



# CAMELS Rating



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# Overview of Bank Supervision



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FEDERAL RESERVE BANK  
OF RICHMOND  
Richmond • Baltimore • Charlotte

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## Disclaimer

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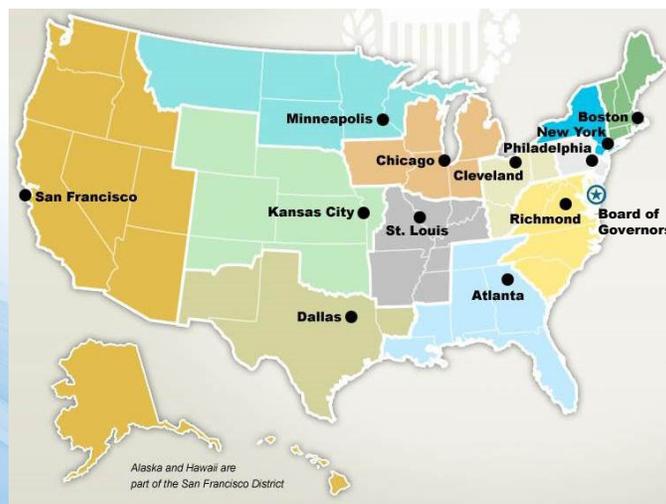
## Today's Agenda

- Introduction to the Federal Reserve System
- Introduction to bank supervision and the CAMELS Bank Rating System
- Break
- CAMELS Case Study
  - Introduction
  - Group Work
  - Debrief
- Integration of CAMELS and Your Bank Simulation Results

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## A decentralized central bank



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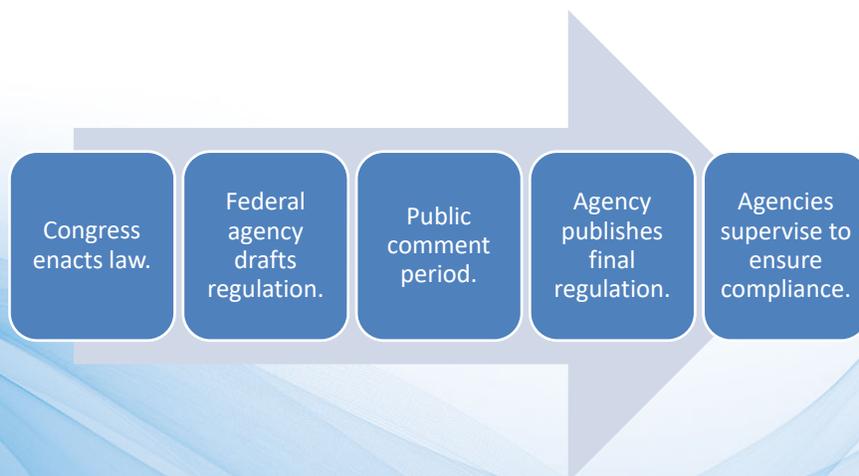
## Supervision and Regulation – Why?

- There are many reasons to regulate banks and the financial system.
  - Financial Stability
  - Protection of the Federal Deposit Insurance Fund
  - Consumer Protection
  - Competition
- The Fed's ability to carry out its central bank functions depends in part on the information gathered from its supervisory responsibilities.

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## From Law to Regulation to Supervision



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## Who Supervises Financial Institutions?

FDIC	FRS	NCUA	OCC	State Banking Commissions
State chartered banks who are not members of the Federal Reserve	State chartered banks who are members of the Federal Reserve  Bank holding companies  Savings and loan holding companies  U.S. operations of foreign banks.	State credit unions  Federal credit unions	National banks  Federal savings associations  Federal branches and agencies of foreign banks	State chartered banks and credit unions.

The CFPB also has supervisory authority over certain institutions to ensure consumer protection laws and regulations are being followed.

