



OFFICE OF THE STATE BANK COMMISSIONER
Banking Division
Examination Ratings

SAFETY AND SOUNDNESS	2
Composite Ratings	2
Component Ratings.....	3
Capital Adequacy	3
Asset Quality	4
Management.....	4
Earnings.....	6
Liquidity.....	7
Sensitivity to Market Risk.....	7
INFORMATION TECHNOLOGY	9
Composite Ratings	9
Component Ratings.....	10
Audit.....	10
Management.....	11
Development and Acquisition.....	13
Support and Delivery	15
BANK SECRECY ACT / ANTI-MONEY LAUNDERING	17
TRUST	18
Composite Ratings	18
Component Ratings.....	19
Management.....	19
Operations, Internal Controls & Auditing	20
Earnings.....	21
Alternate Rating of Earnings	23
Compliance	24
Asset Management	25

SAFETY AND SOUNDNESS

Uniform Financial Institution Rating System (UFIRS) Composite and Component (CAMELS) 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, liquidity adequacy, and sensitivity to market risk. The composite ratings are defined as follows:

Composite 1

Financial institutions in this group are sound in every respect and generally have components rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These financial institutions are the most capable of withstanding the vagaries of business conditions and are resistant to outside influences such as economic instability in their trade area. These financial institutions are in substantial compliance with laws and regulations. As a result, these financial institutions exhibit the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile, 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, generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within the board of directors' and 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. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, 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; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions 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 generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. Financial institutions in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. 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 exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; often contain inadequate risk management practices relative to the institution's size, complexity, and risk profile; and are of the greatest supervisory concern. The volume and severity of problems are 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. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable.

Component Ratings

Each of the component rating descriptions are divided into an introductory paragraph, a list of principal evaluation factors, and a brief description of each numerical rating. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components. The evaluation factors for each component rating are in no particular order of importance.

Capital Adequacy

A financial institution is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. The effect of credit, market, and other risks on the institution's financial condition 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 to 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 upon, but not limited to, an assessment of the following evaluation factors:

- The level and quality of capital and the overall financial condition of the institution;
- The ability of management to address emerging needs for additional capital;
- The nature, trend, and volume of problem assets, and the adequacy of the allowance 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; and
- Access to capital markets and other sources of capital including support provided by a parent holding company.

Ratings

A rating of 1 indicates a strong capital level relative to the institution's risk profile.

A rating of 2 indicates a satisfactory capital level relative to the financial institution's risk profile.

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.

A rating of 4 indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened. Assistance from shareholders or other external sources of financial support may be required.

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 other assets, as well as 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 counter-party, issuer, or borrower default under actual or implied contractual agreements. All other risks that may affect the value or marketability 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 upon, but not limited to, an assessment of the following evaluation factors:

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices;
- The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance sheet transactions;
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves;
- The credit risk arising from or reduced by off-balance sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit;
- The diversification and quality of the loan and investment portfolios;
- The extent of securities underwriting activities and exposure to counter-parties 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; and
- The volume and nature of credit-documentation exceptions.

Ratings

A rating of 1 indicates strong asset quality and credit administration practices. Identified weaknesses are minor in nature and risk exposure is modest in relation to capital protection and management's abilities. Asset quality in such institutions is of minimal supervisory concern.

A rating of 2 indicates satisfactory asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a limited level of supervisory attention. Risk exposure is commensurate with capital protection and management's abilities.

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.

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 that, if left unchecked, may threaten its viability.

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, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations is reflected in this rating. Generally, directors need

not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Senior management is responsible for developing and implementing policies, procedures, and practices that translate the board's goals, objectives, and risk limits into prudent operating standards.

Depending on the nature and scope of an 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 taking into consideration the size and sophistication of the institution; maintenance of an appropriate audit program and internal control environment; and effective risk monitoring and management information systems. This rating should reflect the board and management's ability as it applies to all aspects of banking operations as well as other financial service activities in which the institution is involved.

The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors:

- The level and quality of oversight and support of all institution activities by the board of directors and management;
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products;
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities;
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile;
- 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; and
- The overall performance of the institution and its risk profile.

Ratings

A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. 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.

A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses 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.

A rating of 3 indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or 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.

A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. 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 management or the board may be necessary.

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 management or the board of directors is necessary.

Earnings

This rating reflects not only the quantity and trend 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 ALLL, or by 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 is based upon, but not limited to, an assessment of the following evaluation factors:

- 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 adequacy of provisions to maintain the allowance for loan and lease losses and other valuation allowance accounts; and
- The earnings exposure to market risk such as interest rate, foreign exchange, and price risks.

