5090, (703) 883–4020, TDD (703) 883–4444.

SUPPLEMENTARY INFORMATION: The text of the Board's policy statement on disaster relief efforts by Farm Credit institutions is set forth below in its entirety:

Farm Credit Administration Board Policy Statement on Disaster Relief Efforts by Farm Credit Institutions

NV–96–27

FCA–PS–71

Effective Date: June 13, 1996.

Effect on Previous Action: Supersedes FCA Bookletter 368–OE, September 14, 1993.

Source of Authority: Section 5.17 of the Farm Credit Act of 1971, as amended.

The FCA board hereby adopts the following policy statement:

The Farm Credit Administration (FCA) recognizes that in the aftermath of hurricanes, floods, droughts, or other natural or man-made disasters, specific sections of the country or segments of the agricultural community are declared to be disaster areas. Such disaster area declarations may be made by the President of the United States, the Governor of a State, or a specific Federal or State government agency. When a disaster area includes a rural community where a Farm Credit institution is located or does business, the institution can be affected in two ways: directly, such as by physical damage to the institution itself or incapacitation of employees; or indirectly, such as by damage suffered by individuals and businesses with loans from the institution. In the interest of providing the highest quality and most efficient service to agricultural borrowers, the FCA encourages Farm Credit institutions operating in disaster-affected areas to work within their communities to help alleviate pressures on borrowers under stress.

When conducted in a reasonable and prudent manner, the efforts of Farm Credit institutions to work in the public's interest with borrowers in the disaster areas will be considered consistent with safe and sound business practices. It is the FCA's belief that the institutions have considerable flexibility under the existing regulations to provide appropriate disaster relief. Such relief efforts may include, but would not necessarily be limited to, extending the terms of loan repayment or restructuring a borrower's debt obligations. In addition, a Farm Credit institution may consider easing some loan documentation or credit-extension terms for new loans to certain borrowers or requesting the FCA to grant relief from specific regulatory requirements. It is the FCA's belief that the principal objectives of any disaster assistance program developed by a Farm Credit institution and approved by its board should be to:

1. Provide necessary and timely relief to disaster-affected customers of the institution;

2. Minimize the adverse effects of the disaster on the profitability, financial condition, operating efficiency, and morale of customers, as well as on the institution;

3. Review applicable statutory and regulatory requirements and determine whether requesting the FCA to provide exceptions from regulatory requirements would be appropriate; and

4. Promote, through such consideration and actions, the Farm Credit System's mandate to provide American farmers and ranchers with sound, adequate, and constructive credit and closely related services.

The FCA further believes that proper risk controls and management oversight should be exercised to ensure that such efforts serve the interests of the lending institution as well as those of the community. Any institution providing disaster relief should document such relief actions as well as any significant departures from otherwise applicable institution policies and procedures.

The aforementioned objectives and risk controls are conditions and characteristics on which the FCA will evaluate an institution's relief activities. These objectives and risk controls should be set forth in any request to the FCA for specific regulatory relief.

The FCA also recognizes that conditions related to a disaster may impair an institution's ability to comply in a timely way with regulatory reporting and publishing requirements. Farm Credit institutions should contact their FCA field office when relief from specific regulatory or reporting requirements is needed.

Additionally, the Board of Governors of the Federal Reserve System (Federal Reserve Board) has, from time to time, granted relief from certain Regulation Z requirements to consumers located in declared disaster areas. It is likely that the Federal Reserve Board will continue to promulgate similar temporary exceptions in disaster-affected areas. When this occurs, the FCA will, as a matter of convenience, continue to notify the Farm Credit institutions affected by Regulation Z exceptions.

Adopted this 13th day of June, 1996 by order of the Board.

Dated: July 12, 1996.

Floyd Fithian,

Secretary, Farm Credit Administration Board.

[FR Doc. 96–18218 Filed 7–17–96; 8:45 am]

BILLING CODE 6705–01–P

FEDERAL ELECTION COMMISSION

Sunshine Act Meeting

AGENCY: Federal Election Commission.

DATE AND TIME: Thursday, July 25, 1996 at 10:00 a.m.

PLACE: 999 E Street, N.W. Washington, D.C. (Ninth Floor).

STATUS: This Meeting Will Be Open to the Public.