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## Who We Supervise In The Fifth District

Community Banks	Regional Banking Organizations	Large Financial Institutions	Systemically Important
Less than \$10 billion in assets	\$10 - \$99 billion in assets	\$100 billion or more in assets, but sufficiently complex	Failure may trigger a financial crisis
53 banks, 145 bank holding companies, and 6 SLHCs	<ul style="list-style-type: none"> <li>• United</li> <li>• Atlantic Union</li> <li>• Sandy Spring</li> <li>• Eagle</li> <li>• First BC (NC)</li> <li>• Live Oak</li> <li>• United Community</li> </ul>	<ul style="list-style-type: none"> <li>• Truist</li> <li>• Capital One</li> <li>• First Citizens</li> </ul>	Bank of America

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## What Does Supervision Cover?

Safety & Soundness	Consumer Affairs	Community Reinvestment Act
<ul style="list-style-type: none"> <li>Financial condition and stability</li> <li>Information technology</li> <li>Trust and wealth management</li> </ul>	<ul style="list-style-type: none"> <li>Consumer protection, including fair lending.</li> </ul>	<ul style="list-style-type: none"> <li>Serving the credit needs of the entire community.</li> </ul>

At the conclusion, we issue a **rating**.

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## The Bigger The Firm, The More Supervisory Rigor

Community Banks	Regional Banking Organizations	Large Financial Institutions	Systemically Important
Point-in-time exams	Continuous monitoring	Continuous monitoring	Continuous Monitoring
	Topical, point-in-time inspections	Topical, point-in-time inspections	Topical, point-in-time Inspections
		Horizontal assessments	Enhanced Prudential Standards
			National Program

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## Risk-Focused Supervision

- A risk-focused supervision process is where more resources are used to address institutions or areas that present heightened risk.
- Examiners don't just consider financial performance. They also evaluate the quality of risk management across six key risks.

Credit Risk

Liquidity Risk

Market Risk

Operational Risk

Legal Risk

Compliance Risk

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## Supervisory Tools

- Examination Findings
- Examination Ratings
- Continuous Monitoring
  - Including Applications
- Meetings with Board of Directors
- Supervisory Actions (Informal and Formal)

INFORMAL	FORMAL
Commitments	Written Agreement
Board Resolutions	Cease and Desist Order
Memorandum of Understanding	Civil Money Penalty
	Prompt Corrective Action Directive
	Suspension or Prohibition from Banking

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## What Do Consumer Compliance Exams Evaluate?

- Board and management oversight
- Compliance program
- Violations of law and consumer harm

Overall Composite Rating

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## What Do CRA Exams Evaluate?

Exam Type	Frequency (months)	Asset Size Thresholds (As of 12/31/19)	Areas Reviewed and Rated
Small Bank	48 or 60	< \$326 million	Lending
Intermediate Small Bank	24 or 36	\$326 million - \$1.305 billion	Lending Community Development *
Large Bank	24	> \$1.305 billion	Lending Investments Services

**Lending Test Covers:**

- Loan to deposit ratio
- Lending inside of the bank's markets
- Distribution of loans by geography
- Distribution of loans by borrower income and revenue size

**Community Development Test Covers:**

Number and dollar amount of:

- Community development loans
- Qualified investments
- Community development services

\* Combined Investments and Services

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## What Do Holding Company Inspections Evaluate?

- Consolidated risk management
- Consolidated financial condition
- **Impact**

Overall Composite Rating

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## What Do Safety and Soundness Bank Exams Evaluate?

- CAMELS
  - **C**apital
  - **A**sset Quality
  - **M**anagement
  - **E**arnings
  - **L**iquidity
  - **S**ensitivity to Market Risk
- Information Technology

Overall Composite & Risk Management Rating

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## Supervisory Ratings

1 – Strong	All is well.
2 – Satisfactory	
3 – Less than satisfactory	
4 – Deficient	Moderate to severe problems that require an enforcement action and increased supervisory oversight.
5 – Critically Deficient	

Each component is rated on a scale of 1 to 5. All ratings are assessed based on a combination of financial indicators and risk management practices.

