

The image shows the exterior of a large, classical-style building, identified as the Sixth Federal Reserve District. In the foreground, a large, light-colored marble pillar stands prominently. The pillar has the words "SIXTH FEDERAL RESERVE DISTRICT" engraved on it in a serif font. The building behind it is multi-storied with many windows and classical architectural elements like columns. The sky is clear and blue, and other modern buildings are visible in the background.

SIXTH
FEDERAL RESERVE
DISTRICT

Federal Reserve Bank of Atlanta

Highlights of the Supervisory Process for Community Banking Organizations

Welcome to the Federal Reserve System. The Federal Reserve has been in the business of ensuring the safety and soundness of financial institutions since it was founded by Congress in 1913. Through its decentralized structure, evolving use of technology, continuing examiner education programs, and partnership with state regulators, the Federal Reserve provides its state member banks with a supervisory process that is anticipatory, responsive, efficient, and of the highest quality.

BOARD OF GOVERNORS STRUCTURE AND RESERVE BANK STRUCTURE

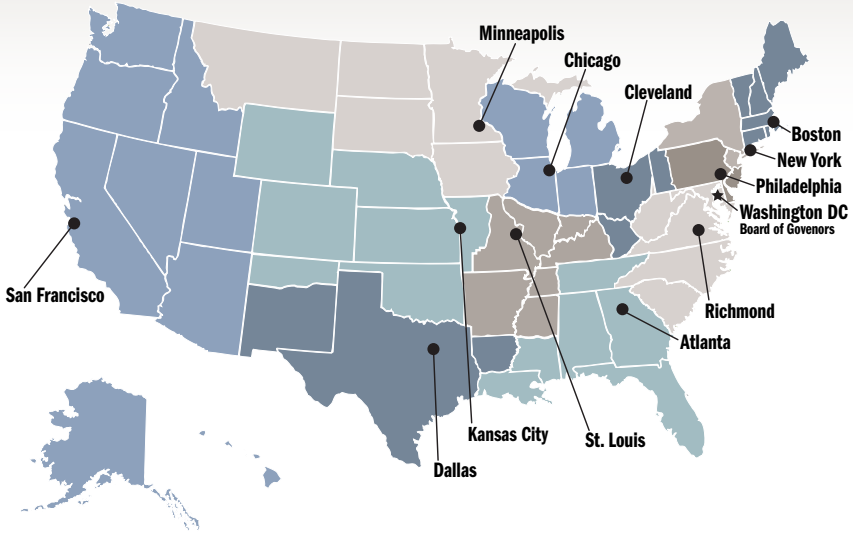
Congress designed the structure of the Federal Reserve System to give it a broad perspective on the economy and on economic activity in all parts of the nation. It is a federal system, composed of a central, governmental agency—the Board of Governors in Washington, DC—and 12 regional Federal Reserve Banks, including the Federal Reserve Bank of Atlanta (the Atlanta Fed). The Atlanta Fed footprint covers the Sixth Federal Reserve District, which includes Alabama, Florida, and Georgia, and portions of Louisiana, Mississippi, and Tennessee. (See map on page 2.)

The Atlanta Fed and the other Reserve Banks play an important role in all three of the Federal Reserve's functions: monetary policy, bank supervision and regulation, and the operation of a nationwide payment system.

SIXTH DISTRICT SUPERVISION AND REGULATION ORGANIZATIONAL STRUCTURE OVERVIEW

The Atlanta Fed's Supervision and Regulation (S&R) Division is responsible for promoting the safety and soundness of the banking system, fostering stability in financial markets, ensuring compliance with applicable laws and regulations, and encouraging banking institutions to responsibly meet the financial needs of their communities. The S&R Division is divided into four main supervisory areas: community banking, large and regional banking, international banking, and consumer compliance. These functional areas are supported by risk specialty teams, including credit, capital assessment, market and liquidity, information technology (IT), Bank Secrecy Act/Anti-Money Laundering (BSA/AML), and operational risk and fiduciary activities. Members of these teams have extensive experience in their areas of expertise and, along with other subject matter experts at each of the other 11 Reserve Banks and the Board of Governors, can be relied on to provide a horizontal perspective on current and emerging risks and to provide technical assistance on individual bank examinations. The Atlanta Fed also has the Center for Real Estate Analytics, which provides information and research highlighting and defining real estate activity within the Sixth District and on the national landscape.