Ratings

A rating of 1 indicates earnings that are strong. Earnings are more than sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings.

A rating of 2 indicates earnings that are satisfactory. Earnings are sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings. 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.

A rating of 3 indicates earnings that need to be improved. Earnings may not fully support operations and provide for the accretion of capital and allowance levels in relation to the institution's overall condition, growth, and other factors affecting the quality, quantity, and trend of earnings.

A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Institutions so rated may be characterized by erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from the previous years.

A rating of 5 indicates earnings that are 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 the adequacy of a financial institution's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. 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 banking 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 upon, but not limited to, an assessment of the following evaluation factors:

- The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its 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, to fund longer-term assets;
- The trend and stability of deposits;
- The ability to securitize and sell certain pools of assets; and
- The capability 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.

Ratings

A rating of 1 indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

A rating of 2 indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.

A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.

A rating of 4 indicates deficient liquidity levels or inadequate funds management practices. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs.

A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs.

Sensitivity to Market Risk

The sensitivity to market risk component reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a financial institution's earnings or economic capital. When evaluating this component, consideration should be given to management's ability to identify, measure,

monitor, and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earnings in relation to its level of market risk exposure. For many institutions, the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates. In some larger institutions, foreign operations can be a significant source of market risk. For some institutions, trading activities are a major source of market risk. Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors:

- The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchange rates, commodity prices, or equity prices;
- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile;
- The nature and complexity of interest rate risk exposure arising from non-trading positions; and
- Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

Ratings

A rating of 1 indicates that market risk sensitivity is well controlled and that there is minimal potential that the earnings performance or capital position will be adversely affected. Risk management practices are strong for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide substantial support for the degree of market risk taken by the institution.

A rating of 2 indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.

A rating of 3 indicates that control of market risk sensitivity needs improvement or that there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital may not adequately support the degree of market risk taken by the institution.

A rating of 4 indicates that control of market risk sensitivity is unacceptable or that there is high potential that the earnings performance or capital position will be adversely affected. Risk management practices are deficient for the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital provide inadequate support for the degree of market risk taken by the institution.

A rating of 5 indicates that control of market risk sensitivity is unacceptable or that the level of market risk taken by the institution is an imminent threat to its viability. Risk management practices are wholly inadequate for the size, sophistication, and level of market risk accepted by the institution.

INFORMATION TECHNOLOGY

Uniform Rating System for Information Technology (URSIT) Composite and Component Ratings

Composite Ratings

Composite 1

Financial institutions and service providers rated composite 1 exhibit strong performance in every respect and generally have components rated 1 or 2. Weaknesses in IT are minor in nature and are easily corrected during the normal course of business. Risk management processes provide a comprehensive program to identify and monitor risk relative to the size, complexity, and risk profile of the entity. Strategic plans are well defined and fully integrated throughout the organization. This allows management to quickly adapt to changing market, business, and technology needs of the entity. Management identifies weaknesses promptly and takes appropriate corrective action to resolve audit and regulatory concerns. The financial condition of the service provider is strong and overall performance shows no cause for supervisory concern.

Composite 2

Financial institutions and service providers rated composite 2 exhibit safe and sound performance but may demonstrate modest weaknesses in operating performance, monitoring, management processes, or system development. Generally, senior management corrects weaknesses in the normal course of business. Risk management processes adequately identify and monitor risk relative to the size, complexity, and risk profile of the entity. Strategic plans are defined but may require clarification, better coordination, or improved communication throughout the organization. As a result, management anticipates, but responds less quickly, to changes in market, business, and technological needs of the entity. Management normally identifies weaknesses and takes appropriate corrective action. However, greater reliance is placed on audit and regulatory intervention to identify and resolve concerns. The financial condition of the service provider is acceptable and while internal control weaknesses may exist, there are no significant supervisory concerns. As a result, supervisory action is informal and limited.

Composite 3

Financial institutions and service providers rated composite 3 exhibits some degree of supervisory concern due to a combination of weaknesses that may range from moderate to severe. If weaknesses persist, further deterioration in the condition and performance of the institution or service provider is likely. Risk management processes may not effectively identify risks and may not be appropriate for the size, complexity, or risk profile of the entity. Strategic plans are vaguely defined and may not provide adequate direction for IT initiatives. As a result, management often has difficulty responding to changes in business, market, and technological needs of the entity. Self-assessment practices are weak and are generally reactive to audit and regulatory exceptions. Repeat concerns may exist indicating that management may lack the ability or willingness to resolve concerns. The financial condition of the service provider may be weak and/or negative trends may be evident. While financial or operational failure is unlikely, increased supervision is necessary. Formal or informal supervisory action may be necessary to secure corrective action.