ITEMS TO BE DISCUSSED:

Correction and Approval of Minutes.

Advisory Opinion 1996–25: Stanley M. Brand on behalf of Seafarers Political Activity Donation (''SPAD'').

Advisory Opinion 1996–28: Richard W. Shaffer on behalf of the Lehigh Valley Citizens for Don Ritter.

Administrative Matters.

PERSON TO CONTACT FOR INFORMATION: Mr. Ron Harris, Press Officer, Telephone: (202) 219–4155.

Delores Hardy,

Administrative Assistant.

[FR Doc. 96–18436 Filed 7–16–96; 2:59 pm]

BILLING CODE 6715–01–M

FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

Uniform Financial Institutions Rating System

AGENCY: Federal Financial Institutions Examination Council.

ACTION: Notice and request for comment.

SUMMARY: The Federal Financial Institutions Examination Council (FFIEC) is requesting comment on proposed changes to the Uniform Financial institutions Rating System (UFIRS), commonly referred to as the CAMEL rating system. The term ''financial institutions'' refers to those insured depository institutions whose primary Federal supervisory agency is represented on the FFIEC. The agencies comprising the FFIEC are the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

The proposed revisions update the rating system to reflect changes that have occurred in the financial services

industry and in supervisory policies and procedures since the rating system was first adopted in 1979. The proposed changes include: The reformatting and clarification of the existing component rating descriptions; the addition of a sixth rating component addressing sensitivity to market risks; an increase in emphasis on the quality of risk management processes in each of the rating components, particularly in the management component; the addition of language in composite rating definitions to parallel the proposed changes in component rating descriptions; and, the explicit identification of the risk types that are to be considered in assigning component ratings. After reviewing public comments, the FFIEC intends to make appropriate additional changes to the revised UFIRS and adopt a final rating system.

The FFIEC notes that some agency regulations currently use an institution's UFIRS or CAMEL rating in determining an institution's status under those regulations. The agencies may consider amending those regulations to incorporate any changes made to the UFIRS system.

DATES: Comments must be received by September 16, 1996.

ADDRESSES: Comments should be sent to Joe M. Cleaver, Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue NW., Suite 200, Washington, DC 20037, or by facsimile transmission to (202) 634–6556.

FOR FURTHER INFORMATION CONTACT:

OCC: Lawrence W. (Bill) Morris, National Bank Examiner, Office of Chief National Bank Examiner, (202) 874–5350, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

FRB: Kevin Bertsch, Supervisory Financial Analyst, (202) 452–5265, or Constance Powell, Supervisory Financial Analyst, (202) 452–3506, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson, (202) 452–3544, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551.

FDIC: Daniel M. Gautsch, Examination Specialist, (202) 898–6912, Office of Policy, Division of Supervision. For legal issues, Linda L. Stamp, Counsel, (202) 898–7310, Supervision and Legislation Branch, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.

OTS: William J. Magrini, Senior Project Manager, (202) 906–5744, Supervision Policy, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

Background Information

The UFIRS is an internal supervisory rating system used by the Federal supervisory agencies for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special supervisory attention or concern. The UFIRS was adopted in 1979 and is commonly referred to as the CAMEL rating system. Under the UFIRS, each financial institution is assigned a composite rating based on an evaluation and rating of five essential components of an institution's financial condition and operations. These component factors address the adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, and the adequacy of liquidity. Both the composite and the component ratings are assigned on a 1 to 5 numerical scale. A 1 indicates the strongest performance and management practices, and the least degree of supervisory concern, while a 5 indicates the weakest performance and management practices and, therefore, the highest degree of supervisory concern.

The composite rating reflects an institution's overall financial condition, compliance with laws and regulations, and management capability. The composite ratings are used by the Federal supervisory agencies to monitor aggregate trends in the overall soundness of financial institutions.

The rating system also provides a means for the Federal supervisory agencies to monitor, for various statistical and supervisory purposes, the types and severity of problems that institutions may be experiencing. This monitoring is possible since the composite rating assigned under UFIRS is based on the ratings of several essential aspects of a financial institution's condition and operations. For example, liquidity is one of the aspects of an institution's operations that is assigned a component rating. Thus, UFIRS allows the Federal supervisory agencies to readily identify all institutions that are experiencing a liquidity problem, to gauge the severity of the problem, and to determine the level of supervisory concern that may be warranted.

