ARKANSAS STATE BANK DEPARTMENT
EXAMINATION POLICY

Policy Number	05-01
Effective Date	07-18-05
Supersedes	96-03
Approval	

SUBJECT: **Disclosure of Bank Holding Company Ratings**

The Arkansas State Bank Department ("ASBD") has revised its approach to examining bank holding companies ("BHC") to comply with revisions made by the Board of Governors of the Federal Reserve System, which will be applied to all BHC examinations beginning on or after January 1, 2005. Under the new approach, ASBD holding company examinations will incorporate increased emphasis on risk management, a more flexible and comprehensive evaluation of financial condition, and an explicit determination of the likelihood that nondepository institutions of a holding company will have a significant impact on depository subsidiaries.

Each holding company's Board of Directors will be advised of the assigned rating in the examination report. The holding company rating will not be a matter of public information. The rating disclosed in the examination report is that assigned by the Examiner in Charge and approved by supervisory personnel and the Bank Commissioner as a result of an independent examination by the Arkansas State Bank Department or as a result of a joint or concurrent examination in which the Arkansas State Bank Department participated.

The BHC rating system takes into consideration certain financial, managerial, and compliance factors that are common to all BHCs. Under this system, ASBD and Federal Reserve Bank of St. Louis ("Federal Reserve") endeavor to ensure that all BHCs are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on the BHCs exhibiting financial and operational weaknesses or adverse trends. The rating system serves as a useful vehicle for identifying problem or deteriorating BHCs, as well as for categorizing BHCs with deficiencies in particular areas. Further, the rating system assists ASBD and Federal Reserve in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry.

Each BHC is assigned a composite rating (C) based on an evaluation and rating of its managerial and financial condition and an assessment of future potential risk to its subsidiary depository institution(s). The main components of the rating system represent: Risk Management (R); Financial Condition (F); and potential Impact (I) of the parent company and nondepository subsidiaries (collectively nondepository entities) on the subsidiary depository institutions. While ASBD and the Federal Reserve expect all bank holding companies to act as a source of strength to their subsidiary depository institutions, the Impact rating focuses on downside risk--that is, on the likelihood of significant negative impact by the nondepository entities on the subsidiary depository institution. A fourth component rating, Depository Institution (D), will generally mirror the primary regulator's assessment of the subsidiary depository institutions. Thus, the primary component and composite ratings are displayed:

R F I / C (D)

In order to provide a consistent framework for assessing risk management, the R component is supported by four subcomponents that reflect the effectiveness of the banking organization's risk management and controls. The subcomponents are: Board and Senior Management Oversight; Policies, Procedures, and Limits; Risk Monitoring and Management Information Systems; and Internal Controls. The F component is similarly supported by four subcomponents reflecting an assessment of the quality of the banking organization's Capital; Asset quality; Earnings; and Liquidity.

A simplified version of the rating system that requires only the assignment of the risk management component rating and composite rating will be applied to noncomplex BHC's with assets below $1 billion.

Composite, component, and subcomponent ratings are assigned based on a 1 to 5 numerical scale. A 1 numeric rating indicates the highest rating, strongest performance and practices, and least degree of supervisory concern, whereas a 5 numeric rating indicates the lowest rating, weakest performance, and the highest degree of supervisory concern.

The composite rating generally bears a close relationship to the component ratings assigned. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation of the BHC. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the BHC. Therefore, the composite rating is not derived by computing the arithmetic average of the component ratings. Nevertheless, the composite rating generally bears a close relationship to the component ratings assigned.

The following three sections contain detailed descriptions of the composite, component, and subcomponent ratings, definitions of the ratings, and implementation guidance by BHC type.

I. Description of the Rating System Elements
The "R" (Risk Management) Component

- R represents an evaluation of the ability of the BHC's Board of directors and senior management, as appropriate for their respective positions, to identify, measure, monitor, and control risk. The R rating underscores the importance of the control environment, taking into consideration the complexity of the organization and the risk inherent in its activities.
- The R rating is supported by four subcomponents that are each assigned a separate rating. The four subcomponents are as follows: 1) Board and Senior Management Oversight; 2) Policies, Procedures and Limits; 3) Risk Monitoring and Management Information

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Systems; and 4) Internal Controls. The subcomponents are evaluated in the context of the risks undertaken by and inherent to a banking organization and the overall level of complexity of the firm's operations.

RISK MANAGEMENT SUBCOMPONENTS

Board and Senior Management Oversight
This subcomponent evaluates the adequacy and effectiveness of Board and senior management's understanding and management of risk inherent in the BHC's activities, as well as the general capabilities of management. It also includes consideration of management's ability to identify and understand the risks undertaken by the institution, to hire competent staff, and to respond to changes in the institution's risk profile or innovations in the banking sector.

Policies, Procedures and Limits
This subcomponent evaluates the adequacy of a BHC's policies, procedures, and limits given the risks inherent in the activities of the consolidated BHC and the organization's stated goals and objectives. This analysis will include consideration of the adequacy of the institution's accounting and risk disclosure policies and procedures.

Risk Monitoring and Management Information Systems
This subcomponent assesses the adequacy of a BHC's risk measurement and monitoring, and the adequacy of its management reports and information systems. This analysis will include a review of the assumptions, data and procedures used to measure risk and the consistency of these tools with the level of complexity of the organization's activities.

Internal Controls
This subcomponent evaluates the adequacy of a BHC's internal controls and internal audit procedures, including the accuracy of financial reporting and disclosure and the strength and influence, within the organization, of the internal audit team. This analysis will also include a review of the independence of control areas from management and the consistency of the scope coverage of the internal audit team with the complexity of the organization.

The "F" (Financial Condition) Component

- F represents an evaluation of the consolidated organization's financial strength. The F rating focuses on the ability of the BHC's resources to support the level of risk associated with its activities.
- The F rating is supported by four subcomponents: C (capital), A (asset quality), E (earnings), and L (liquidity). The CAEL subcomponents can be evaluated along individual business lines, product lines, or on a legal entity basis, depending on what is most appropriate given

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the structure of the organization. The assessment of the CAEL components will utilize benchmarks and metrics appropriate to the business activity being evaluated.