The Atlanta Fed's S&R Division's community banking area is responsible for supervising state member banks with assets of less than \$10 billion. The area has dedicated case managers who are responsible for executing the supervisory program, conducting continuous



monitoring activities, and serving as the primary point of contact for an assigned portfolio of state member banking organizations. Bankers also have ready access to the Reserve Bank community banking officers who have direct responsibility for their institution. Such a structure provides continuity for bankers and allows for the building of solid relationships. Examination staff report to staff managers, who are responsible for executing a career development and performance management program for assigned staff to ensure that skillsets remain commensurate with current and emerging banking industry activities and risks.

The community banking area also works closely with other areas in the S&R Division, such as consumer compliance and applications, to ensure that a state member bank's needs are identified and discussed across various business lines. Moreover, for those state member banks that are owned by a bank or financial holding company, an inspection of the holding company is usually conducted in conjunction with the state member bank examination, or offsite shortly thereafter, promoting a consistent supervisory approach for the entire organization and reducing the regulatory burden on bank management.

SUPERVISORY PROCESS

The supervisory process entails both onsite and offsite examination activities conducted by examination staff and offsite continuous monitoring conducted by case managers. Continuous monitoring activities typically occur quarterly and include reviews of regulatory data and institution-specific internal management reports, follow-up on outstanding supervisory issues, and meetings with management.

Typically, state member banks have an onsite full-scope examination at least once every 12 months. State member banks that have assets of less than \$250 million and that meet certain criteria may be examined once every 18 months. Banks in less-than-satisfactory condition are usually examined on a six-month cycle. The Federal Reserve coordinates its examinations with those of the bank's chartering state and may alternate examination cycles with the bank's state supervisor. In the case of larger community banks and those that have significant risk profiles, joint examinations are conducted with both the Atlanta Fed and the applicable state agency participating on the examination. Banks are assigned various ratings at each full-scope examination as described below.

The main objective of the supervisory process is to evaluate the overall safety and soundness of the banking organization, which includes an assessment of the bank's financial condition, risk management systems, and compliance with applicable banking laws and regulations. Each bank is assigned a composite rating based on an evaluation and rating of six essential components. This rating is known as the "CAMELS" rating, which is explained in the Federal Reserve's Supervision and Regulation (SR) Letter 96-38, "Uniform Financial Institutions Rating System." These six components address the adequacy of capital (C), quality of assets (A), management and administration (M), quality and level of earnings (E), adequacy of liquidity (L), and sensitivity to market risk (S). These six component factors focus on both financial performance and risk management elements.

Each bank is also assigned a separate risk management rating, which is described in SR Letter 95-51, "Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies." Risk management systems are evaluated against factors necessary to operate the bank in a safe and sound manner and their ability to identify, measure, monitor, and control risks of the institution's activities. When rating the quality of risk management at state member banks, examiners

place primary consideration on findings relating to the following elements of a sound risk management system: active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls. Principles of sound risk management apply to the entire spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risks.

An information technology, or “URSIT,” rating is also assigned at each full-scope bank examination led by the Reserve Bank. This rating system, which is described in SR Letter 99-8, “Uniform Rating System for Information Technology,” consists of a composite rating based on an evaluation of four component ratings: audit, management, development and acquisition, and support and delivery. A full URSIT rating is assigned for those banks with inhouse IT operations. Banks that outsource IT activities are assigned a composite rating only. Even when an institution outsources certain aspects or all of its technology operations, it is still responsible for overseeing the vendor to ensure that its activities are conducted in a safe and sound manner and in compliance with applicable laws and regulations, just as if the institution were performing the activities inhouse. Management can request examination reports for technology service providers and multiregional data processing servicers supervised by the Federal Financial Institutions Examination Council (FFIEC) as another data source in executing its oversight responsibilities for its third-party vendors. Requests can be coordinated by an institution’s Reserve Bank case manager.