UFIRS has proven to be an effective means for the Federal supervisory agencies to determine the safety and soundness of financial institutions. A number of changes, however, have occurred in the financial services industry and in supervisory policies and procedures since the rating system was first adopted. The FFIEC's Task Force on Supervision has reviewed the existing rating system in light of these industry trends. The Task Force has concluded that the current UFIRS framework continues to provide an effective vehicle for summarizing conclusions about the soundness of financial institutions. As a result, the FFIEC proposes to retain the basic rating framework, and the revised rating system will continue to assign a composite rating based on an evaluation and rating of essential components of an institution's financial condition and operations. However, the FFIEC proposes certain enhancements to the rating system.

Discussion of Proposed Changes to the Rating System

1. Structure and Format

The FFIEC proposes to enhance and clarify the component rating descriptions by reformatting each component into three distinct sections. These sections are: (a) An introductory paragraph discussing in general terms the areas to be considered when rating each component; (b) a bullet-style listing of the specific evaluation factors to be considered when assigning the component rating; and, (c) a brief qualitative description of the five rating grades that can be assigned to a particular component.

2. Component for Sensitivity to Market Risks

The FFIEC proposes to adopt a sixth rating component addressing sensitivity to market risks. This component would include interest rate risk, to which every institution is subject, price risk, and foreign exchange risk.

In recent years, financial institutions have increased their holdings of complicated on- and off-balance sheet instruments, such as structured notes and collateralized mortgaged obligations (CMOs), that are sensitive to changes in interest rates. In addition, the increase in competitive pressures has constrained, in some cases, institutions' abilities to advantageously price loans and deposits. Thus, there is a growing need for financial institutions to monitor and manage their interest rate risk, as well as for the Federal supervisory agencies to monitor the degree of this risk. In addition, for those institutions that have substantial trading

operations or large foreign positions, there is an increased susceptibility to price and foreign exchange risks that also must be closely monitored by the Federal supervisory agencies.

Under the current UFIRS, these market risks are considered within a number of components. For example, interest rate risk is considered when evaluating the earnings component since this risk can have a direct effect on future earnings. Interest rate risk is also considered when evaluating the liquidity component since interest rate risk is a factor of an institution's overall asset/liability management practices. Under the revised rating system, certain aspects of an institution's sensitivity to market risks would continue to be considered when evaluating these other components. However, the conclusions on an institution's sensitivity to interest rate, price, and foreign exchange risks would be summarized under the new component in recognition of the impact these risks can have on an institution's overall risk profile.

3. Risk Management

The FFIEC is proposing that the revised rating system reflect an increase in emphasis on risk management processes. The Federal supervisory agencies currently consider the quality of risk management processes in applying the UFIRS, particularly in the management component. Changes in the financial services industry, however, have broadened the range of financial products offered by institutions and accelerated the pace of transactions. These trends reinforce the importance of institutions having sound risk management processes. Accordingly, the revised rating system would contain language in each of the components emphasizing the consideration of processes of identify, measure, monitor, and control risks.

4. Composite Rating Definitions

The FFIEC is proposing changes in the composite rating definitions to parallel the changes in the component rating descriptions. Under the FFIEC's proposal, the revised composite rating definitions would contain an explicit reference to the quality of overall risk management practices. The basic context of the existing composite rating definitions is being retained. The composite rating would continue to be based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance.

5. Identification of Risk Types

The FFIEC is proposing that the types of risks associated with each of the component ratings be explicitly identified. For example, the proposed rating description for asset quality notes that a primary consideration in assigning the component rating is an assessment of credit risk associated with loans, investments, other real estate owned, and certain off-balance sheet transactions. However, all other risks affecting the quality of assets, including, but not limited to, operational, market, reputation, strategic, and compliance risks, also would be considered.

Request for Comments

The FFIEC requests comment on the proposed changes to the rating system. In addition, the FFIEC invites comments on the following questions:

1. Does the proposed, revised rating system capture the essential aspects of a financial institution's condition, compliance with laws and regulations, and overall operating soundness? If not, what additional or different components should be considered?

2. Does the proposed management component rating adequately represent an assessment of the quality of the board of directors' and management's oversight regarding an institution's operating performance, risk management practices, and internal controls? If not, what other factors should be considered when rating management?