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## A is for Asset Quality

*Credit risk arises from the potential that a borrower or counterparty will fail to perform on an obligation.*

- Level, trend, and severity of problem assets
- Concentrations of credit/asset diversification
- Underwriting, credit administration, risk identification, policies and procedures
- Adequacy of reserves
- Management and board reporting

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## E is for Earnings

- The ability of earnings to support operations, provide for loan loss reserves, and augment capital
- Quantity **AND** Quality
- Budgeting and forecasting

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## C is for Capital

- The ability of capital to absorb unexpected losses
- Consistent with the bank's risk profile – riskier balance sheet, activities, or strategy require more capital
- Quantity **AND** Quality
- Access to capital sources
- Capital management practices (dividends, share repurchases, etc.)
- Management and board reporting

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## L is for Liquidity

*Liquidity risk is the potential an institution will not be able to meet its obligations as they come due or offset exposures at a reasonable price.*

- Reasonable cushion of highly liquid assets
- Stability of deposits
- Reliance on wholesale or other potentially volatile funding sources
- Contingency funding plan
- Management and board reporting

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## S is for Sensitivity to Market Risk

*Market risk is the risk to an institution's financial condition resulting from adverse movements in market rates or prices.*

- The ability of earnings and capital to absorb changes in interest rates
- Reasonableness of forecasting models and assumptions

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## M is for Management

*Operational risk is the risk resulting from inadequate or failed processes, people, and systems, or from external events.*

- Quality and depth of the board of directors and senior management
- Corporate governance
- Effectiveness of strategic planning and ability to adapt to changing business conditions
- Compliance with laws and regulations

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## Questions ?

### Overview of Bank Supervision

Mike Riddle  
Jason Schemmel

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## As part of the nation's central bank, we're committed to strengthening the economy and our communities

### We're working to ensure a stable and sound economy

- We manage the nation's money supply to keep inflation low and help the economy grow
- We supervise financial institutions to help protect our nation's financial system
- We safeguard the integrity of our nation's payments systems

### We're dedicated to serving the American public and the Fifth District

- We collaborate and work together on behalf of our national and regional economy
- We foster a diverse and inclusive workplace
- We invest in our employees' development and growth to successfully deliver on our mission

### We're helping make our communities a better place to live

- We partner with community members to help promote local economic growth
- We educate people about how the economy works
- We volunteer our time, talents and resources to give back to our communities

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### Five Facts About the Fed — to Help Clarify Who We Are and What We Do

#### The Federal Reserve is audited

*We are transparent. The Board of Governors in Washington, D.C. and the 12 regional Reserve Banks are **subject to internal and external audits**, including audits by the U.S. Government Accountability Office. We also report regularly to Congress through hearings, reports and reviews.*

#### We are accountable to the American people, not Wall Street

*Reserve Banks are **independently governed by regional boards of directors** who are selected by banks within their communities and the Fed's Board of Governors. Our directors provide a Main Street perspective, represent the economic diversity in their communities and help inform economic policy. This structure underscores the political independence of the Fed.*

#### We are an independent, nonpartisan organization

*We are an independent entity within government—subject to oversight through congressional hearings, reports, reviews and audits. Our structure enables the Fed's monetary policy decisions to be **free of short-term political pressures**.*

#### We issue, store, distribute and inspect our nation's currency and coin

*We distribute currency and coin to banks and ensure U.S. currency is genuine and fit for recirculation. **But, we don't print or mint money**—that's the work of the U.S. Treasury.*

#### We are working to ensure a stable and sound economy

*We manage the nation's money supply to keep inflation low and help the economy grow, but we don't manage the nation's fiscal policy. We also **supervise financial institutions to help protect our nation's financial system**, and we safeguard the integrity and efficiency of our payments systems.*

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## Supervision Regulation & Credit Department

### Fed Supervision is Built on Strong Relationships

The Supervision, Regulation and Credit team oversees a diverse range of financial institutions, which includes all state-member banks as well as bank holding companies and savings and loan holding companies.