All component and composite ratings are based on a 1 to 5 numerical scale. A 1 is the highest rating, indicating the strongest performance and risk management practices and the least degree of supervisory concern. A 5 is the lowest rating, indicating the weakest performance, inadequate risk management practices, and the highest degree of supervisory concern. Evaluations of all the rating components take into consideration an institution’s size and sophistication, the nature and complexity of its activities, and its risk profile. Refer to the above-referenced SR letters for specific rating definitions.

Most examinations are announced in advance, although a Reserve Bank can conduct surprise examinations. Prior to the start of the examination, management is asked to respond to a first-day letter and questionnaire that requests information necessary to conduct the examination. Examination activities are performed both onsite and offsite.

Examinations typically last for two weeks or more if the bank is large, has significant operations, or is in troubled condition. Once the examination is complete, an informal discussion is typically held with management on the last day onsite to discuss preliminary examination findings. After discussions are conducted within the Reserve Bank to ensure consistency in approach and appropriate application of ratings, a final exit meeting is held with management to discuss the examination findings and the bank's CAMELS, risk management, and IT ratings. The board of directors plays an essential role in managing a bank's operations and is directly responsible for the soundness of a bank. If an examination finds significant problems, the bank is in deteriorating or less than satisfactory condition, or the bank is operating under a supervisory enforcement action, a meeting is also usually held with the bank's board of directors.

Additional details on various specialty areas, including those for BSA/AML, consumer compliance, and the Community Reinvestment Act, can be found in the next section, "Helpful References."

HELPFUL REFERENCES

- **Board of Governors of the Federal Reserve System:** www.federalreserve.gov
 - SR letters: www.federalreserve.gov/bankinforeg/topics/topics.htm
 - Supervision manuals: www.federalreserve.gov/boarddocs/supmanual/
Includes links to the Bank Holding Company Supervision Manual, the BSA/AML Examination Manual, the Commercial Bank Examination Manual, the Consumer Compliance Handbook, the FFIEC IT Examination Handbook, and the Trading & Capital Markets Activities Manual.
 - Regulations: www.federalreserve.gov/bankinforeg/reglisting.htm
 - Community Reinvestment Act: www.federalreserve.gov/communitydev/cra_about.htm
 - Community Banking Connections, a quarterly Federal Reserve System publication dedicated to addressing current banking issues: www.communitybanking-connections.org/

- **Federal Reserve Bank of Atlanta:** www.frbatlanta.org/
 - Key Reserve Bank S&R contacts: www.frbatlanta.org/banking/sr/sr_contacts.cfm
 - Financial Update, a quarterly publication with articles of interest to the banking community: www.frbatlanta.org/pubs/financialupdate/
 - Center for Real Estate Analytics: www.frbatlanta.org/realestateanalytics/

- **Federal Financial Institutions Examination Council:** www.ffiec.gov
 - Includes links to the Uniform Bank Performance Report (UBPR), the BSA/AML InfoBase, and the IT Handbook InfoBase.

- **United States Department of the Treasury – Office of Financial Assets Control (OFAC)**
 - www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx

- **United States Department of Treasury – Financial Crimes Enforcement Network (FinCEN)**
 - BSA statutes and regulations: www.fincen.gov/statutes_regs/bsa/
 - BSA Reporting Forms: www.fincen.gov/forms/bsa_forms/

- **Conference of State Bank Supervisors:** www.csbs.org/Pages/default.aspx

For more banking information
and resources visit

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