Proposed Text of the Uniform Financial Institutions Rating System

Uniform Financial Institutions[1] Rating System

Introduction

The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions Examination Council (FFIEC) on November 13, 1979. Over the years, the UFIRS has proven to be an effective internal supervisory tool for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special attention or concern. A number of changes, however, have occurred in the banking industry and in the Federal supervisory agencies' policies and procedures which have prompted a review and revision of the 1979 rating system. The revisions to UFIRS include the addition of a sixth component addressing sensitivity to market risks; the explicit reference to the quality of risk management processes in the management component; and the identification of risk elements within the composite and component rating descriptions.

The UFIRS takes into consideration certain financial, managerial, and compliance factors that are common to all institutions. Under this system, the supervisory agencies endeavor to ensure that all financial institutions are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on the financial institutions exhibiting financial and operational weaknesses or adverse trends.

The UFIRS also serves as a useful vehicle for identifying problem or deteriorating financial institutions, as well as for categorizing institutions with deficiencies in particular component areas. Further, the rating system assists Congress in following safety and soundness trends and in assessing the aggregate strength and soundness of the financial industry. As such, the UFIRS assists the agencies in fulfilling their collective mission of maintaining stability and public confidence in the nation's financial system.

Overview

Under the UFIRS, each financial institution is assigned a composite rating based on an evaluation and rating of six essential components of an institution's financial condition and operations. These component factors address the adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risks.

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

[1] For purposes of this rating system, the term financial institution refers to those insured depository institutions whose primary Federal supervisory agency is represented on the Federal Financial Institutions Examination Council (FFIEC). The agencies comprising the FFIEC are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. The term financial institution includes Federally supervised commercial banks, savings and loan associations, mutual savings banks and credit unions.

depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. Therefore, the composite rating is not derived by computing an arithmetic average of the component ratings.

The ability of management to respond to changing circumstances and to address the risks that may arise from changing business conditions, or the initiation of new activities or products, is an important factor in evaluating a financial institution's overall risk profile and the level of supervisory attention warranted. For this reason, the management component is given special consideration when assigning a composite rating.

The following two sections contain the composite rating definitions, and the descriptions and definitions for the six component ratings.

Composite Ratings

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 risks. The rating scale ranges from 1 to 5, with a rating of 1 indicating the strongest performance and risk management practices, and the level of least supervisory concern. A 5 rating indicates the most critically deficient level of performance, the weakest risk management practices, and the greatest supervisory concern. The composite ratings are defined as follows:

Composite 1

Financial institutions in this group are sound in every respect; as such, all components are rated 1 or 2. Any weakness is minor and can be handled in a routine manner by management. Substantial compliance with laws and regulations is noted. These financial institutions are more capable of withstanding the vagaries of business conditions and are resistant to outside influences such as economic instability in their trade area. As a result, these financial institutions exhibit the strongest performance and risk management practices and give no cause for supervisory concern.

Composite 2

Financial institutions in this group are fundamentally sound. For a financial institution to receive this rating, normally no component rating should be more severe than 3. Only modest weaknesses are present and are well within management's capabilities and willingness to correct. These financial institutions are stable and are capable of withstanding business fluctuations. These financial institutions are in substantial compliance with laws and regulations and there are no material supervisory concerns. Overall risk management practices are satisfactory. As a result, the supervisory response is informal and limited.

Composite 3

Financial institutions in this group exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe. Risk management practices may be less than satisfactory. The concerns, however, are not of the magnitude to cause a component to be rated more severely than 4.

Financial institutions in this group generally are less capable of withstanding business fluctuations; are more vulnerable to outside influences than those institutions rated a composite 1 or 2; and, management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. These financial institutions are a supervisory concern and require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions.

Composite 4

Financial institutions in this group are in an unsafe and unsound condition. These are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. Risk management practices are generally unacceptable. The weaknesses and problems are not being satisfactorily addressed or resolved by management. There may be significant noncompliance with laws and regulations. Financial institutions in this group generally are not capable of withstanding business fluctuations. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.