Financial Condition Subcomponents (CAEL)

In evaluating each of the CAEL subcomponents, examination staff will continue to review relevant market indicators, such as equity and debt prices, external debt ratings, credit spreads, and qualitative rating agency assessments as a source of information complementary to examination findings.

Capital Adequacy

C reflects the adequacy of an organization's consolidated capital position, from a regulatory capital perspective and an economic capital perspective, as appropriate to the BHC (*refer to 12 CFR 225, Appendices A and D for regulatory minimum capital ratios for BHCs*). The evaluation of capital adequacy should consider the risk inherent in an organization's activities and the ability of capital to absorb unanticipated losses, to provide a base for growth, and to support the level and composition of the parent company and subsidiaries' debt.

Asset Quality

A reflects the quality of an organization's consolidated assets. The evaluation should include, as appropriate, both on-balance sheet and off-balance sheet exposures, and the level of criticized and nonperforming assets. Forward-looking indicators of asset quality, such as the adequacy of underwriting standards, the level of concentration risk, the adequacy of credit administration policies and procedures, and the adequacy of management information systems for credit risk, are also evaluated.

Earnings

E reflects the quality of consolidated earnings. The evaluation considers the level, trend, and sources of earnings, as well as the ability of earnings to augment capital as necessary, to provide ongoing support for a BHC's activities.

Liquidity

L reflects the consolidated organization's ability to attract and maintain the sources of funds necessary to support its operations and meet its obligations. The funding conditions for each of the material legal entities in the holding company structure will be evaluated to determine if any weaknesses exist that could affect the funding profile of the consolidated organization.

The "I" (Impact) Component

The I component is rated on a five-point numerical scale. However, the descriptive definitions of the numerical ratings for I are different than those of the other components and subcomponents. I Ratings are defined as follows:

1 – low likelihood of significant negative impact;
2 – limited likelihood of significant negative impact;
3 – moderate likelihood of significant negative impact;
4 – considerable likelihood of significant negative impact; and
5 – high likelihood of significant negative impact.

The I component is an assessment of the potential impact of the nondepository entities on the subsidiary depository institution(s). The I assessment will evaluate both the risk management practices and financial condition of the nondepository entities--an analysis that will borrow heavily from the analysis conducted for the R and F components. Consistent with current practices, nondepository entities will be evaluated using benchmarks and analysis appropriate for those businesses. In addition, for functionally regulated nondepository subsidiaries, examination staff will continue to rely, to the extent possible, on the work of those functional regulators to assess the risk management practices and financial condition of those entities. In rating the I component, examination staff is required to evaluate the degree to which current or potential issues within the nondepository entities present a threat to the safety and soundness of the subsidiary depository institution(s). In this regard, the I component will give a clearer indication of the degree of risk posed by the nondepository entity(ies) to the federal safety net than does the current rating system.

The I component focuses on the aggregate impact of the nondepository entities on the subsidiary depository institution(s). In this regard, the I rating does not include individual subcomponent ratings for the parent company and nondepository subsidiaries. Any risk management and financial issues at the parent company and/or nondepository subsidiaries that potentially impact the safety and soundness of the subsidiary depository institution(s) will be identified in the written comments under the I rating. As a general rule, nondepository subsidiaries will be included in the I analysis whenever their assets exceed five percent of the BHC's consolidated capital or $10 million, whichever is lower.
The analysis of the parent company for the purpose of assigning an I rating will emphasize weaknesses that could directly impact the risk management or financial condition of the subsidiary depository institution(s). Similarly, the analysis of the nondepository subsidiaries for the purpose of assigning an I rating will emphasize weaknesses that could negatively impact the parent company's relationship with its subsidiary depository institution(s) and weaknesses that have a direct impact on the risk management practices or financial condition of the subsidiary depository institution(s). The analysis under the I component considers existing as well as

potential issues and risks that may impact the subsidiary depository institution(s) now or in the future.

The following risk management and financial factors are considered in assigning the I rating:

Risk Management Factors
- *Strategic Considerations*: The potential risks posed to the subsidiary depository institution(s) by the nondepository entities' plans for growth in existing activities and expansion into new products and services;
- *Operational Considerations*: The spillover impact on the subsidiary depository institution(s) from actual losses, a poor control environment, or an operational loss history in the nondepository entities;
- *Legal and Reputational Considerations*: The spillover effect on the subsidiary depository institution(s) of complaints and litigation that name one or more of the nondepository entities as defendants, or violations of laws or regulations, especially pertaining to intercompany transactions where the subsidiary depository institution(s) is involved; and,
- *Concentration Considerations*: The potential risks posed to the subsidiary depository institution(s) by concentrations within the nondepository entities in business lines, geographic areas, industries, customers, or other factors.

Financial Factors
- *Capital Distribution*: The distribution and transferability of capital across the legal entities;
- *Intra-Group Exposures*: The extent to which intra-group exposures, including servicing agreements, have the potential to undermine the condition of subsidiary depository institution(s); and,
- *Parent Company Cash Flow and Leverage*: The extent to which the parent company is dependent on dividend payments, from both the nondepository subsidiaries and the subsidiary depository institution(s), to service debt and cover fixed charges. Also, the effect that these upstreamed cash flows have had, or can be expected to have, on the financial condition of the BHC's nondepository subsidiaries and subsidiary depository institution(s).

The "C" (Composite) Rating

C is the overall composite assessment of the BHC as reflected by consolidated risk management, consolidated financial strength, and the potential impact of the nondepository entities on the subsidiary depository institution(s). The composite rating encompasses both a forward-looking and static assessment of the consolidated organization, as well as an assessment of the relationship between the depository and nondepository entities. The C rating is not derived as a simple numeric average of the R, F, and I components; but rather it reflects examiner judgment with respect to the relative importance of each component to the safe and sound operation of the BHC.

The "(D)" (Depository Institutions) Component

The (D) component will generally reflect the composite CAMELS rating assigned by the subsidiary depository institution's primary regulator. In a multi-bank BHC, the (D) rating will reflect a weighted average of the CAMELS composite ratings of the individual subsidiary depository institutions, weighted by both asset size and the relative importance of each depository institution within the holding company structure. In this regard, the CAMELS composite rating for a subsidiary depository institution that dominates the corporate culture may figure more prominently in the assignment of the (D) rating than would be dictated by asset size, particularly when problems exist within that depository institution.

