Ratings: Developing, Assigning, and Presenting

This Handbook Section provides guidance in the following areas:

- Summarizing regulatory findings for the comprehensive Report of Examination (ROE) comments and conclusions.
- Assigning appropriate CAMELS composite and component, Compliance and, if applicable, Trust ratings.
- Meeting with association management and the board of directors to present the ROE findings.

LINKS
Program
Appendix A
Appendix B

Comments and Conclusions

There are unique factors to consider when developing conclusions, comments, and ratings for each CAMELS component, Compliance, and Trust area. (See the Trust and Asset Management Handbook for guidance in the Trust area.) Each comment should be accurate, complete and concise.

Developing Report Comments

The following checklist will assist in developing individual CAMELS and Compliance comments for the ROE:

- Disclose the rating.
- Clearly state the conclusion and a summary of findings.
- Clearly identify patterns, practices, trends, and their causes.
- Present comments in a meaningful order, discussing major strengths and weaknesses, with proper emphasis and tone accorded to individual topics. The severity of the problem will dictate its order of presentation. Consider how the problem affects the association's other activities and any mitigating circumstances.
- Identify substantive safety and soundness and compliance issues.

- Include the deficient underlying practices when you note patterns of regulatory noncompliance.
- Include a summary of material deficiencies that support 3, 4, and 5 component and compliance ratings.
- Support conclusions with appropriate analysis and prepare a concise, effective summary that does not lose the reader in detail.
- Assess the effect of examination findings on future operations.
- Include a discussion of corrective action where necessary.
- Identify actions needed to correct weaknesses, outstanding deficiencies, or violations as appropriate.
- The extent to which the association has adequately addressed self-identified deficiencies and violations, substantive violations discovered during the examination, with a discussion of the underlying cause of each substantive violation.
- Support the comments with work papers and other retained documents. Include information that provides a clear understanding of the overall condition, adequacy of management practices, causes of major problems, and recommendations for remedial action.

The Compliance comment should discuss:

- The details of the compliance management program and the effectiveness of management in implementing the compliance program.
- The BSA and Customer Identification Program. Discuss the structure and effectiveness of the association's BSA Program, specifically referencing regulatory requirements (internal controls, independent testing, designated person and training), Customer Identification Program, and any comments pertinent to examination findings. Examination comments on BSA must address all of the applicable requirements set forth in the most current FFIEC BSA/AML Examination Manual as specified in Preparing the BSA/AML Comments for the Report of Examination on pages 50-51. For associations with effective BSA Programs, comments should be concise but convey that the program contains all required elements and is effective. For associations with isolated to pervasive BSA Program issues or concerns, clearly identify where weaknesses exist, corrective action is needed, and the association's progress toward or capacity to implement those actions.
- The adequacy of inclusion and coverage of each of the working SMAART components.

- The extent to which the association has adequately addressed self-identified deficiencies and violations, substantive violations discovered during the examination, with a discussion of the underlying cause of each substantive violation.

For 1- and 2-rated savings associations, if there are no findings of deteriorating performance or materially inadequate controls in a particular CAMELS or Compliance section, you may eliminate the individual narrative page and summarize the conclusions on the Examination Conclusions and Comments page in the ROE. You must address compliance management in the Examination Conclusions and Comments if you do not use the Management page.

Primary Factors to Consider

Consider the following primary factors when developing your conclusions and ratings:

- Material items that relate to safety and soundness, and significant adverse findings for technology risks, compliance, or trust and the causes of those problems.
- An assessment of the compliance management program's performance.
- An assessment of the effectiveness of overall risk management.
- Regulatory violations and the reasons for any material patterns. List violations on the Violations of Laws and Regulations page. You should not include them on the Examination Conclusions and Comments page unless they are significant.
- How your findings within each of the CAMELS, Compliance, and Trust areas interrelate, affect the overall financial condition and safety and soundness of the association's operations, and reflect on the effectiveness of management.
- Material adverse findings outstanding from the prior examination and management's efforts to date to correct the problems.

Formulating an Overall Conclusion

As you complete individual report comments and compile work papers, you should begin to formulate an impression of the association's overall condition. The Examination Conclusions and Comments page must provide a concise narrative statement of the major findings of examination, supporting the conclusions you present.

The development of a substantive overall conclusion requires that you:

- Review major findings from the examination (including trends).
- Consider the association's operating environment (both internal and external factors).