Composite 5

Financial institutions in this group are in an extremely unsafe and unsound condition, exhibit a critically deficient performance, often contain the weakest risk management practices, and are of the greatest supervisory concern. The volume and severity of problems is beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the financial institution to be viable. Continuous close supervisory attention is warranted. Institutions in this group pose a significant risk to the deposit insurance fund. Failure is highly probable and the least-cost resolution alternatives are being considered by the appropriate agencies.

Component Ratings

Each of the component rating descriptions is divided into three sections: an introductory paragraph; a list of the principal evaluation factors that relate to that component; and, a brief description of each numerical rating for that component. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components.

Capital Adequacy

A financial institution is expected to maintain capital commensurate with its existing and potential risk exposures and the ability of management to identify, measure, monitor, and control these exposures. The effect of credit, market and other risks on the financial condition of an institution should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution's activities will determine the extent of which it may be necessary to maintain capital at levels above required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the institution's capital.

The capital adequacy of an institution is rated based on an assessment of:

- The level and quality of capital and the overall financial condition of the institution.
- The nature and extent of risks to the organization.
- The ability of management to identify, measure, monitor, and control risk and address emerging needs for additional capital.

- The nature, trend, and volume of problem assets, and the adequacy of allowances for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- Risk exposure represented by off-balance sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.
- Access to capital markets and other sources of capital.
- Compliance with applicable laws, regulations, and supervisory guidelines, including plans for maintaining adequate capital or correcting other deficiencies.

Ratings

1. A rating of 1 indicates a strong capital level that is more than adequate to support an institution's risk profile.
2. A rating of 2 indicates a satisfactory capital level given the financial institution's risk exposure and the quality of its risk management practices.
3. A rating of 3 indicates a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institution's capital level exceeds minimum regulatory and statutory requirements.
4. A rating of 4 indicates a deficient level of capital. In light of the level of risk exposure, viability of the institution may be threatened. Assistance from shareholders or other external sources of financial support is required.
5. A rating of 5 indicates a critically deficient level of capital such that the institution's viability is threatened. Immediate assistance from shareholders or other external sources of financial support is required.

Asset Quality

The asset quality rating reflects the quantity of existing and potential credit risk associated with the loan and investment portfolios, other real estate owned, and off-balance sheet transactions. The ability of management to identify, measure, monitor, and control credit risk is also reflected here. The evaluation of asset quality should consider the adequacy of the allowance for loan and lease losses and weigh the exposure to counterparty, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or salability of an institution's assets, including, but not limited to, operating, market, reputation, strategic, or compliance risks should also be considered.

The asset quality of a financial institution is rated based on an assessment of:

- The adequacy of underwriting standards and appropriateness of risk identification practices.
- The level, distribution, severity, and trend of classified assets, nonaccrual and restructured loans, delinquent loans, and nonperforming assets.
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- The exposure to off-balance sheet transactions, such as unfunded commitments, commercial and standby letters of credit, and lines of credit.
- The volume, diversification, and quality of the loan and investment portfolios.
- The extent of securities underwriting activities and exposure to counterparties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal controls and management information systems.
- Compliance with applicable laws and regulations.

Ratings

1. A rating of 1 indicates strong asset quality and credit administration practices without either significant weaknesses or risk exposure. Asset quality in such institutions is of minimal supervisory concern.
2. A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications, other weaknesses, and risks warrant a limited level of supervisory attention.
3. A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices.
4. A rating of 4 is assigned to financial institutions with deficient asset quality or credit administration practices. The levels of risk and problem assets are significant, inadequately controlled, and subject the financial institution to potential losses in excess of a reasonable limit that, if left unchecked, may threaten its viability.
5. A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability.

Management

The capability of the board of directors and management 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 is reflected in this rating. Depending on the nature and scope of an institution's activities, management practices may need to address some or all of the following risks: credit, market, operating or transaction, reputation, strategic, compliance, legal, liquidity, and other risks. Sound management practices are demonstrated by: active oversight by the board of directors and management; competent personnel; adequate policies, processes and controls addressing areas of an institution's operations; and 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 banking operations as well as other financial service activities in which the institution may be involved.

The performance of management and the board of directors and the quality of risk management is rated based upon an assessment of:

- The level and quality of oversight and support of institution activities by the board of directors and management.
- The ability of the board of directors and management to plan for, and respond to, changing circumstances, and address risks that may arise from changing business conditions or the initiation of new activities or products.
- The adequacy of, and conformance with, internal policies and controls addressing the operations and risks of significant activities.
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems.
- The adequacy of audits and internal controls to: promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations, and internal policies.