To highlight the presence of one or more problem depository institution(s) in a multi-bank BHC whose depository institution component, based on weighted averages, might not otherwise reveal their presence (i.e., depository institution ratings of 1, 2 or 3), a problem modifier, "P" will be attached to the depository institution rating (e.g., 1P, 2P, or 3P). Thus, 2P would indicate that, while on balance the depository subsidiaries are rated satisfactory, there exists a problem depository institution (composite 4 or 5) among the subsidiary depository institutions. The problem identifier is unnecessary when the **D** component is rated 4 or 5.

II. Implementation of BHC Rating System by Bank Holding Company Type

Arkansas State Bank Department's revision of the BHC rating system was driven by the need to align the rating system with current Federal Reserve supervisory practices. The rating system will require analysis and support similar to that required by the former BOPEC rating system for BHCs of all sizes. As such, the level of analysis and support will vary based upon whether a BHC has been determined to be "complex" or "noncomplex." In addition, the resources dedicated to the examination of each BHC will continue to be determined by the risk posed by the subsidiary depository institution(s) to the federal safety net (defined as the deposit insurance fund, the payments systems, and the Federal Reserve's discount window) and the risk posed by the BHC to the subsidiary depository institution(s).

NONCOMPLEX BHCS WITH ASSETS OF $1 BILLION OR LESS (SHELL HOLDING COMPANIES)

Rating: R and C
Consistent with SR 02-1, examination staff will assign only an R and C rating for all companies in the shell BHC program (noncomplex BHCs with assets under $1 billion). The R rating is the

M rating from the subsidiary depository institution's CAMELS rating. The C rating is the subsidiary depository institution's composite CAMELS rating.

NONCOMPLEX BHCS WITH ASSETS GREATER THAN $1 BILLION

One-Bank Holding Company
Rating: RFI/C (D)
For all noncomplex, one-bank holding companies with assets of greater than $1 billion, examination staff will assign all component and subcomponent ratings; however, examination staff will continue to rely heavily on information and analysis contained in the report of examination for the subsidiary depository institution to assign the R and F ratings. If examination staff have reviewed the primary regulator's examination report and are comfortable with the analysis and conclusions contained in that report, then the BHC ratings should be supported with concise language that indicates that the conclusions are based on the analysis of the primary regulator. No additional analysis will be required.

Please note, however, in cases where the analysis and conclusions of the primary regulator are insufficient to assign the ratings, the primary regulator will be contacted to ascertain whether additional analysis and support may be available. Further, if discussions with the primary regulator do not provide sufficient information to assign the ratings, discussions with BHC management may be warranted to obtain adequate information to assign the ratings. In most cases, additional information or support obtained through these steps will be sufficient to permit the assignment of the R and F ratings. To the extent that additional analysis is deemed necessary, the level of analysis and resources spent on this assessment should be in line with the level of risk the subsidiary depository institution poses to the federal safety net. In addition, any activities that involve information gathering with respect to the subsidiary depository institution should be coordinated with and, if possible, conducted by, the primary regulator of that institution.

Examination staff will be required to make an independent assessment in order to assign the I rating, which provides an evaluation of the impact of the BHC on the subsidiary depository institution. Analysis for the I rating in non-complex one-bank holding companies should place particular emphasis on issues related to parent company cash flow and compliance with Sections 23A and 23B of the Federal Reserve Act, as implemented by Regulation W.

Multi-Bank Holding Company Rating: RFI/C (D)
For all noncomplex BHCs with assets of greater than $1 billion and having more than one subsidiary depository institution, examination staff will assign all component and subcomponent ratings of the new system. Examiners will rely, to the extent possible, on the work conducted by the primary bank regulators to assign the R and F ratings. However, any risk management or other important functions conducted by the nondepository entities of the BHC, or conducted

across legal entity lines, should be subject to review by ASBD and/or Federal Reserve examination staff. These reviews should be conducted in coordination with the primary regulator(s). The assessment for the I rating will require an independent assessment by ASBD or Federal Reserve examination staff.

COMPLEX BHCs

Rating: RFI/C (D)
For complex BHCs, examination staff will assign all component and subcomponent ratings of the new rating system. The ratings analysis should be based on the primary and functional regulators' assessment of the subsidiary entities, as well as on the examiners' assessment of the consolidated organization as determined through the BHC examination process. The resources needed for the examination and the level of support needed for developing a full rating will depend upon the complexity of the organization, including structure and activities, and should be commensurate with the level of risk posed by the subsidiary depository institution(s) to the federal safety net and the level of risk posed by the BHC to the subsidiary depository institution(s).

NONTRADITIONAL BHCs

Rating: RFI/C (D)
Examination staff will be required to assign the full rating system for nontraditional BHCs. Nontraditional BHCs include BHCs in which most or all nondepository operations are regulated by a functional regulator and in which the subsidiary depository institution(s) are small in relation to the nondepository entities. The rating system is not intended to introduce significant additional work in the rating process for these organizations. As discussed above, the level of analysis conducted and resources needed to examine the BHC and to assign the consolidated R and F ratings should be commensurate with the level of risk posed by the subsidiary depository institution(s) to the federal safety net and the level of risk posed by the BHC to the subsidiary depository institution(s). The report of examination by, and other information obtained from, the functional and primary bank regulators should provide the basis for the consolidated R and F ratings. On-site work, to the extent it involves areas that are the primary responsibility of the functional or primary bank regulator, should be coordinated with and, if possible, conducted by, those regulators. Examination staff should concentrate their independent analysis for the R and F ratings around activities and risk management conducted by the parent company and non-functionally regulated nondepository subsidiaries, as well as around activities and risk management functions that are related to the subsidiary depository institution(s), for example, audit functions for the depository institution(s) and compliance with Sections 23A and 23B of the Federal Reserve Act, as implemented by Regulation W.

III. Rating Definitions for the RFI/C (D) Rating System

All component and subcomponent ratings are rated on a five-point numerical scale, with the exception of the I component, ratings will be assigned in ascending order of supervisory concern as follows:
1 – Strong; 2 – Satisfactory; 3 – Fair; 4 – Marginal; and 5 – Unsatisfactory.

A description of the I component ratings is in the I section below.