- Consider the need for supervisory monitoring or enforcement action.
- Convert ultimate determinations into ratings.
- Communicate results effectively.
- Facilitate the corrective action process.
- State conclusions and the overall evaluation in the ROE.

There are both objective and subjective factors involved in a comprehensive analysis of the association's present and expected future condition. You must weigh the significance of criticisms, deficiencies, and exceptions that may offset strengths. This requires reviewing CAMELS, compliance management, and trust comments, and other findings for interrelationships. Whenever a practice or other factor materially affects safety and soundness or compliance performance, you must look at both the present and potential future consequences.

One goal of the regulatory process is to prevent problems from developing or escalating in the future. Therefore, early identification of risk or weaknesses in management practices is key. Support any projections with adequate facts and analyses.

When developing a conclusion about the association's future prospects, consider:

- Existing systems, policies, and procedures.
- The business plan.
- Projections for operating performance.
- Use of information technology.
- Management effectiveness and ability to effect corrective actions.
- Current financial market and economic conditions.

One goal of the regulatory process is to prevent problems from developing or escalating in the future.

ASSIGNING RATINGS

After formulating the conclusions, you can begin the rating process. In a comprehensive examination, OTS rates a savings association in the following areas:

- **CAMELS components and composite ratings** – OTS uses the CAMELS rating system to evaluate a savings association's overall condition and performance by assessing six rating components. The six components are Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. OTS then assigns each association a composite rating based on your assessment of its overall condition and level of supervisory concern.

- **Compliance rating** – OTS uses a Compliance Rating System that addresses general compliance with fair lending, consumer protection, and other public interest laws and regulations. This rating system is substantially equivalent to the FFIEC-approved interagency compliance rating system.

- Trust component and composite ratings – when applicable, OTS uses the Uniform Interagency Trust Ratings Definitions to evaluate the overall condition and performance of the trust operations. (See Trust and Asset Management Handbook Section 060, Assignment of Ratings.

In order to assess management and the association's overall condition, you must adequately consider all areas and their interrelationships. This section briefly presents the main areas you must review in order to assign the six CAMELS component and composite ratings, and the Compliance rating. (See also the Appendices that follow this Section for detailed rating guidelines.)

You should follow the examination procedures within each of the chapters as required by the examination scope to develop the ratings.

OTS personnel use the ratings for a variety of purposes:

- To reflect trends for a particular association.

- To make comparisons with peers.

- To assess the condition of the industry.

The ratings help determine appropriate strategies including the following:

- Frequency and scope of off-site and on-site analysis.

- Enforcement actions.

- Meetings with association personnel.

- Analyzing applications (such as, merger, acquisitions, subordinated debt issuance), and notifications (such as, transactional website filings).

Because ratings determine a variety of critical decisions, a systematic and logical analysis is essential. While objective analysis and findings primarily determine ratings, there are some subjective factors, too.

CAMELS Rating System

The Uniform Financial Institutions Rating System (UFIRS) is the definitive statement on safety and soundness ratings. (See Appendix A.) Aggregate rating information enables the public and Congress to assess the condition of the savings and loan industry. Because the four banking regulatory agencies adopted the UFIRS, Congress and others can readily compare composite rating data for all types of insured savings associations.

This section expands on, or highlights certain parts of the policy statement as it applies to savings associations.

Composite Rating

The composite rating is a qualitative assessment by the agency of the association's condition and the agency's overall level of supervisory concern.

Composite ratings reflect a careful evaluation of an institution's managerial, operational, financial, and compliance performance.

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The six key components used to assess an institution's financial condition and operations are: capital adequacy, asset quality, management capability, earnings quantity and quality, the adequacy of liquidity, and sensitivity to market risk. The rating scale ranges from 1 to 5, with a rating of 1 indicating: the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile; and the level of least supervisory concern. A 5 rating indicates: the most critically deficient level of performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and the greatest supervisory concern.

Although the composite rating assigned to the association should normally have a close relationship to the individual CAMELS component ratings, you should not derive the composite rating merely by computing an arithmetic average of the component ratings. Such a simplistic, mechanical approach will not reflect the true condition of the savings association; nor will it indicate the appropriate supervisory actions.

The composite CAMELS rating, the CAMELS component ratings, and supporting documentation all play an important part in the regulatory process in support of any necessary enforcement action.

One of the principal objectives of the CAMELS rating process is to identify, through an overall assessment of the association as reflected in the composite rating, those associations that pose a risk of failure and merit more than normal supervisory attention. Thus, you should give more weight to individual CAMELS criteria that more strongly affect the condition and viability of the association. The composite CAMELS rating, the CAMELS component ratings, and supporting documentation all play an important part in the regulatory process in support of any necessary enforcement action.

