Coordination with federal authorities
- §16-26-7 Uniform financial institutions rating system
- §16-26-8 Rating system for a nondepository financial services loan company

Subchapter 2 Examination Frequency

- §16-26-14 Examination priority and frequency
- §16-26-15 Institutions rated "1" or "2"
- §16-26-16 Institutions rated "3"
- §16-26-17 Institutions rated "4" or "5"
- §16-26-18 Newly chartered or licensed institutions
- §16-26-19 Institutions converting from a federal charter
- §16-26-20 Institutions which have had a change of control

Subchapter 3 Examination Scope and Format

- §16-26-26 Examination scope
- §16-26-27 Examination format and procedure

§16-26-1

Subchapter 4 Specialty Examinations

§16-26-33 Examination of holding company, subsidiary, or affiliate

Subchapter 5 Off-site Monitoring

§16-26-39 Off-site monitoring

SUBCHAPTER 1

GENERAL PROVISIONS

§16-26-1 Objectives. The objective of this chapter is to set forth the policies of the division of financial institutions with respect to examination priorities, frequency, scope, and procedures. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:11-102, 412:12-108, 412:13-100, 412:13-223)

§16-26-2 Definitions. As used in this chapter:

"Affiliate" with respect to an existing or proposed financial institution or a financial institution holding company, means any company that controls the financial institution or the financial institution holding company and any other company that is under common control with the financial institution or the financial institution holding company. The following shall not be considered to be an affiliate:

- (1) Any company, other than a financial institution, that is a subsidiary of a financial institution;
- (2) Any company engaged solely in holding or leasing the premises of a financial institution;
- (3) Any company engaged solely in conducting a safe deposit business;
- (4) Any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and
- (5) Any company where control results from the exercise of rights arising out of a bona fide debt previously contracted, but only for the period of time specifically authorized under applicable state or federal law or regulation.

"Commissioner" means the commissioner of financial institutions of this State.

"Division" means the division of financial institutions of the department of commerce and consumer affairs of this State.

"Examination" means the periodic on-site review and evaluation of the condition of a financial institution which is conducted in accordance with designated policies and procedures.

"FDIC" means the Federal Deposit Insurance Corporation, which provides insurance on deposits to commercial banks, savings banks, savings and loan associations and depository financial services loan companies. The FDIC has primary federal supervisory authority over insured state banks that are not members of the federal reserve system and depository financial services loan companies.

"FFIEC" means the Federal Financial Institutions Examination Council, the interagency body which prescribes uniform principles, standards, and reporting forms for the federal examination and supervision of insured depository institutions, bank holding companies, and savings and loan holding companies. The council has five member agencies: the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the National Credit Union Administration.

"Hawaii financial institution" or "institution" means:

- (1) A corporation or credit union which holds a charter or license under chapter 412, HRS, or under prior Hawaii law, authorizing it to accept deposits, to make loans in excess of the rates permitted in chapter 478, HRS, or to engage in the business of a trust company; or
  - (2) A resulting bank as defined in article 12 of chapter 412, HRS,
- and includes a corporation, mutual savings and loan association or credit union existing and chartered as a Hawaii financial institution or licensed to transact business in this State on July 1, 1993. A Hawaii financial institution may be a bank, resulting bank as defined in article 12 of chapter 412, HRS, savings bank, savings and loan association, depository financial services loan company, nondepository financial services loan company, trust company, credit union, or intra-Pacific bank.

"Holding company" means any company which controls another company.

"NCUA" means the National Credit Union Administration, the federal agency that charters, insures, and supervises federal credit unions. Through the National Credit Union Share Insurance Fund, the NCUA provides deposit

§16-26-2

insurance to federal credit unions and to many state-chartered credit unions, including all Hawaii-chartered credit unions.

"Off-site monitoring" means the systematic method of tracking the financial condition of institutions between examinations by use of trends, ratios, and comparisons with peer group performance.

"OTS" means the Office of Thrift Supervision, the federal regulatory agency for savings and loan associations and savings banks.

"Subsidiary" means a corporation, joint venture, partnership, or other company that is controlled by another corporation.

"Visitation" means an examination of an institution for a specific or limited purpose. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:1-109, 412:2-200, 412:11-102, 412:12-108, 412:13-223)

§16-26-3 Repealed. [R 1/27/01]

§16-26-4 Purpose of examination. (a) Disclosure of any information related to an examination of an institution is prohibited by statute, but public knowledge of the examination process should promote confidence in the integrity of the financial system and in individual institutions.