RISK MANAGEMENT COMPONENT

Rating 1 (Strong). A rating of 1 indicates that management effectively identifies and controls all major types of risk posed by the BHC's activities. The board and senior management are active participants in monitoring risk. Management ensures that appropriate policies and limits are understood, reviewed, and approved by the board of directors. Policies and limits are supported by risk monitoring procedures, reports, and management information systems. The board and senior management are provided with the necessary information to make timely and appropriate decisions in response to changing conditions. Risk management practices are fully effective in identifying, monitoring, and controlling the risks to the institution. Internal controls and audit procedures are sufficiently comprehensive and appropriate to the size and activities of the institution.

Internal controls and audit procedures are sufficiently comprehensive and appropriate to the size and activities of the institution. There are few noted exceptions to the institution's established policies and procedures, and none is material. Management effectively and accurately monitors the condition of the institution consistent with the standards of safety and soundness, and in accordance with internal and supervisory policies and practices. Risk management processes are fully effective in identifying, monitoring, and controlling the risks to the institution.

Rating 2 (Satisfactory). A rating of 2 indicates that the institution's management of risk is largely effective, but lacking to some modest degree. Management demonstrates a responsiveness and ability to cope successfully with existing and foreseeable risks. While the institution may have some minor risk management weaknesses, problems are generally being resolved. Board and senior management oversight, policies, risk monitoring procedures, and management information systems are considered satisfactory and effective. Internal controls may display modest weaknesses, but are correctable in the normal course of business. Risks are controlled in a manner that requires only normal supervisory attention.

The BHC's risk management practices and infrastructure are satisfactory and generally are adjusted appropriately in response to changing industry practices and current regulatory guidance. Staff experience, expertise and depth are generally appropriate to manage the risks assumed by the institution.

Internal controls may display modest weaknesses or deficiencies, but they are correctable in the normal course of business. The examiner may have recommendations for improvement, but the weaknesses noted should not have a significant effect on the safety and soundness of the institution.

Rating 3 (Fair). A rating of 3 signifies that risk management practices are lacking to some degree and require more than normal supervisory attention. One or more of the four elements of sound risk management (board/senior management oversight; policies/procedures, risk management monitoring/management information systems; and internal controls) is considered less than acceptable. Certain risk management practices are in need of improvement to ensure that the board and senior management are able to identify, monitor, and control all significant risks to the institution. The risks associated with the noted weaknesses could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

The internal control system may be lacking in some important aspects, particularly as indicated by continued control exceptions or by a failure to adhere to written policies and procedures. The risk management weaknesses could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

Rating 4(Marginal). A rating of 4 represents risk management practices that fail to properly identify, monitor, and control risk exposure. Generally, such a situation reflects inadequate guidance and supervision by the board and senior management. One or more of the four elements of sound risk management (board/senior management oversight; policies/procedures, risk management monitoring/management information systems; and internal controls) is deficient and requires immediate corrective action. Unless properly addressed, these conditions could seriously affect the safety and soundness of the institution.

The institution may have serious identified weaknesses, such as an inadequate separation of duties, that require substantial improvement in internal control or accounting procedures, or improved adherence to supervisory standards or requirements. The risk management deficiencies warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

Rating 5 (Unsatisfactory). A rating of 5 indicates a critical absence of effective risk management practices with respect to the identifying, monitoring, or controlling risk exposure. One or more of the four elements of sound risk management (board/senior management oversight;

policies/procedures, risk management monitoring/management information systems; and internal controls) is considered wholly deficient. The board and senior management have not demonstrated the capability to address these deficiencies. Internal controls are critically weak and could seriously jeopardize the continued viability of the institution. Deficiencies in the institution's risk management procedures require immediate and close supervisory attention.

Internal controls are critically weak and, as such, could seriously jeopardize the continued viability of the institution. I f not already evident, there is an immediate concern as to the reliability of accounting records and regulatory reports and the potential for losses if corrective measures are not taken immediately. Deficiencies in the institution's risk management procedures and internal controls require immediate and close supervisory attention.

RISK MANAGEMENT SUBCOMONENTS

BOARD AND SENIOR MANAGEMENT OVERSIGHT

Rating 1 (Strong). An assessment of Strong indicates that the board and senior management clearly understand the types of risk inherent in the BHC's activities and actively participate in managing those risks. Consistent with the standards of safety and soundness, oversight of risk management practices is considered strong. The board has approved appropriate policies and business strategies, and ensures that management is fully capable of guiding the BHC. Management provides effective supervision of the day-to-day activities of officers and employees. There is a sufficient depth of staff to ensure sound operations and compliance with laws and regulations.

Management provides effective supervision of the day-to-day activities of all officers and employees, including the supervision of the senior officers and the heads of business lines. Staff is hired that possess experience and expertise consistent with the scope and complexity of the organization's business activities. There is a sufficient depth of staff to ensure sound operations. Management ensures compliance with laws and regulations and that employees have the integrity, ethical values, and competence consistent with a prudent management philosophy and operating style.

Management responds appropriately to changes in the marketplace. It identifies all risks associated with new activities or products before they are launched, and ensures that the appropriate infrastructure and internal controls are established.

Rating 2 (Satisfactory). An assessment of Satisfactory indicates that the board and senior management have an adequate understanding of the organization's risk profile and provide generally effective risk management oversight. Risk management practices may be lacking to a modest degree; however, these practices can be adjusted in accordance with regulatory guidance. The board has approved appropriate policies and ensures that management is capable of guiding the BHC. Management's day-to-day supervision is largely effective and the staff's experience, expertise and depth is sufficient to operate in a safe and sound manner. Weaknesses noted are correctable in the normal course of business and should not have a significant effect on the safety and soundness of the institution.

Senior management generally adjusts risk management practices appropriately in accordance with enhancements to industry practices and regulatory guidance, and adjusts exposure limits as necessary to reflect the institution's changing risk profile, although these practices may be lacking in some modest degree. Policies, limits, and tracking reports are generally appropriate, understood, and regularly reviewed, and the new product approval process adequately identifies the associated risks and necessary controls.