The Examination Conclusions and Comments page, the CAMELS comments, and the work papers should support the composite rating. In the ROE, disclose the composite CAMELS ratings, refer to the definition of the assigned ratings, and explain the correlation between the association's circumstances and the ratings.

OTS uses an association's composite rating as one of the factors to determine whether OTS should designate the association as being in "troubled condition." OTS designates in troubled condition any association that has a composite CAMELS rating of 4 or 5. OTS defines other qualifiers of troubled condition in 12 CFR § 563.555. These associations are subject to greater regulatory scrutiny and restrictions, such as requirements to receive prior approval before engaging in certain activities.

When you examine an association in troubled condition, you should consult the regulatory profile, supervisory correspondence, the previous examination, and any other pertinent information to determine the operating restrictions to which an association is subject. You must then analyze the association's operations and ensure that it complies with all restrictions. For further information regarding operating restrictions, refer to Examination Handbook Section 080, Enforcement Actions.

The composite rating also supports OTS's differential regulation policy. The composite rating establishes both the OTS and the Federal Deposit Insurance Corporation (FDIC) fee assessment levels and determines the levels of supervisory oversight and restrictions. This policy provides tighter restrictions for associations with lower composite ratings and other factors, and is evident in the following guidance:

- Examination Handbook Section 080, Enforcement Actions.
- RB 3b (Policy Statement on Growth for Savings Associations).
- OTS assessment regulation at 12 CFR § 502.10.
- OTS audit regulation at 12 CFR § 562.4.
- OTS transactions with affiliates regulation at 12 CFR § 563.41.
- OTS capital regulation at 12 CFR § 565.4.
- OTS directors' regulation at 12 CFR §§ 563.550 through 563.590.
- FDIC risk-based deposit insurance assessment regulation at 12 CFR Part 327.
- FDIC brokered deposit restrictions regulation at 12 CFR § 337.6.

Component Ratings

Generally, component ratings reflect examination findings and an examiner's assessment of an association's performance in the six key performance groups that are common to all associations. We highlight below the UFIRS definition for each CAMELS component.

Capital Adequacy

Maintaining an adequate level of capital is a critical element for depository associations. While meeting regulatory capital requirements is a key factor in determining capital adequacy, the association's operations and risk position may warrant additional capital beyond the minimum regulatory requirements. You should determine whether capital is adequate in relation to the risk profile and operations of the association. In addition, you should evaluate capital levels in relation to future needs.

Maintaining an adequate level of capital is a critical element for depository associations.

Since maintaining a sufficient level of capital is critical for an association to maintain operations, you should appropriately weigh the importance of capital on the viability of the association when formulating the composite rating. You should also consider the association's dividend payout policy and practice. You should rate an association's capital adequacy considering all criteria cited in the UFIRS statement.

PCA Levels

In general, an association in any of the three lower-tier Prompt Corrective Action (PCA) categories warrants a 4 or 5 Capital component rating. A capital rating of 4 is appropriate if the association is undercapitalized or significantly undercapitalized but asset quality, earnings, or interest rate risk problems will not cause the association to become critically undercapitalized in the next 12 months. Also, a capital rating of 4 may be appropriate for an association that does not have sufficient capital based on its capital level compared with the risks present in its operations, even though the association may meet the minimum regulatory requirements.

An association warrants a 5 rating if it is "critically undercapitalized," or has significant asset quality problems, negative earning trends, or high interest rate risk exposure that will cause the association to become critically undercapitalized within the next 12 months.

See the Capital Chapter of this Handbook for more detailed instructions for reviewing capital adequacy.

Asset Quality

An accurate evaluation of an association's asset quality can be one of the most important products of the examination. The asset quality rating reflects the extent of credit risk associated with the loan and investment portfolios, real estate owned, other assets, and off-balance-sheet risks as well as the association's ability to manage those risks. The evaluation of an association's asset quality is dependent on the association's policies and procedures relating to loan underwriting and asset procurement, the proper monitoring and classification of assets, the nature of the risk inherent in the association's portfolios including exposure to concentrations, and the adequacy of the association's valuation allowances.