(b) The examination of a depository institution is designed to determine the financial condition of the institution, to evaluate the safety and soundness of its operations, to evaluate its management, and to determine compliance with applicable laws and rules. It is aimed at early detection of adverse trends and problems, so as to allow time for remedial action to be taken to correct unsafe and unsound practices or violations of laws and rules.

(c) The examination provides the commissioner with an understanding of the nature, relative seriousness, and ultimate cause of an institution's problems and provides the factual foundation on which to order corrective actions or measures. The examination, therefore, plays a key role in the supervisory and enforcement process.

(d) The examination of a depository institution does not serve the function of an audit. The examiner performs an evaluation function, rating capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. The examiner accepts and relies on an institution's records and on statements and information provided by its employees, officers, and directors, and does not independently verify matters disclosed on an institution's books and records.

(e) The examination is not undertaken for the detection of fraud, nor is its sole or primary purpose to assure the complete correctness or appropriateness of records. Nevertheless, where deemed appropriate, in those cases where the examiner in charge perceives the need, the examination branch chief may make the determination to expand the scope of an examination to include the use of certain audit techniques and procedures and shall notify the deputy commissioner in writing of the expansion of the examination scope. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-104, 412:2-107, 412:2-200, 412:2-201) (Imp: HRS §§412:2-100, 412:2-104, 412:2-200, 412:2-201, 412:11-102, 412:12-108, 412:13-223)

§16-26-5 Purpose of visitation. (a) The purpose of a visitation may include one or more of the following:

- (1) Determination of an institution's progress in complying with requirements of a formal corrective order or memorandum of understanding;
- (2) Determination of the reasons for an apparent adverse situation revealed by off-site review;
- (3) Determination of an institution's progress in improving the quality of its assets or correcting other deficiencies, since the last examination or visitation; or
- (4) Determination of the condition of an institution that is newly chartered, recently converted from a federal charter, or has recently undergone a change in management or control.

(b) When circumstances warrant, a visitation may be expanded into an examination. A visitation by federal regulators may be accepted in lieu of a visitation by the division, as deemed appropriate by the commissioner. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200, 412:2-201) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:11-102, 412:12-108, 412:13-223)

§16-26-6 Coordination with federal authorities. (a) Every effort shall be made to conduct joint examinations and visitations with federal authorities, or alternating independent examinations and visitations, so that regulatory resources may be maximized and duplication of effort may be minimized.

(b) The scope and frequency of examinations and visitations conducted by the division, shall not be governed by the needs of federal authorities, availability of federal personnel, or the requirements of federal laws or rules.

Where circumstances make it impossible to conduct a joint examination within the twenty-four month period or other period provided by law, the division shall conduct an independent examination. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200, 412:2-201) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:2-301, 412:11-102, 412:12-108, 412:13-223)

§16-26-7 Uniform financial institutions rating system. (a) The division adopts the "Uniform Financial Institutions Rating System" (UFIRS), which was issued and recommended by the Federal Financial Institutions Examination Council. The rating system reflects in a comprehensive and uniform fashion an institution's financial condition, compliance with laws and regulations, and overall operating soundness. Its primary purpose is to help identify those institutions whose financial, operating, or compliance weaknesses require special supervisory attention or warrant a higher than normal degree of supervisory concern.

(b) The uniform rating of institutions will ensure that:

- (1) The degree of supervisory attention and the type of supervisory response are based upon the severity and nature of an institution's problems;
- (2) Supervisory attention and action are, to the extent possible, administered uniformly and consistently, regardless of the type of institution or the identity of the regulatory agency; and
- (3) Appropriate supervisory action is taken to address those institutions whose problems entail the greatest potential for hardship or inconvenience to depositors, borrowers, or the public; or those institutions whose potential weaknesses would most seriously disrupt the proper and efficient functioning of the financial system.