Senior management's day-to-day supervision of management and staff at all levels is generally effective. The level of staffing, and its experience, expertise, and depth, is sufficient to operate the business lines in a safe and sound manner. Minor weaknesses may exist in the staffing, infrastructure, and risk management processes for individual business lines or products, but these weaknesses have been identified by management, are correctable in the normal course of business, and are in the process of being addressed. Weaknesses noted should not have a significant effect on the safety and soundness of the institution.

Rating 3 (Fair). An assessment of Fair indicates that board and senior management oversight is lacking to some degree and requires more than normal supervisory attention. Weaknesses in risk management have precluded the institution from fully addressing significant risks to the institution. The deficiencies may include a lack of knowledge with respect to the organization's risk profile, insufficient risk management practices, ineffective policies, inadequate or under-utilized management reporting, or a significant lack of regulatory compliance. The day-to-day supervision of officer activities or the depth and expertise of the staff may be lacking. Certain risk management practices are in need of improvement to ensure that management and the board is able to identify, monitor, and control all significant risks to the institution. Weaknesses noted could adversely affect the safety and soundness of the institution if corrective action is not taken by management.

Rating 4 (Marginal). An assessment of Marginal indicates that the board and senior management oversight is deficient and reflects a lack of adequate guidance and supervision. A number of significant risks to the institution have not been adequately addressed. Multiple board and management weaknesses are in need of immediate improvement. Weaknesses may include inadequate knowledge with respect to the organization's risk profile, insufficient oversight of risk management practices, ineffective policies or limits, inadequate or considerably under-utilized management reporting, or an inability to respond to regulatory guidance. Staff supervision may be lacking and officers may not possess the experience and expertise needed for the scope and complexity of the organization's business activities. These conditions warrant a high degree of supervisory attention and could seriously affect the safety and soundness of the institution if not addressed.

Rating 5 (Unsatisfactory). An assessment of Unsatisfactory indicates a critical absence of effective board and senior management oversight practices. Problems may include a severe lack of knowledge with respect to the organization's risk profile, insufficient oversight of risk management practices, wholly ineffective policies or limits, critically inadequate or under-utilized management reporting, a complete inability to respond to industry enhancements and changes in regulatory guidance, or failure to execute appropriate business strategies. Staffing may be inadequate, inexpert, and/or inadequately supervised. The deficiencies require immediate and close supervisory attention, as management and the board have not demonstrated the capability to address them. Weaknesses could seriously jeopardize the continued viability of the institution.

POLICIES, PROCEDURES AND LIMITS

Rating 1 (Strong). An assessment of Strong indicates that policies, procedures, and limits provide effective identification, measurement, monitoring, and control of the risks posed by all significant activities. Practices are consistent with the institution's goals and overall financial strength. Policies and procedures clearly delineate accountability and lines of authority across the institution's activities. The policies also provide for the review of new activities to ensure that infrastructure is adequate to identify, monitor, and control all risks.

Rating 2 (Satisfactory). An assessment of Satisfactory indicates that adequate policies, procedures and limits are in place to address all major business areas. Policies and procedures are generally consistent with the institution's goals and objectives and its overall financial strength. Any identified deficiencies are minor in nature and correctable in the normal course of business. Weaknesses should not have a significant effect on the safety and soundness of the institution.

Rating 3 (Fair). An assessment of Fair indicates that deficiencies exist in policies, procedures, and limits that require more than normal supervisory attention. Policies and procedures inadequately identify, measure, monitor, or control the risks posed by significant activities. Practices may reflect inadequate staff experience and be inconsistent with the financial strength of the organization. Weaknesses could have an adverse effect on the safety and soundness of the institution unless corrective action is taken by management.

Rating 4 (Marginal). An assessment of Marginal indicates deficient policies, procedures, and limits that do not address a number of significant risks to the institution. Policies and procedures ineffectively identify, measure, monitor, or control the risks posed by significant activities. Multiple practices are in need of immediate improvement. These conditions warrant a high degree of supervisory attention and could seriously affect the safety and soundness of the institution if not addressed.

Rating 5 (Unsatisfactory). An assessment of Unsatisfactory indicates a critical absence of effective policies, procedures, and limits. Practices are largely ineffective with regard to identifying, measuring, monitoring, or controlling the risks posed by significant activities. These deficiencies reflect inadequate staff experience and are inconsistent with a typical financial institution. Critical weaknesses could seriously jeopardize the continued viability of the institution and require immediate and close supervisory attention.

RISK MONITRING AND MIS

Rating 1 (Strong). An assessment of Strong indicates that risk monitoring practices and MIS reports address all material risks. The key assumptions, data sources, and procedures used in measuring and monitoring risk are appropriate, adequately documented, and tested for reliability on an ongoing basis. Reports and other forms of communication are appropriately structured to monitor exposures and compliance with established goals. Management and Board reports are accurate and contain sufficient information to identify adverse trends and to adequately evaluate the level of risk faced by the institution.

Rating 2 (Satisfactory). An assessment of Satisfactory indicates that risk monitoring practices and MIS reports cover major risks, although they may be lacking in some modest degree. In general, the reports contain valid assumptions that are periodically tested for accuracy and properly distributed to appropriate decision-makers. Reports and other forms of communication structured to monitor exposures and compliance with established goals. Identified weaknesses are in the process of being addressed.

Rating 3 (Fair). An assessment of Fair signifies that weaknesses exist in the institution's risk monitoring practices or the MIS reports that require more than normal supervisory attention. Deficiencies may contribute to ineffective risk identification or monitoring through inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. In addition, MIS reports may not be distributed to the appropriate decision-makers, adequately monitor significant risks, or properly identify adverse trends and the level of risk faced by the institution. Weaknesses noted could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

Rating 4 (Marginal). An assessment of Marginal represents deficient risk monitoring practices or MIS reports that could seriously affect the safety and soundness of the institution. A number of significant risks to the institution are not adequately monitored or reported. Ineffective risk identification may result from notably inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. In addition, MIS reports may not be distributed to the appropriate decision-makers, may inadequately monitor significant risks, or fail to identify adverse trends and the level of risk faced by the institution. The risk monitoring and MIS deficiencies warrant a high degree of supervisory attention and could seriously affect the safety and soundness of the institution if not addressed.