When asset quality is in doubt because of excessive or inadequately controlled risk, the association's asset quality component rating should reflect this concern. In order to attain a 1 or 2 Asset Quality component rating, an association must fully control its credit risk. If an association has a high exposure to credit risk, it is not sufficient to demonstrate that the loans are profitable or that the association has not experienced significant losses in the near term. Management must demonstrate that it has identified credit risks, measured the potential exposure to loss, established systems to monitor such risk on an ongoing basis, and has taken adequate steps to limit and control those risks. Otherwise, a significant supervisory concern will exist relative to the association's asset quality.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that they have established appropriate policies, procedures, and practices. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards.

Depending on the nature and scope of an association's activities, management practices may need to address some or all of the following risks:

- Credit
- Interest rate
- Market
- Operating or transaction
- Reputation
- Strategic

- Compliance
- Legal
- Liquidity
- Price

The following practices demonstrate sound management:

- Active oversight by the board of directors and management.
- Competent personnel.
- Adequate policies, processes, and controls taking into consideration the size and sophistication of the association.
- Maintenance of an appropriate compliance management program.
- An audit program and internal control environment appropriate to the size, complexity, and risk profile of the association.
- Effective risk monitoring and management information systems.

This rating should reflect the board's and management's ability as it applies to all aspects of thrift operations as well as other financial service activities in which the association is involved.

Consistent with the UFIRS definition, your assessment and rating of the management component must reflect the board of directors and management's ability and effectiveness in managing all aspects of an association's operations and risks, including the compliance management function. The Management rating component should also include the association's approach to compliance, that is, its demonstrated capacity to administer and implement a compliance program using SMAART components.

You must address your assessment of management and the board as it relates to overall risk mitigation activities including compliance management, technology risk controls and, if applicable, trust and asset management. A Compliance or Trust rating of 3 or lower, or most recent IT examination rating of 3 or lower, should be reflected in the Management component of the CAMELS rating as follows:

- When the Compliance, IT, or Trust rating is 3, the Management rating may not be better than 2.
- When the Compliance, IT, or Trust ratings is 4 or 5, the Management rating may not be better than 3.

Generally, the level of substantive violations, programmatic deficiencies and OTS supervisory attention associated with compliance ratings of 4 or 5 are inconsistent with management performance under the CAMELS system of anything higher than a 3 for Management, and may be sufficient alone, or in combination with other management shortcomings, to compel even lower ratings of Management.

Earnings

You must determine whether earnings are sufficient for necessary capital formation. An association should have minimum earnings sufficient to absorb losses without impairing capital. Quality (stability) and composition (source) of earnings are important criteria. The association cannot rely on income that is nonrecurring, such as gains on the sale of portfolio loans, to maintain profitability. You should consider the extent to which extraordinary items, such as nonrecurring securities transactions and tax effects contribute to net income.

You should consider the adequacy of transfers to the general and specific valuation allowances; if the association needs more allowances, this will negatively affect earnings.

You should also consider the association's operating risks to determine if its earnings position is stable and sufficient. Use professional judgment and analyze the stability and sufficiency of noninterest earnings, including gains on sales of loans and securities. In addition, consider the adequacy of an association's interest rate risk management; if it is inadequate the association's earnings may be adversely affected by a change in market interest rates.

Liquidity

Savings associations must maintain sufficient liquidity to ensure safe and sound operations (12 CFR 563.161.) An association's liquidity management process should be sufficient to meet its daily funding needs and cover both expected and unexpected deviations from normal daily operations. Primary tools for measuring and managing liquidity risk include cash flow projections, diversified funding sources, stress testing, a cushion of liquid assets, and a formal, well-developed contingency funding plan. OTS expects all savings associations to manage liquidity risk using processes and systems commensurate with the institution's complexity, risk profile, and scope of operations. See CEO Memo 342, Interagency Policy Statement on Funding and Liquidity Risk Management.

Sensitivity to Market Risk

The UFIRS bases the sensitivity to market risk component rating on two dimensions:

- The association's level of market risk.
- The quality of the association's practices for managing market risk.

Because few savings associations have significant exposure to foreign exchange risk or commodity or equity price risks, OTS generally assesses interest rate risk as the only form of market risk. You must assess both dimensions and combine those assessments into a component rating.

You must base your conclusions about an association's level of interest rate risk – the first dimension for determining the Sensitivity component rating – primarily on the interest rate sensitivity of the association's net portfolio value (NPV). You must pay primary attention to two specific measures of risk: Interest Rate Sensitivity Measure and Post-shock NPV Ratio. (See the TB 13a glossary for definitions.)