• Compliance with laws and regulations.
• Responsiveness to recommendations from auditors and supervisory authorities.
• Management depth and succession.
• The extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority.
• Reasonableness of compensation policies and avoidance of self-dealing.
• Demonstrated willingness to serve the legitimate banking needs of the community.
• The overall performance of the institution and the level of risk to which it is exposed.

Ratings

1. A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

2. A rating of 2 indicates satisfactory management and board performance and risk management practices. Minor weakness may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

3. A rating of 3 indicates management and board performance or risk management practices that need improvement. Performance or risk management practices are less than satisfactory given the nature of an institution's activities. The capabilities of management and the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

4. A rating of 4 indicates deficient management and board performance or risk management practices. Risk management practices are inadequate considering the institution's activities, or the level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening of management or the board may be necessary.

5. A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and the board of directors have not demonstrated the ability to correct problems and implement appropriate risk management practices. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the institution. Replacing or strengthening of management or the board of directors is necessary.

Earnings

This rating reflects not only the quantity of earnings, but also factors that may affect the sustainability or quality of earnings. The quantity as well as the quality of earnings can be affected by excessive or inadequately managed credit risk, that may result in loan losses and require additions to the allowance for loan and lease losses, or high levels of market risk, that may unduly expose an institution's earnings to volatility in interest rates. The quality of earnings may also be diminished by undue reliance on extraordinary gains, nonrecurring events, or favorable tax effects. Future earnings may be adversely affected by: an inability to forecast or control funding and operating expenses; improperly executed or ill-advised business strategies; or poorly managed or uncontrolled exposure to other risks.

The rating of an institution's earnings will be based on an assessment of:
• The level of earnings, including trends and stability.
• The ability to provide for adequate capital through retained earnings.
• The quality and sources of earnings.
• The level of expenses in relation to operations.
• The adequacy of the budgeting systems, forecasting processes, and management information systems in general.
• The exposure to credit risk and the adequacy of the allowance for loan and lease losses and other valuation allowance accounts.
• The exposure to market risks such as interest rate, foreign exchange, and price risks.
• The level of compliance with applicable laws and regulations.

Ratings

1. A rating of 1 indicates earnings that are strong. Earnings are sufficient to support operations and maintain an adequate level of capital after consideration is given to risks and other factors affecting the quality and quantity of earnings.

2. A rating of 2 indicates earnings that are satisfactory. However, earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the institution's level of earnings is adequate in view of the assessment factors listed above.

3. A rating of 3 should be accorded to earnings that need to be improved in order to fully support operations and provide for the accretion of capital in relation to the financial institution's inherent risks.

4. A rating of 4 indicates earnings are deficient to support operations and retain an appropriate capital level. Institutions so rated may be characterized by erratic fluctuations in net income or net interest margin, the development of a significant negative trend, nominal earnings, unsustainable earnings, intermittent losses or a substantive drop in earnings from the previous year.

5. A rating of 5 indicates earnings performance that is critically deficient. A financial institution with earnings rated 5 is experiencing losses that represent a distinct threat to its viability through the erosion of capital.

Liquidity

In evaluating a financial institution's liquidity position and risk, consideration should be given to current and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate credit needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

Liquidity is rated based on a review and assessment of:
• The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting operations or condition.
• The availability of assets readily convertible to cash without undue loss.

• Access to money markets and other sources of funding.
• The level of diversification of funding sources, both on- and off-balance sheet.
• The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits.
• The trend and stability of deposits.
• The ability to securitize and sell certain pools of assets.
• The competence of management to properly identify, measure, monitor and control the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.
• Compliance with applicable laws and regulations.

Ratings

1. A rating of 1 indicates a strong liquidity position and well-developed funds management practices after consideration of risk and other factors. The institution has reliable access to a sufficient volume of liquidity to meet present and anticipated liquidity needs. Access to external sources of funds is on favorable terms.

2. A rating of 2 indicates satisfactory levels of liquidity and risks, but modest weaknesses may be evident in quantitative measures of liquidity or in funds management practices given risk exposures.