Rating 5 (Unsatisfactory). An assessment of Unsatisfactory indicates a critical absence of risk monitoring and MIS. They are wholly deficient due to inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. Moreover, MIS reports may not be distributed to the appropriate decision-makers, fail to monitor significant risks, or fail to identify adverse trends and the level of risk faced by the institution. These critical weaknesses require immediate and close supervisory attention, as they could seriously jeopardize the continued viability of the institution.

INTERNAL CONTROLS

Rating 1 (Strong). An assessment of Strong indicates that the system of internal controls is robust for the type of risks posed by the organization's activities. The organizational structure establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits. Procedures exist for ensuring separation of duties, compliance with applicable laws and regulations, and accurate financial, operational, and regulatory reports. Internal audit or other control review practices provide independence and objectivity. Information systems are thoroughly tested and reviewed. Internal control weaknesses are well documented and receive prompt managerial attention. The Board or its audit committee regularly reviews the effectiveness of internal audits and other control review activities.

Rating 2 (Satisfactory). An assessment of Satisfactory indicates that the system of internal controls adequately covers major risks and business areas, although modest weaknesses are present. In general, the control functions are independent from the business lines, and there is appropriate separation of duties. The control system supports accuracy in record-keeping practices and reporting systems, is adequately documented, and verifies compliance with laws and regulations. Internal controls and information systems are adequately tested and reviewed, and the coverage, procedures, findings, and responses to audits and review tests are documented. Identified material weaknesses are given appropriate attention and management's actions to address material weaknesses are objectively reviewed and verified. The board or its audit committee reviews the effectiveness of internal audits and other control review activities. Any weaknesses or deficiencies that have been identified are modest in nature and in the process of being addressed.

*Rating 3 (Fair)***.** An assessment of Fair signifies that weaknesses exist in the system of internal controls that require more than normal supervisory attention. The weaknesses may include insufficient oversight of internal controls and audit by the board or its audit committee; unclear or conflicting lines of authority and responsibility; a lack of independence between control areas and business activities; or ineffective separation of duties. The internal control system may produce inadequate or untimely risk coverage and verification, including monitoring compliance with safety and soundness laws, inaccurate reporting and recordkeeping, or a lack of documentation for work performed. Weaknesses noted could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

Rating 4 (Marginal). An assessment of Marginal represents a deficient internal control system that does not adequately address a number of significant risks to the institution. The deficiencies may include neglect of internal controls and audit by the board or its audit committee; conflicting lines of authority and responsibility; a lack of independence between control areas and business activities; or no separation of duties in critical areas. The internal control system may produce inadequate risk coverage and verification in certain areas, including inaccurate reports and records, a lack of documentation for work performed, poor compliance monitoring for safety and soundness laws, or infrequent management review and correction of identified weaknesses. The internal control deficiencies warrant a high degree of supervisory attention and could seriously affect the safety and soundness of the institution if not addressed.

Rating 5 (Unsatisfactory). An assessment of Unsatisfactory indicates a critical absence of an internal control system. There may be no oversight by the board or its audit committee; conflicting lines of authority and responsibility; no distinction between control areas and business activities; or no separation of duties. The internal control system may produce totally inadequate or untimely risk coverage and verification, including monitoring compliance with safety and soundness; completely inaccurate records or regulatory reporting; a severe lack of documentation for work performed; or no management review and correction of identified weaknesses. Such deficiencies require immediate and close supervisory attention, as they could seriously jeopardize the continued viability of the institution.

FINANCIAL CONDITION COMPONENT

Rating 1 (Strong). A rating of 1 indicates that the consolidated BHC is financially sound in almost every respect. Any negative findings are basically of a minor nature and can be handled in a routine manner. The capital adequacy, asset quality, earnings, and liquidity of the consolidated BHC are more than adequate to protect the company from reasonably foreseeable external economic and financial disturbances. The company generates more than sufficient cash flow to service its debt and fixed obligations with no harm to subsidiaries of the organization.

Rating 2 (Satisfactory). A rating of 2 indicates that the consolidated BHC is fundamentally financially sound, but may have modest weaknesses correctable in the normal course of business. The capital adequacy, asset quality, earnings and liquidity of the consolidated BHC are adequate to protect the company from external economic and financial disturbances. The company also generates sufficient cash flow to service its obligations; however, areas of weakness could develop into areas of greater concern. To the extent minor adjustments are handled in the normal course of business, the supervisory response is limited.

Rating 3 (Fair). A rating of 3 indicates that the consolidated BHC exhibits a combination of weaknesses ranging from fair to moderately severe. The company has less than adequate financial strength stemming from one or more of the following: modest capital deficiencies, substandard asset quality, weak earnings, or liquidity problems. As a result, the BHC and its subsidiaries are less resistant to adverse business conditions. The financial condition of the BHC will likely deteriorate if concerted action is not taken to correct areas of weakness. The company's cash flow is sufficient to meet immediate obligations, but may not remain adequate if action is not taken to correct weaknesses. Consequently, the BHC is vulnerable and requires more than normal supervision. Overall financial strength and capacity are still such as to pose only a remote threat to the viability of the company.

Rating 4 (Marginal). A rating of 4 indicates that the consolidated BHC has either inadequate capital, an immoderate volume of problem assets, very weak earnings, serious liquidity issues, or a combination of factors that are less than satisfactory. An additional weakness may be that the BHC's cash flow needs are met only by upstreaming imprudent dividends and/or fees from subsidiaries. Unless prompt action is taken to correct these conditions, they could impair future viability. BHCs in this category require close supervisory attention and increased financial surveillance.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the volume and character of financial weaknesses of the BHC are so critical as to require urgent aid from shareholders or other sources to prevent insolvency. The imminent inability of such a company to service its fixed obligations and/or prevent capital depletion due to severe operating losses places its viability in serious doubt. Such companies require immediate corrective action and constant supervisory attention.

FINANCIAL CONDITION SUBCOMPONENTS

The financial condition subcomponents can be evaluated along business lines, product lines, or legal entity lines--depending on which type of review is most appropriate for the holding company structure.

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CAPITAL ADEQUACY

Rating 1 (Strong). A rating of 1 indicates that the consolidated BHC maintains more than adequate capital to: 1) support the volume and risk characteristics of all parent and subsidiary business lines and products; 2) provide a sufficient cushion to absorb unanticipated losses arising from the parent company and subsidiary activities; and 3) support the level and composition of corporate and subsidiary borrowing. In addition, a company assigned a rating of 1 has more than sufficient capital to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries.