(c) In accordance with the UFIRS, each institution shall be assigned a uniform composite rating based on an evaluation of pertinent financial and operational standards, criteria, and principles. This overall rating is expressed through use of a numerical scale of "1" through "5" in ascending order of supervisory concern. Thus, "1" represents the highest rating and, consequently, the lowest level of supervisory concern; "5" represents the lowest rating and, therefore, the highest degree of supervisory concern. The uniform composite rating and individual component ratings shall be contained in the report of examination and shall be deemed confidential, pursuant to section 412:2-104, HRS. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-104, 412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-104, 412:2-200, 412:2-201, 412:12-108)

§16-26-8 Rating system for a nondepository financial services loan company. (a) In assigning a composite rating to a nondepository financial services loan company, the UFIRS adopted in section 16-26-7 shall not be used. In lieu thereof, the division shall evaluate and weigh several factors, including the nature and extent of present compliance by the institution with consumer credit law and other Hawaii statutes, the commitment of management to compliance and its ability and willingness to take the necessary steps to assure compliance, and the adequacy of operating systems, including internal procedures, controls, and audit activities designed to ensure compliance on a routine and consistent basis. This evaluation system of a nondepository financial services loan company shall be called the Nondepository Rating System ("NRS"). The assignment of the composite compliance rating may incorporate other factors that impact significantly on the overall effectiveness of an institution's compliance efforts.

(b) Each nondepository institution shall be assigned a composite rating based on an evaluation of pertinent compliance standards, criteria, and principles. This overall rating is expressed through use of a numerical scale of "1" through "5" in ascending order of supervisory concern. Thus, "1" represents the highest rating and, consequently, the lowest level of supervisory concern; "5" represents the lowest rating and, therefore, the highest degree of supervisory concern. The composite rating and individual component ratings shall be contained in the report of examination and shall be deemed confidential, pursuant to section 412:2-104, HRS. [Eff and comp 1/27/01] (Auth: HRS §§412:2-104, 412:2-107, 412:2-200) (Imp: HRS §§412:2-104, 412:2-200)

## SUBCHAPTER 2

### EXAMINATION FREQUENCY

§16-26-14 Examination priority and frequency. (a) The division's priority shall be the effective examination and supervision of those institutions requiring special supervisory attention.

(b) Each institution shall be examined at least once every twenty-four months unless otherwise provided by law. If an additional examination within the twenty-four month interval is deemed necessary, the commissioner may order the examination to be conducted. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108, 412:13-223)

§16-26-15

§16-26-15 Institutions rated "1" or "2". (a) Each institution assigned a UFIRS or NRS composite rating of "1" or "2" is to be examined as deemed necessary with a maximum permissible interval between examinations of twenty-four months.

(b) At least one visitation may be performed in each twelve-month period during which an examination is not conducted. An off-site review may be substituted for a visitation if no adverse factors or trends are noted in the off-site review.

(c) Additional examinations or visitations may be conducted when it is believed that the condition of an institution may have deteriorated or may have been affected adversely. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108)

§16-26-16 Institutions rated "3". (a) Each institution assigned a UFIRS or NRS composite rating of "3" is to be examined at least once every twelve months. This interval may be extended up to every eighteen months when a longer interval is deemed appropriate. Acceptable reasons for extending an interval would include, but not be limited to: compliance with enforcement actions, favorable financial trends, and satisfactory improvement noted from meetings with the institution's management, visitations, progress reports, or other sources of information.

(b) At least one visitation shall be performed in each six-month period when an examination is not conducted. An off-site review may be substituted for a visitation if no additional adverse factors or trends are noted in the review.

(c) Additional examinations or visitations of such institutions are encouraged when deemed necessary. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108)

§16-26-17 Institutions rated "4" or "5". (a) Each institution assigned a UFIRS or NRS composite rating of "4" or "5" shall be examined at least once every twelve months.

(b) Additional examinations or visitations to monitor progress or to prevent deterioration should be performed when deemed necessary. At a minimum, one visitation shall be performed in each three-month period when an examination or other appropriate supervisory activity is not conducted. [Eff



8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108)

§16-26-18 Newly chartered or licensed institutions. Each newly chartered or licensed institution shall be examined within the first twelve months of operation. In addition, as time and resources of the division allow, at least one visitation is to be performed within the first sixty days and one hundred-twenty days, respectively. Subsequent to the first examination and through the third year of operation, at least one visitation shall be performed in each twelve-month period during which an examination is not conducted. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108, 412:13-223)

§16-26-19 Institutions converting from a federal charter. Each institution converting from a federal charter to a state charter shall be examined within twelve months of the conversion if the institution was previously assigned a UFIRS composite rating of "3", "4", or "5" by the applicable federal regulatory agency. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108, 412:13-223)

§16-26-20 Institutions which have had a change of control. (a) Each institution in which there has been a change of control in ownership or management shall be examined within the first twelve months of the change, unless satisfactory financial and managerial records of performance are demonstrated by the new owners or managers in the interim period.