Composite 4

Financial institutions and service providers rated composite 4 operate in an unsafe and unsound environment that may impair the future viability of the entity. Operating weaknesses are indicative of serious managerial deficiencies. Risk management processes inadequately identify and monitor risk, and practices are not appropriate given the size, complexity, and risk profile of the entity. Strategic plans are poorly defined and not coordinated or communicated throughout the organization. As a result, management and the board are not committed to, or may be incapable of ensuring, that technological needs are met. Management does not perform self-assessments and demonstrates an inability or unwillingness to correct audit and regulatory concerns. The financial condition of the service provider is severely impaired or deteriorating. Failure of the financial institution or service provider may be

likely unless IT problems are remedied. Close supervisory attention is necessary and, in most cases, formal enforcement action is warranted.

Composite 5

Financial institutions and service providers rated composite 5 exhibit critically deficient operating performances and are in need of immediate remedial action. Operational problems and serious weaknesses may exist throughout the organization. Risk management processes are severely deficient and provide management little or no perception of risk relative to the size, complexity, and risk profile of the entity. Strategic plans do not exist or are ineffective, and management and the board provide little or no direction for IT initiatives. As a result, management is unaware of, or inattentive to, technological needs of the entity. Management is unwilling or incapable of correcting audit and regulatory concerns. The financial condition of the service provider is poor and failure is highly probable due to poor operating performance or financial instability. Ongoing supervisory attention is necessary.

Component Ratings

Each of the component rating descriptions are divided into an introductory paragraph, a list of principal evaluation factors, and a brief description of each numerical rating. Some of the evaluation factors are reiterated under one or more of the other components to reinforce the interrelationship between components. The evaluation factors for each component rating are in no particular order of importance.

Audit

Financial institutions and service providers are expected to provide independent assessments of their exposure to risks and the quality of internal controls associated with the acquisition, implementation and use of information technology.⁵ Audit practices should address the IT risk exposures throughout the institution and its service provider(s) in the areas of user and data center operations, client/server architecture, local and wide area networks, telecommunications, information security, electronic data interchange, systems development, and contingency planning. This rating should reflect the adequacy of the organization's overall IT audit program, including the internal and external auditor's abilities to detect and report significant risks to management and the board of directors on a timely basis. It should also reflect the internal and external auditor's capability to promote a safe, sound, and effective operation.

The performance of audit is rated based upon an assessment of factors such as:

- The level of independence maintained by audit and the quality of the oversight and support provided by the board of directors and management;
- The adequacy of audit's risk analysis methodology used to prioritize the allocation of audit resources and to formulate the audit schedule;
- The scope, frequency, accuracy, and timeliness of internal and external audit reports;
- The extent of audit participation in application development, acquisition, and testing, to ensure the effectiveness of internal controls and audit trails;
- The adequacy of the overall audit plan in providing appropriate coverage of IT risks;
- The auditor's adherence to codes of ethics and professional audit standards;
- The qualifications of the auditor, staff succession, and continued development through training;
- The existence of timely and formal follow-up and reporting on management's resolution of identified problems or weaknesses;
- The quality and effectiveness of internal and external audit activity as it relates to IT controls.

Ratings

A rating of ``1" indicates strong audit performance. Audit independently identifies and reports weaknesses and risks to the board of directors or its audit committee in a thorough and timely manner. Outstanding audit issues are monitored until resolved. Risk analysis ensures that audit plans address all significant IT operations, procurement, and development activities with appropriate scope and frequency. Audit work is performed in

accordance with professional auditing standards and report content is timely, constructive, accurate, and complete. Because audit is strong, examiners may place substantial reliance on audit results.

A rating of ``2" indicates satisfactory audit performance. Audit independently identifies and reports weaknesses and risks to the board of directors or audit committee, but reports may be less timely. Significant outstanding audit issues are monitored until resolved. Risk analysis ensures that audit plans address all significant IT operations, procurement, and development activities; however, minor concerns may be noted with the scope or frequency. Audit work is performed in accordance with professional auditing standards; however, minor or infrequent problems may arise with the timeliness, completeness and accuracy of reports. Because audit is satisfactory, examiners may rely on audit results but because minor concerns exist, examiners may need to expand verification procedures in certain situations.

A rating of ``3" indicates less than satisfactory audit performance. Audit identifies and reports weaknesses and risks; however, independence may be compromised and reports presented to the board or audit committee may be less than satisfactory in content and timeliness. Outstanding audit issues may not be adequately monitored. Risk analysis is less than satisfactory. As a result, the audit plan may not provide sufficient audit scope or frequency for IT operations, procurement, and development activities. Audit work is generally performed in accordance with professional auditing standards; however, occasional problems may be noted with the timeliness, completeness and/or accuracy of reports. Because audit is less than satisfactory, examiners must use caution if they rely on the audit results.