Rating 2 (Satisfactory). A rating of 2 indicates that the consolidated BHC maintains adequate capital to: 1) support the volume and risk characteristics of all parent and subsidiary business lines and products; 2) provide a sufficient cushion to absorb unanticipated losses arising from holding company and subsidiary activities; and 3) support the level and composition of corporate and subsidiary borrowing. In addition, a company assigned a rating of 2 has sufficient capital to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries.

Rating 3 (Fair). A rating of 3 indicates that the consolidated BHC may not maintain sufficient capital to ensure support for one or more of the following: 1) the volume and risk characteristics of all parent and subsidiary business lines and products; 2) the unanticipated losses arising from holding company and subsidiary activities; or 3) the level and composition of corporate and subsidiary borrowing. In addition, a company assigned a rating of 3 may not maintain a sufficient capital position to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries. The capital position of the consolidated BHC could quickly become inadequate in the event of asset deterioration or other negative factors and therefore requires more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the capital level of the consolidated BHC is significantly below the amount needed to ensure support for one or more of the following: 1) the volume and risk characteristics of all parent and subsidiary business lines and products; 2) the unanticipated losses arising from holding company and subsidiary activities; and 3) the level and composition of corporate and subsidiary borrowing. In addition, a company assigned a rating of 4 does not maintain a sufficient capital position to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries. If left unchecked, the consolidated capital position of the company might evolve into weaknesses or conditions that could threaten the viability of the institution. The capital position of the consolidated BHC requires immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the level of capital of the consolidated BHC is critically deficient and in need of immediate corrective action. The consolidated capital position threatens the viability of the institution and requires constant supervisory attention.

ASSET QUALITY

Rating 1 (Strong). A rating of 1 indicates that the BHC maintains strong asset quality across all parts of the organization, with a very low level of criticized and nonperforming assets. Credit risk across the organization is commensurate with management's abilities and modest in relation to credit risk management practices.

Rating 2 (Satisfactory). A rating of 2 indicates that the BHC maintains satisfactory asset quality across all parts of the organization, with a manageable level of criticized and nonperforming assets. Any identified weaknesses in asset quality are correctable in the normal course of business. Credit risk across the organization is commensurate with management's abilities and generally modest in relation to credit risk management practices.

Rating 3 (Fair). A rating of 3 indicates that the asset quality across all or a material part of the consolidated BHC is less than satisfactory. The BHC may be facing a decrease in the overall quality of assets currently maintained on and off balance sheet. The BHC may also be experiencing an increase in credit risk exposure that has not been met with an appropriate improvement in risk management practices. BHCs assigned a rating of 3 require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the BHC's asset quality is deficient. The level of problem assets and/or unmitigated credit risk subjects the holding company to potential losses that, if left unchecked, may threaten its viability. BHCs assigned a rating of 4 require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the BHC's asset quality is critically deficient and presents an imminent threat to the institution's viability. BHCs assigned a rating of 5 require immediate remedial action and constant supervisory attention.

EARNINGS

Rating 1 (Strong). A rating of 1 indicates that the quantity and quality of the BHC's consolidated earnings over time are more than sufficient to make full provision for the absorption of losses and accretion of capital when due consideration is given to asset quality and BHC growth. Generally, BHCs with a 1 rating have earnings well above peer-group averages.

Rating 2 (Satisfactory). A rating of 2 indicates that the quantity and quality of the BHC's consolidated earnings over time are generally adequate to make provision for the absorption of losses and accretion of capital when due consideration is given to asset quality and BHC growth. Generally, BHCs with a 2 earnings rating have earnings that are in line with or slightly above peer-group averages.

Rating 3 (Fair). A rating of 3 indicates that the BHC's consolidated earnings are not fully adequate to make provisions for the absorption of losses and the accretion of capital in relation to company growth. The consolidated earnings of companies rated 3 may be further clouded by static or inconsistent earnings trends, chronically insufficient earnings, or less than satisfactory asset quality. BHCs with a 3 rating for earnings generally have earnings below peer-group averages. Such BHCs require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the BHC's consolidated earnings, while generally positive, are clearly not sufficient to make full provision for losses and the necessary accretion of capital. BHCs with earnings rated 4 may be characterized by erratic fluctuations in net income, poor earnings (and the likelihood of the development of a further downward trend), intermittent losses, chronically depressed earnings, or a substantial drop from the previous year. The earnings of such companies are generally substantially below peer-group averages. Such BHCs require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the BHC is experiencing losses or reflecting a level of earnings that is worse than that described for the 4 rating. Such losses, if not reversed, represent a distinct threat to the BHC's solvency through erosion of capital. Such BHCs require immediate and constant supervisory attention.

LIQUIDITY

Rating 1 (Strong). A rating of 1 indicates that the BHC maintains strong liquidity levels and well developed funds management practices. The parent company and subsidiaries have reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

Rating 2 (Satisfactory). A rating of 2 indicates that the BHC maintains satisfactory liquidity levels and funds management practices. The parent company and subsidiaries have access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses in funds management practices may be evident, but those weaknesses are correctable in the normal course of business.

Rating 3 (Fair). A rating of 3 indicates that the BHC's liquidity levels or funds management practices are in need of improvement. BHCs rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices at the parent company and/or subsidiary levels. However, these deficiencies are considered correctable in the normal course of business. Such BHCs require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the BHC's liquidity levels or funds management practices are deficient. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs at the parent company and/or subsidiary levels and require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the BHC's liquidity levels or funds management practices are critically deficient and may threaten the continued viability of the institution. Institutions rated 5 require constant supervisory attention and immediate external financial assistance to meet maturing obligations or other liquidity needs..

IMPACT COMPONENT

The I component rating reflects the aggregate potential impact of the nondepository entities on the subsidiary depository institution(s). The I component is rated on a five-point numerical scale. Ratings will be assigned in ascending order of supervisory concern as follows:

1 – low likelihood of significant negative impact;
2 – limited likelihood of significant negative impact;
3 – moderate likelihood of significant negative impact;
4 – considerable likelihood of significant negative impact; and
5 – high likelihood of significant negative impact.