- **Interest Rate Sensitivity Measure**. This measure by itself, may not give cause for supervisory concern when the association has a strong capital position. Because an association's risk of failure is inextricably linked to capital and, hence, to its ability to absorb adverse economic shocks, an association with a high level of economic capital, that is, NPV, may be able safely to support a high sensitivity measure.

- **Post-shock NPV Ratio**. This ratio is a more comprehensive gauge of risk than the sensitivity measure because it incorporates estimates of the current economic value of an institution's portfolio, in addition to the reported capital level and interest rate risk sensitivity. There are three potential causes of a low, that is, risky, post-shock NPV ratio:

  — Low reported capital

  — Significant unrecognized depreciation in the value of the portfolio

  — High interest rate sensitivity.

Although the first two situations may cause supervisory concern and receive attention under the portions of the examination devoted to evaluating Capital Adequacy, Asset Quality, or Earnings, they do not necessarily represent an interest rate risk problem. Only when an association's low post-shock NPV is, in whole or in part, caused by high interest rate sensitivity is there suggestion of an interest rate risk problem.

Refer to TB 13a (Section IV, Table 1) for the guidelines to determine the level of interest rate risk. Use these risk levels as starting points in your ratings assessments; however, you have broad discretion to exercise judgment. TB 13a provides these risk levels as guidance; they are not mandatory.

OTS produces quarterly estimates of the sensitivity measure of the post-shock NPV ratio for each association that files TFR Schedule CMR. You can find these estimates in the Interest Rate Risk Exposure Report for the association.

In drawing conclusions about the quality of an association's risk management practices – the second dimension of the Sensitivity component rating – you must assess all significant facets of the association's risk management process.

Consider the following eight factors when assessing the quality of an association's risk management practices:

- Quality of oversight by the board and senior management.

- Prudence of board-approved IRR limits.
- Adherence to IRR limits.
- Quality of system for measuring NPV sensitivity.
- Quality of system for measuring earnings sensitivity.
- Integration of risk management with decision-making.
- Investments and derivatives including risk management policies and procedures.
- Association's size, complexity, and risk profile.

Although TB 13a (Table 2) provides guidelines on how to combine your assessment of these two dimensions into a component rating, you must exercise judgment in assigning ratings based on the facts you encounter at each association. TB 13a (Section IV) provides a nonexhaustive list of factors you might consider in applying the Sensitivity rating guidelines to a particular association.

Thrift Performance Evaluation and CAMELS Rating Assignments

The Uniform Thrift Performance Report (UTPR) provides percentile rankings for many measures of association performance as compared to peer performance. Use the Risk Monitoring System (RMS) Query Builder to find the CAMELS composite ratings of other associations with similar key ratios. These tools are useful in comparing an association's performance with that of its peers to assign ratings that are consistent with associations having similar ratios. However, since the composite CAMELS rating is an indicator of the overall health and viability of an association, it is important that you rate associations on their absolute performance as well as against regional or state peer performance. Associations in some states or regions may perform better than peer averages or medians, but perform poorly in absolute terms or when compared with peer averages or medians of other regions. Peer performance in such cases would not necessarily reflect associations that were being operated in a safe and sound manner. Rather, those averages could reflect substandard performance. The CAMELS ratings should accurately reflect the condition of an association, regardless of local or regional peer performance.

You cannot measure an association's performance solely in numbers. Because an association meets its minimum regulatory capital or other regulatory requirement does not guarantee that its condition is viable. Therefore, you must use professional judgment and consider both qualitative and quantitative criteria when analyzing an association's performance, taking into account:

Because an association meets its minimum regulatory capital or other regulatory requirement does not guarantee that its condition is viable.

- Quality of management and the board of directors.
- Quality and composition of the asset portfolio.
- Risks inherent in the business activities, including technology risks, and quality of risk management practices.
- Financial performance.

Further, since financial numbers are lagging indicators of an association's condition, you must also conduct a qualitative analysis of current and projected operations when assigning CAMELS ratings. You should weigh the analysis of quantitative and qualitative data to determine the rating for each CAMELS component.

Compliance Rating System

OTS adopted a Compliance Rating System substantially equivalent to the FFIEC-approved interagency compliance rating system. The FFIEC consumer compliance rating system states that a consumer compliance rating evaluates and weighs the following:

- The nature and extent of present compliance with consumer protection and civil rights statutes and regulations.
- The commitment of management to compliance and its ability and willingness to take the necessary steps to assure compliance.
- The adequacy of operating systems, including internal procedures, controls, and audit activities designed to ensure compliance on a routine and consistent basis.