3. A rating of 3 denotes liquidity and risk levels or funds management practices in need of improvement. Institutions rated 3 for liquidity may lack ready access to funds on reasonable terms and may evidence significant weaknesses in funds management practices given risk exposures.

4. A rating of 4 represents a deficient liquidity and risk position for current and anticipated needs and inadequate funds management practices. Institutions so rated may not be able to obtain funds from traditional funding sources to meet risk exposures.

5. A rating of 5 indicates a liquidity and risk position so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 for liquidity require immediate external financial assistance to meet maturing obligations and other liquidity needs.

Sensitivity to Market Risks

The sensitivity to market risks component reflects the degree to which changes in interest rates, foreign exhchange rates, or commodity or equity prices can affect a financial institution's assets, earnings, liabilities and capital values. The capacity of management to identify, measure, monitor and control market risk exposure is also a factor that should be considered. Market risks encompass interest rate risk, price risk, and foreign exchange risk. The primary element considered in evaluating market risks is the sensitivity of assets, liabilities, off-balance sheet commitments, and earnings to variability in interest rates. This vulnerability is measured by potential changes in earnings or economic value of capital under an appropriate range of economic scenarios. When significant to an institution, consideration should also be given to the price risk related to trading and investment portfolios. If applicable, the foreign exchange risk to assets, earnings, and capital should also be considered because of the periodic revaluation of financial positions denominated in foreign currencies into U.S. dollar equivalents.

Market risks are rated based on an assement of the following, as appropriate:
• The sensitivity of the financial institutions's net earnings or the economic value of its capital to changes in interest rates under varying scenarios and stress environments.
• The volume, composition, and volatility of any foreign exchange or other trading positions taken by the financial institutions.
• The actual or potential volatility of earnings or capital because of any change in market valuation of trading portfolios or financial instruments.
• The ability of management to identify, measure, monitor and control exposure to interest rate risk, as well as price and foreign exchange risk where applicable and material to an institution.

Ratings

1. A rating of 1 indicates minimal exposure to interest rate, price or foreign exchange risk. Institutions rated 1 have limited exposure to interest rate and other market risks and have strong management systems in place to identify, measure, monitor and control these risks.

2. A rating of 2 is indicative of moderate and controlled exposure to interest rate, price or foreign exchange risk. Management systems are satisfactory, and ensure that market risks are maintained at an acceptable level.

3. A rating of 3 indicates that one or more elements of this component are in need of improvement. A 3 rating may reflect an elevated level of interest rate sensitivity or exposure. It may also indicate significant foreign exchange or repricing exposures which subject earnings and capital to a moderate level of volatility. Management systems for market risks may reflect weaknesses and need improvement.

4. A rating of 4 reflects a financial institution that exhibits exposures to market risks that may erode earnings and threaten solvency. A 4 rating indicates an inordinate exposure to changes in interest rates, or to foreign exchange revaluation or other repricing effects. Management systems for market risks are deficient.

5. A rating of 5 reflects a financial institution with extreme interest rate, foreign exchange, or price risk exposure constituting a critical deficiency, and the continued viability of the institution is threatened.

[End of proposed text of Uniform Financial Institution Rating System.]

Keith J. Todd,

Assistant Excecutive Secretary, Federal Financial Institutions Examination Council.

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FEDERAL HOUSING FINANCE BOARD

Sunshine Act Meeting; Announcing an Open Meeting of the Board

TIME AND DATE: 10:00 a.m., Thursday, July 25, 1996.

PLACE: Board Room, Second Floor, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

STATUS: The entire meeting will be open to the public.

MATTERS TO BE CONSIDERED DURING PORTIONS OPEN TO THE PUBLIC:

• Repeal of Section 934.6 (Budgets) of the Finance Board's Regulations.
• Procedures for Resolution of Outstanding Examination or Supervisory Issues.
• Adoption of Proposed FHLBank System Compensation Regulation.
• 1996 Federal Home Loan Bank Incentive Compensation Plan.
• FHLBank Directors' Compensation Expenses—Final Rule.

CONTACT PERSON FOR MORE INFORMATION: Elaine L. Baker, Secretary to the Board, (202) 408–2837.

Rita I. Fair,

Managing Director.

[FR Doc. 96–18413 Filed 7–16–96; 2:18 pm]

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