We provide:

- Fair, consistent, and tailored supervision with dedicated points of contact  
A dedicated portfolio officer and central points of contact provide timely communication and responses to questions and possess in-depth institutional knowledge.
- Knowledgeable and responsive staff and risk specialists  
Our staff go through a rigorous training program and have broad expertise due to the range of banks (size, risk profiles, and operating models) in the Fifth District.
- Committed outreach and education programs  
We proactively communicate expectations, risk topics, and other pertinent supervisory and regulatory issues with our institutions before examinations to avoid surprises, and we host a variety of informative conferences, seminars, and training opportunities.
- One local federal regulator for your bank AND holding company  
The Federal Reserve is the sole federal regulator for holding companies and their subsidiary banks that have elected state membership.
- Fed Stock dividend, supervision without fees, access to Fed services and a voice in district board representation  
Federal Reserve stock pays a 6% dividend, there are no fees for examinations or applications regardless of condition or size, and member banks are eligible to elect board members of their local Reserve Bank and can serve on Federal Reserve Advisory Councils.

To find out more, please visit us at <https://www.richmondfed.org/banking/overview>

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## Federal Reserve Resources

- **Supervision News Flash** helps you stay abreast of **topics and trends affecting financial institutions**. We share **insights on what our examiners, analysts and economists are seeing** both within the Richmond Fed's portfolio as well as trends from across the entire System. Sign up and read past issues at **RichmondFed.org**
- **Ask the Fed®** is a free program covering the **latest financial and regulatory developments** for senior banking officials and boards of directors. Ask the Fed® has monthly conference calls that feature Fed experts and guest speakers on top banking issues of the day, with time at the end for questions and comments. **stlouisfed.org/askthefed/**
- **Bank Board of Directors Desktop** is The Federal Reserve System's free online training curriculum to help bank directors **quickly develop an understanding of their role** in performing bank oversight responsibilities. Also included are links to web based resources, including data, publications, events and the federal banking agencies that bank directors may find useful in performing their bank oversight responsibilities. **bankdirectorsdesktop.org**
- The **Richmond Fed's website** includes a banker education section with links to fraud awareness, speakers' bureau, resources for financial institution directors, introduction to regulatory reporting. Look under Education for Bankers.

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## Federal Reserve Resources

- **Community Banking Connections** covers issues that community banks face, providing resources on key supervisory guidance, highlighting new regulations and offering perspectives from bank examiners and other Federal Reserve staff [communitybankingconnections.org](https://communitybankingconnections.org)
- **FedLinks** articles highlight key elements of a supervisory topic to improve clarity and understanding about the topic and examiner expectations for applying related supervisory guidance. FedLinks articles are **most helpful for bank holding companies and banks with assets of \$10 billion or less**. [communitybankingconnections.org/fedlinks.cfm](https://communitybankingconnections.org/fedlinks.cfm)
- **The BSA Coalition** is a forum in which experts at financial institutions, regulatory and law enforcement agencies and other organizations can discuss and debate questions, guidance and day-to-day issues affecting the development and implementation of **effective Bank Secrecy Act/Anti-Money Laundering programs**. [bsacoalition.org](https://bsacoalition.org)
- **Outlook Live** is The Federal Reserve System's **audio conference series on consumer compliance issues and hot topics** such as CRA, HMDA and fair lending compliance; service member financial protection and compliance consideration for vendor risk management. Live sessions are scheduled throughout the year, and archives of past presentations are available on the website. [consumercomplianceoutlook.org/outlook-live](https://consumercomplianceoutlook.org/outlook-live)
- **Consumer Compliance Outlook** is a Federal Reserve System publication dedicated to consumer compliance issues. [consumercomplianceoutlook.org](https://consumercomplianceoutlook.org)

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## CASE STUDY

### **Maryland Terrapins Bank**

### Company Overview

- Founded in 1856 by Gary Williams in College Park, Md.
- Grew from a single branch in College Park to a total of 10 branches throughout Maryland. The final branch opened in 2005.
- Presidency remained in the Williams family until the current president. The Williams family still controls 60% of the voting stock.