The primary purpose of the Compliance Rating System is to help identify those associations whose compliance with civil rights, consumer protection and other public interest statutes and regulations, displays weaknesses requiring special supervisory attention and is cause for more than a normal degree of supervisory concern.

Assigning the Compliance Rating

In assigning a Compliance Rating, you must identify and evaluate all factors relevant to ensuring compliance with civil rights, consumer protection and other public interest statutes and regulations.

In general, these factors include:

- Implementation of a formal written compliance management program reliably covering OTS's SMAART components suitable to the size and operational complexity of the association.

- The commitment of the board and management, as evidenced by its ability and willingness to maintain compliance.
- Internal self-assessments and compliance reviews.
- Competency of management, as evidenced by the adequacy of operating systems, including internal procedures and controls designed to ensure compliance.
- Appropriate compliance training programs.
- The nature and extent of violations (including repeat violations) and deficiencies in actual compliance performance as a measure of the effectiveness of management's efforts.

Other factors unique to specific situations will require attention if you determine they significantly affect the overall effectiveness of an association's compliance efforts.

The Compliance Rating System is a scale of 1 through 5, in increasing order of supervisory concern. A rating of 1 indicates excellence, while a rating of 5 represents the lowest, most critically deficient level of performance and the highest level of supervisory concern. The Compliance Rating System is a single-value rating system. The single rating value assigned reflects overall compliance performance and you must substantiate the rating by the contents of the ROE and the examination work papers. Characteristics of the five Compliance Ratings available to the examiner will conform to the rating descriptions in Appendix B. However, as these descriptions are a composite, not all characteristics will be present at every institution. You must apply this guidance to capture an accurate overall evaluation of the association's compliance management performance for the examination period, keeping in mind the policy to encourage self-identifying and self-correcting controls.

The Compliance Rating System is a scale of 1 through 5, in increasing order of supervisory concern.

See Appendix B for a detailed description of the characteristics of the five Compliance Ratings.

Consistency in Rating Assignments

It is essential that OTS apply ratings on a nationally consistent basis. Inconsistencies in assigning CAMELS component and composite, Compliance and, if applicable, Trust ratings may result in confusion and degrade the integrity of the supervisory process. With consistently applied ratings, OTS can compare the condition of the association between the previous examination and the most recent examination. Furthermore, and particularly with CAMELS ratings, you can compare associations on an intraregional and a national basis using RMS Query Builder reports sorted by key ratios. To ensure consistency in the rating process, you must have a thorough understanding of the criteria to assign all applicable ratings.

Maintaining and Updating the Ratings

It is essential that regional offices monitor new developments for each association and update the ratings, as needed, so that the rating is always a current indicator of the association's condition. (Refer to Examination Program 070 for off-site ratings procedures.) Maintaining these ratings requires periodic monitoring with an emphasis on the criteria supporting the ratings for the association. For this reason, it is imperative that you document the significant points supporting the ratings.

> **Deterioration or significant changes in the association's operations or condition, or noncompliance with laws and regulations, may indicate a need for some special supervisory attention.**

Deterioration or significant changes in the association's operations or condition, or noncompliance with laws and regulations, may indicate a need for enhanced supervisory attention. Supervisory attention may include a telephone inquiry or written request for additional information, a limited examination, or a regular examination. Any changes in the criteria that support the current ratings or any new developments may require a change in the CAMELS or Compliance ratings and the supervisory treatment needed.

Since ratings affect the association's assessment and supervisory treatment, OTS must keep them current. Analyze and adequately document any updates to the ratings. The rating OTS reports to an association must always be the most recent rating based on all sources of information.

Documentation and Support

Given the importance of the ratings, it is critical to clearly show and support how you determined these ratings. Include this documentation in the work papers. Discuss adverse findings in the individual sections of the ROE. Summarize overall findings and conclusions in the Examination Conclusions and Comments page of the ROE. For CAMELS ratings in particular, you should review ROE ratios, UTPR schedules, and customized RMS reports and use them to concisely document and support the analysis. You may also find these reports useful in assimilating and reviewing work paper conclusions and organizing your thoughts before drafting the ROE.

Disclosure of Ratings

OTS discloses CAMELS composite and component, and Compliance ratings in the ROE. OTS does not disclose ratings in meetings with association management and boards of directors. (See the next section on Meetings with Management and the Board of Directors.)