Rating 1 (Low Likelihood of Significant Negative Impact). A rating of 1 indicates that the nondepository entities of the BHC are highly unlikely to have a significant negative impact on the subsidiary depository institution(s) due to the sound financial condition of the nondepository entities, the strong risk management practices within the nondepository entities, or the corporate structure of the BHC. The BHC maintains an appropriate capital allocation across the organization commensurate with associated risks. Intra-group exposures, including servicing agreements, are very unlikely to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow is sufficient and not dependent on excessive dividend payments from subsidiaries. The potential risks posed to the subsidiary depository institution(s) by strategic plans, the control environment, risk concentrations, or legal or reputational issues within or facing the nondepository entities are minor in nature and can be addressed in the normal course of business.

Rating 2 (Limited Likelihood of Significant Negative Impact). A rating of 2 indicates a limited likelihood that the nondepository entities of the BHC will have a significant negative impact on the subsidiary depository institution(s) due to the adequate financial condition of the nondepository entities, the satisfactory risk management practices within the parent nondepository entities, or the corporate structure of the BHC. The BHC maintains adequate capital allocation across the organization commensurate with associated risks. Intra-group exposures, including servicing agreements, are unlikely to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow is satisfactory and generally does not require excessive dividend payments from subsidiaries. The potential risks posed to the subsidiary depository institution(s) by strategic plans, the control environment, risk concentrations, or legal or reputational issues within the nondepository entities are modest and can be addressed in the normal course of business.

Rating 3 (Moderate Likelihood of Significant Negative Impact). A rating of 3 indicates a moderate likelihood that the aggregate impact of the nondepository entities of the BHC on the subsidiary depository institution(s) will have a significant negative impact on the subsidiary depository institution(s) due to weaknesses in the financial condition and/or risk management practices of the nondepository entities. The BHC may have only marginally sufficient allocation of capital across the organization to support risks. Intragroup exposures, including servicing agreements, may have the potential to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow may at times require excessive dividend payments from subsidiaries. Strategic growth plans, weaknesses in the control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose significant risks to the subsidiary depository institution(s). A BHC assigned a 3 impact rating requires more than normal supervisory attention, as there could be adverse effects on the safety and soundness of the subsidiary depository institution(s) if corrective action is not taken by management.

Rating 4 (Considerable Likelihood of Significant Negative Impact). A rating of 4 indicates that there is a considerable likelihood that the nondepository entities of the BHC will have a significant negative impact on the subsidiary depository institution(s) due to weaknesses in the financial condition and/or risk management practices of the nondepository entities. A 4-rated BHC may have insufficient capital within the nondepository entities to support their risks and activities. Intra-group exposures, including servicing agreements, may also have the immediate potential to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow may be dependent on excessive dividend payments from subsidiaries. Strategic growth plans, weaknesses in the control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose considerable risks to the subsidiary depository institution(s). A BHC assigned a 4 impact rating requires immediate remedial action and close supervisory attention because the nondepository entities could seriously affect the safety and soundness of the subsidiary depository institution(s).

Rating 5 (High Likelihood of Significant Negative Impact). A rating of 5 indicates a high likelihood that the aggregate impact of the nondepository entities of the BHC on the subsidiary depository institution(s) is or will become significantly negative due to substantial weaknesses in the financial condition and/or risk management practices of the nondepository entities. Strategic growth plans, a deficient control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose critical risks to the subsidiary depository institution(s). The parent company also may be unable to meet its obligations without excessive support from the subsidiary depository institution(s). The BHC requires immediate and close supervisory attention, as the nondepository entities seriously jeopardize the continued viability of the subsidiary depository institution(s).

COMPOSITE RATING

Rating 1 (Strong). BHCs in this group are sound in almost every respect; any negative findings are basically of a minor nature and can be handled in a routine manner. Risk management practices and financial condition provide resistance to external economic and financial disturbances. Cash flow is more than adequate to service debt and other fixed obligations, and the nondepository entities pose little risk to the subsidiary depository institution(s).

Rating 2 (Satisfactory). BHCs in this group are fundamentally sound but may have modest weaknesses in risk management practices or financial condition. The weaknesses could develop into conditions of greater concern but are believed correctable in the normal course of business. As such, the supervisory response is limited. Cash flow is adequate to service obligations, and the nondepository entities are unlikely to have a significant negative impact on the subsidiary depository institution(s).

Rating 3 (Fair). BHCs in this group exhibit a combination of weaknesses in risk management practices and financial condition that range from fair to moderately severe. These companies are less resistant to the onset of adverse business conditions and would likely deteriorate if concerted action is not effective in correcting the areas of weakness. Consequently, these companies are vulnerable and require more than normal supervisory attention and financial surveillance.

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However, the risk management and financial capacity of the company, including the potential negative impact of the nondepository entities on the subsidiary depository institution(s), pose only a remote threat to its continued viability.

Rating 4 (Marginal). BHCs in this group have an immoderate volume of risk management and financial weaknesses, which may pose a heightened risk of significant negative impact on the subsidiary depository institution(s). The holding company's cash flow needs may be being met only by upstreaming imprudent dividends and/or fees from its subsidiaries. Unless prompt action is taken to correct these conditions, the organization's future viability could be impaired. These companies require close supervisory attention and substantially increased financial surveillance.

Rating 5 (Unsatisfactory). The critical volume and character of the risk management and financial weaknesses of BHCs in this category, and concerns about the nondepository entities negatively impacting the subsidiary depository institution(s), could lead to insolvency without urgent aid from shareholders or other sources. The imminent inability to prevent liquidity and/or capital depletion places the BHC's continued viability in serious doubt. These companies require immediate corrective action and constant supervisory attention.

Depository Institutions Component

The (D) component identifies the overall condition of the subsidiary depository institution(s) of the BHC. For BHCs with only one subsidiary depository institution, the (D) component rating will mirror the CAMELS composite rating for that depository institution. To arrive at a (D) component rating for BHCs with multiple subsidiary depository institutions, the CAMELS composite ratings for each of the depository institutions should be weighted, giving consideration to asset size and the relative importance of each depository institution within the overall structure of the organization. In general, it is expected that the resulting (D) component rating will reflect the lead depository institution's CAMELS composite rating.