(b) A visitation may be conducted within ninety days of the date the change in control became operational, then quarterly thereafter until the first examination. Subsequent to the first examination and through the third year from the change of control, at least one visitation may be performed in each twelve-month period during which an examination is not conducted. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:12-108, 412:13-223)

SUBCHAPTER 3

EXAMINATION SCOPE AND FORMAT

§16-26-26 Examination scope. The examination may be general in scope. Examiners may employ detailed work programs, procedures, and questionnaires to review every aspect of a depository institution's corporate affairs. The six key performance standards are: capital adequacy, asset quality, management competency, earnings, liquidity, and sensitivity to market risk. Examiners may also conduct specialized examinations which emphasize close scrutiny of specific areas of an institution's operations and minimize coverage in other areas, depending on an institution's operating and supervisory history. [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:11-102, 412:12-108, 412:13-223)

§16-26-27 Examination format and procedure. (a) Examinations of banks shall be conducted in accordance with the "FDIC Division Of Supervision Manual Of Examination Policies."

(b) Examinations of foreign bank branches and agencies shall be conducted in accordance with the "FFIEC Revised Uniform Report Of Examination For Branches And Agencies Of Foreign Banking Organizations" and related instructions.

(c) Examinations of trust companies shall be conducted by reference to the "FDIC Division of Supervision Trust Examination Manual," as may be applicable to operations of trust companies generally.

(d) Examinations of savings and loan associations shall be conducted in accordance with the "OTS Thrift Activities Regulatory Handbook," and related instructions.

(e) Examinations of depository financial services loan companies shall be conducted in accordance with the "FDIC Division Of Supervision Manual Of Examination Policies."

(f) Examination of nondepository financial services loan companies shall be conducted in accordance with the "Division of Financial Institution Manual Of Examination Policies For Nondepository Financial Services Loan Companies."

(g) Examination of credit unions shall be conducted in accordance with the "NCUA Examiner's Guide."

(h) Examination of the information systems of an institution shall be conducted in accordance with the "FFIEC Information Systems Examination Handbook."

(i) Examinations for compliance with applicable federal consumer protection, fair lending, and record keeping laws and regulations shall be conducted in accordance with the "FDIC Division of Compliance and Consumer\_Affairs Compliance Examination Manual." [Eff 8/13/87; am and comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200, 412:2-201) (Imp: HRS §§412:2-100, 412: -2- 200, 412:2-201, 412:12-108, 412:13-223)

#### SUBCHAPTER 4

##### SPECIALTY EXAMINATIONS

§16-26-33 Examination of holding company, subsidiary, or affiliate. (a) The division shall review and rely on holding company inspection reports prepared by the federal regulatory agencies in determining the frequency or scope of an examination and the UFIRS composite rating of the subsidiary institution.

(b) When the operations of a holding company, subsidiary, or affiliate may have a substantial adverse impact on an institution, an examination of the holding company, subsidiary, or affiliate may be conducted. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-200, 412:2-201, 412:11-102, 412:11-103) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:11-102, 412:11 -103)

#### SUBCHAPTER 5

##### OFF-SITE MONITORING

§16-26-39 Off-site monitoring. Off-site monitoring of institutions involves the systematic review of financial reports, audit statements, and other reports requested on an ad hoc basis. The principal purpose of off-site monitoring is to identify institutions that appear to evidence unusual conditions. Off-site monitoring complements, but does not substitute for, the examination of institutions, and may trigger an early examination or highlight areas in which special attention must be given. [Eff 8/13/87; comp 1/27/01] (Auth: HRS §§412:2-107, 412:2-100, 412:2-200) (Imp: HRS §§412:2-100, 412:2-200, 412:2-201, 412:11-102, 412:11-108, 412:13-223)



DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Amendment and Compilation of Chapter 16-26  
Hawaii Administrative Rules

December 11, 2000

SUMMARY

1. §16-26-2 is amended.
2. §16-26-3 is repealed.
3. §16-26-4 is amended.
4. §§16-26-6 and 16-26-7 are amended.
5. §16-26-8 is added.
6. §§16-26-14 through 16-26-18 are amended.
7. §§16-26-26 and 16-26-27 are amended.
8. Chapter 26 is compiled.

THIS MATERIAL CAN BE MADE AVAILABLE FOR INDIVIDUALS WITH SPECIAL NEEDS IN BRAILLE, LARGE PRINT OR AUDIO TAPE. PLEASE SUBMIT YOUR REQUEST TO THE COMMISSIONER OF FINANCIAL INSTITUTIONS AT (808) 586-2820.

Effective 1/27/01