Obtain sufficient concurrence from regional management, so that the ratings are final, or subject to revision only in rare instances. In accordance with OTS's ROE instructions add the component and Compliance rating to the applicable ROE page. The Examination Conclusions and Comments page should provide a concise narrative statement of the major findings of the examination. In addition, the Examination Conclusions and Comments page should clearly state how the examination findings within each of the CAMELS, Compliance, and Trust areas interrelate and affect the overall financial condition and safety and soundness of the association's operations.

Supervisory Letter

When the regional office changes the CAMELS composite rating or the Compliance rating off-site, they send a supervisory letter to the board of directors to notify them of the change. A change in rating may result from changes in the association's operating strategies or conditions. An on-site review may be appropriate when conditions warrant a downgrade in rating. When the CAMELS composite rating changes, we advise evaluating the need to change all six CAMELS component ratings. Include in the supervisory letter a prohibition against outside disclosure and explain why the rating changed.

MEETINGS WITH MANAGEMENT AND THE BOARD OF DIRECTORS

You should not disclose ratings during examination exit meetings. This is particularly important for examination reports that require review by the large bank unit. For all other cases, it is preferable to use the rating definition terminology in describing the examination results, but not the actual ratings.

Management Discussions

During the discussion with management, you should discuss the criteria you considered in assigning CAMELS component and composite ratings and the compliance rating. You should not disclose the ratings themselves, but do discuss all factors considered in assigning each component rating and those considered in assigning the composite rating. You should indicate that a careful evaluation of each CAMELS component and Compliance determines the composite rating. You should clarify that OTS does not base the composite rating on an arithmetic average of the components, but on a qualitative analysis of the criteria comprising each component, the interrelationship between components, and, more importantly, the overall level of supervisory concern.

The quality of management is the single most important element in the successful operation of an association, and is usually the factor that is most indicative of how well the association identifies, measures, monitors, and controls risk. For this reason, you should take sufficient time to explain to senior management and, when appropriate, to the board of directors, the criteria you considered in assigning the management component rating. Your written comments in support of the management rating should include an assessment of the effectiveness of existing processes to identify, measure, monitor, and control risk. Finally, you should remind management that the ratings disclosed in the examination report remain subject to the confidentiality rules imposed by 12 CFR Part 510 of the OTS Regulations.

The quality of management is the single most important element in the successful operation of an association.

Meetings with the Board of Directors

In addition to meeting with management, OTS encourages you to meet with the boards of directors. It is important to communicate with savings association boards following a comprehensive examination, regardless of the composite rating. Meetings between regulatory staff and the board of directors – the individuals ultimately responsible for a savings association's affairs – serve a variety of functions. They provide opportunity for interaction, and they facilitate long-term communication, especially important when the regulatory process reveals significant adverse information. Meetings help keep directors and regulators mutually informed by providing them an opportunity to discuss any of the following items:

- The examination process and findings.
- The association, its functions, and strategic plans and goals.
- The general financial environment.
- Industry-related concerns.

Meetings give regulators an opportunity to obtain commitments from the board for corrective action.

Types of Meetings

There are two primary types of meetings between regulators and the board: **regular** – those relating to examinations; and **special** – not primarily for presenting examination findings. However, a meeting can serve multiple purposes. For example, a regular meeting can serve to acquaint regulators with the board, enhance communication, and present findings.

Regular Meetings

A regular meeting can result from a comprehensive or limited examination. Generally held at the conclusion of the examination, its primary purpose is to discuss findings and agree on corrective action. These meetings can also enhance the directors' understanding of the regulatory process, establish a rapport, and build lines of communication with regulators.

You should consider attending a regularly scheduled board meeting that occurs during an examination. The purpose is not necessarily to discuss findings although it may be an opportunity to discuss scope and preliminary findings. The main objective; however, is to observe the board in action and establish a rapport.

Generally, you should always meet with the board. While a face-to-face meeting may not be necessary for an association rated 1 or 2, you must make every effort to communicate with the board following each comprehensive examination. A conference call can be an effective option and may enhance the Board's understanding of the regulatory process, as well as bolster lines of communication between the board and regulators.

Always meet face to face if you note adverse trends, increased risk profile, or other matters that need the board's attention. You must meet face to face with the board of directors if the association has:

- A CAMELS composite or Compliance rating of 3, 4 or 5.
- A Holding Company rating of Unsatisfactory.

If an association's assets exceed $1 billion, you should meet face to face with the board regardless of adverse trends.