## Previous Exam Results

- October 2008                    2-2-2-1-2-1/2 (2)
- December 2009                2-3-3-2-2-2/3 (3)
- June 2011                        4-4-4-5-3-2/4 (4)
- January 2012                    ?

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## Management

- Optimistic management and board
- Previously considered satisfactory; responsive to examiners recommendations
- Failed to recognize changes in the economy and related credit risks and did not develop an overall plan to address the rapid increase in classifications

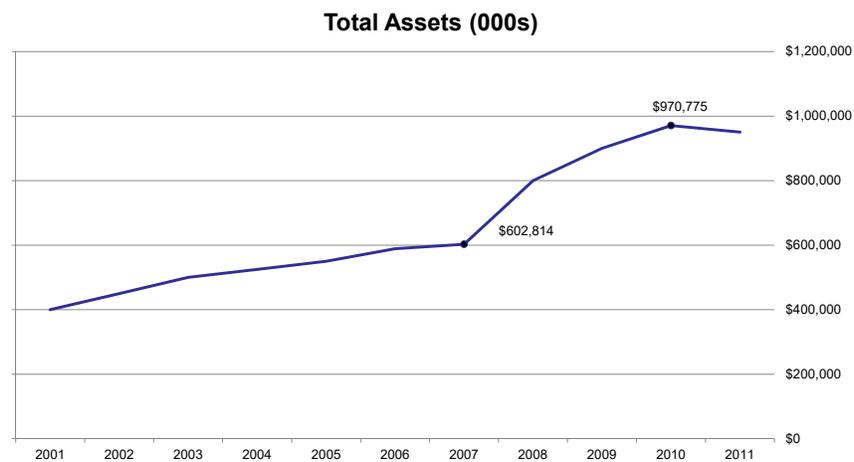
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## Asset Quality