While you normally meet after the examination, you could arrange a regular meeting during the last week. This is appropriate if you have already discussed the examination results with management. Your meeting can also coincide with the board's next regularly scheduled meeting. You can mutually agree on another time to meet as long as that date is within 60 days of completing the examination. Also when scheduling, consider whether directors would benefit from receiving a copy of the final ROE before the meeting.

Participation

When meeting with the board, you should meet with the entire board to ensure all directors are aware of regulatory findings and commitments to correct deficiencies. If all directors cannot attend, you can meet with a group, such as the audit, examination, or executive committee if:

- Outside directors are present.
- There are no material or adverse findings.
- The circumstances do not require a full board.

Honorary directors can participate in meeting discussions, but may not vote. Any person or organization connected with the association, auditor, or holding company representative can attend the meeting upon board resolution. However, you can excuse such people if appropriate. As a rule, state supervisory authorities should attend meetings with the boards of state-chartered institutions.

Special Meetings

Reasons to schedule a special meeting include the following:

- To effect a supervisory action, such as a supervisory agreement or cease and desist order.
- To gather information in order to act on a proposal, application, or request by the association.
- To discuss an association's progress toward corrective action.
- To become acquainted following a change in directorate or a change in regulatory staff.

- To comply with directorate's request to meet.

Meeting Preparation, Presentation, and Documentation

Schedule a mutually acceptable, convenient date and time to hold the meeting. Prepare yourself thoroughly when meeting with the directorate. Conduct yourself professionally and prepare sufficient documentation to ensure appropriate follow-up. A successful meeting will include all of the following steps:

- **Preparation**

  — Ensure that the scheduling and selection of attendees satisfies the meeting's goal.

  — Choose attendees and determine their responsibilities.

  — Select a chairperson.

  — Determine time and location.

  — Develop an agenda.

  — Notify participants of the meeting and its purpose.

  — Meet with regulatory staff participants to discuss the agenda and other related issues.

  — Prepare and organize supporting data, including comparative figures and ratios that indicate trends and graphs to illustrate significant points or trends.

  — Prepare any handouts or overheads for presentation.

- **Presentation**

  — Conduct the meeting in a professional, objective fashion.

  — Present the agenda and follow it within reason.

  — Establish good communication and maintain creditability.

  — Encourage directors' involvement and solicit questions.

  — Answer questions accurately. When unable to do so, tell the board you will find an answer. You may need to refer inquiries to the OTS regional or Washington office.

  — Obtain commitment from board to correct deficiencies, if appropriate.

- **Documentation**
  - — Evaluate and document results of the meeting.
  - — Prepare a memorandum to record results, date, time, location, and participant's names and titles.
  - — Describe the items discussed, the board's reactions, and any commitments for corrective action.
  - — If the board promises corrective action, send the memorandum to them for concurrence.
  - — At the conclusion of any meeting conducted by the board (rather than the regulators), you should ask for a copy of the minutes and review them for accuracy.
  - — Keep a copy of the post-meeting memorandum and agenda in the appropriate supervisory file.
  - — Amend the association's regulatory profile to reflect any changes or future commitments as a result of the meeting.

REFERENCES

Code of Federal Regulations (12 CFR)

OTS Regulations

§ 502.10	Assessments
§ 562.4	Audit of Savings Associations and Holding Companies
§ 563.161	Management and Financial Policies
§ 563.41	Transactions With Affiliates
§ 563.550	Notice of Change of Directors or Senior Executive Officer
§ 565.4	Capital Measures and Capital Category Definitions

FDIC Regulations

Part 327	Assessments
§ 337.6	Brokered Deposits

Office of Thrift Supervision CEO Memos and Bulletins

CEO 212	Interagency Advisory on the Confidentiality of the CAMELS Rating and Other Nonpublic Supervisory Information
CEO 342	Interagency Policy Statement on Funding and Liquidity Risk Management
RB 3b	Policy Statement on Growth for Insured Institutions
RB 18	General Enforcement Policy Series
TB 13a	Management of Interest Rate Risk, Investment Securities, and Derivative Activities
TB 48-27	Assessments and Fees Under 12 CFR Part 502
TB 48-29	Assessments and Fees Under 12 CFR Part 502
TB 68b	Appeals and Ombudsman Matters

Other References

FFIEC Press Release, Uniform Financial Institutions Rating System, December 19, 1996

OTS Transmittal 166: Regulatory Citations to UFIRS