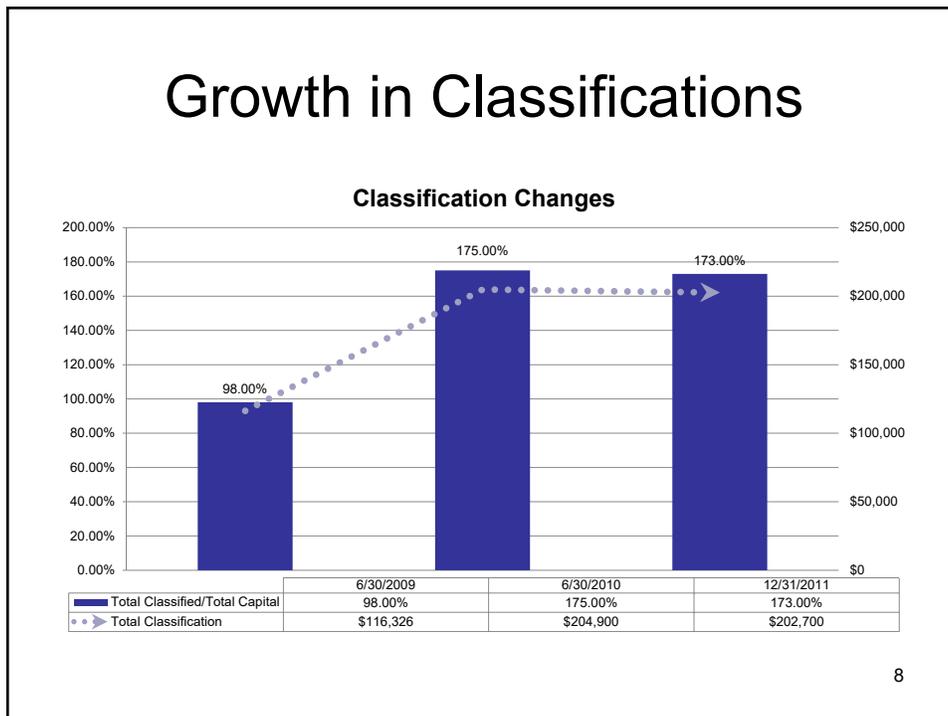
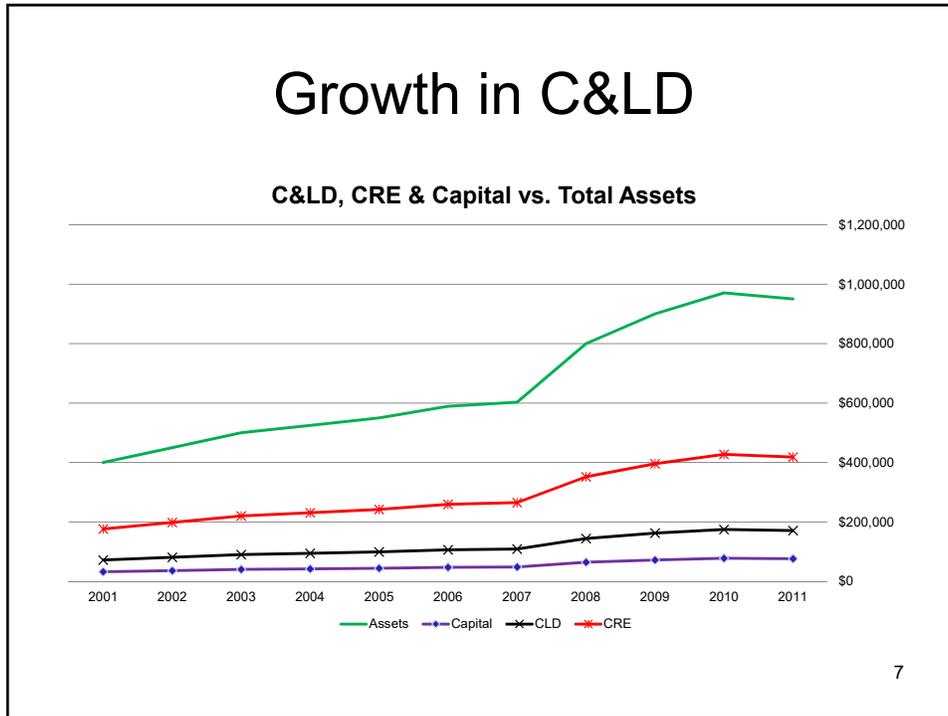
- Aggressive Construction & Land Development (C&LD) lending growth
- Lax credit administration and credit review processes
- Loan downgrades – 15 relationships (15%)
- Nine appraisal violations
- Unable to find experienced problem asset personnel
- 62% of C&LD loans are classified
- ALLL methodology and level not considered adequate
- Nonperforming loans – 6.5% of total loans, down from 9.5% from last examination.

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## Asset Growth



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## Earnings

- At previous exam, ALLL methodology was deemed inappropriate and unacceptable. An additional \$5 million was required in the reserve and management complied.
- Return on assets (ROA) for the prior 6 months is 0.5%.
- Exposure to interest rate risk is not excessive

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## Capital

- At previous examination, capital ratios declined rapidly to 5.9%(Tier one leverage)and 9.9% (total risk-based), pushing them into the adequately capitalized area. Ratios are 6.1% and 10.1% respectively.
- Reluctant to raise capital due to family concerns over dilution, but family is discussing additional investment.

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## Liquidity

- Bank has sufficient short-term assets and access to funding sources to meet expected funding needs in near term
- Forward looking cash flow analysis is adequate
- Deposit base is relatively stable and diversified; reliance on brokered funds is slightly higher than average.

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## Sensitivity to Market Risk

- Level of risk is within tolerance range
- Bank utilizes acceptable models to determine risk, and as a result, monitoring of risk is considered adequate
- Policy is adequate in light of noncomplex balance sheet structure

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## Preliminary Ratings IT & CA

- IT rated “2” but increasing concerns
- CRA rated “Satisfactory”
- Compliance rated “2”; found no substantive violations.

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## Safety & Soundness Results...

### CAMELS

- C?
- A?
- M?
- E?
- L?
- S?
- RM?
- Composite?



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