A rating of ``4" indicates deficient audit performance. Audit may identify weaknesses and risks but it may not independently report to the board or audit committee and report content may be inadequate. Outstanding audit issues may not be adequately monitored and resolved. Risk analysis is deficient. As a result, the audit plan does not provide adequate audit scope or frequency for IT operations, procurement, and development activities. Audit work is often inconsistent with professional auditing standards and the timeliness, accuracy, and completeness of reports is unacceptable. Because audit is deficient, examiners cannot rely on audit results.

A rating of ``5" indicates critically deficient audit performance. If an audit function exists, it lacks sufficient independence and, as a result, does not identify and report weaknesses or risks to the board or audit committee. Outstanding audit issues are not tracked and no follow-up is performed to monitor their resolution. Risk analysis is critically deficient. As a result, the audit plan is ineffective and provides inappropriate audit scope and frequency for IT operations, procurement and development activities. Audit work is not performed in accordance with professional auditing standards and major deficiencies are noted regarding the timeliness, accuracy, and completeness of audit reports. Because audit is critically deficient examiners cannot rely on audit results.

Management

This rating reflects the abilities of the board and management as they apply to all aspects of IT acquisition, development, and operations. Management practices may need to address some or all of the following IT-related risks: strategic planning, quality assurance, project management, risk assessment, infrastructure and architecture, end-user computing, contract administration of third party service providers, organization and human resources, regulatory and legal compliance. Generally, directors need not be actively involved in day-to-day operations; however, they must provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures, and practices have been established. Sound management practices are demonstrated through active oversight by the board of directors and management, competent personnel, sound IT plans, adequate policies and standards, an effective control environment, and risk monitoring. This rating should reflect the board's and management's ability as it applies to all aspects of IT operations.

The performance of management and the quality of risk management are rated based upon an assessment of factors such as:

- The level and quality of oversight and support of the IT activities by the board of directors and management;

- The ability of management to plan for and initiate new activities or products in response to information needs and to address risks that may arise from changing business conditions;
- The ability of management to provide information reports necessary for informed planning and decision making in an effective and efficient manner;
- The adequacy of, and conformance with, internal policies and controls addressing the IT operations and risks of significant business activities;
- The effectiveness of risk monitoring systems;
- The timeliness of corrective action for reported and known problems;
- The level of awareness of and compliance with laws and regulations;
- The level of planning for management succession;
- The ability of management to monitor the services delivered and to measure the organization's progress toward identified goals in an effective and efficient manner;
- The adequacy of contracts and management's ability to monitor relationships with third-party servicers;
- The adequacy of strategic planning and risk management practices to identify, measure, monitor, and control risks, including management's ability to perform self-assessments;
- The ability of management to identify, measure, monitor, and control risks and to address emerging information technology needs and solutions.

In addition to the above, factors such as the following are included in the assessment of management at service providers:

- The financial condition and ongoing viability of the entity;
- The impact of external and internal trends and other factors on the ability of the entity to support continued servicing of client financial institutions;
- The propriety of contractual terms and plans.

Ratings

A rating of ``1" indicates strong performance by management and the board. Effective risk management practices are in place to guide IT activities, and risks are consistently and effectively identified, measured, controlled, and monitored. Management immediately resolves audit and regulatory concerns to ensure sound operations. Written technology plans, policies and procedures, and standards are thorough and properly reflect the complexity of the IT environment. They have been formally adopted, communicated, and enforced throughout the organization. IT systems provide accurate, timely reports to management. These reports serve as the basis of major decisions and as an effective performance-monitoring tool. Outsourcing arrangements are based on comprehensive planning; routine management supervision sustains an appropriate level of control over vendor contracts, performance, and services provided. Management and the board have demonstrated the ability to promptly and successfully address existing IT problems and potential risks.

A rating of ``2" indicates satisfactory performance by management and the board. Adequate risk management practices are in place and guide IT activities. Significant IT risks are identified, measured, monitored, and controlled; however, risk management processes may be less structured or inconsistently applied and modest weaknesses exist. Management routinely resolves audit and regulatory concerns to ensure effective and sound operations, however, corrective actions may not always be implemented in a timely manner. Technology plans, policies and procedures, and standards are adequate and are formally adopted. However, minor weaknesses may exist in management's ability to communicate and enforce them throughout the organization. IT systems provide quality reports to management which serve as a basis for major decisions and a tool for performance planning and monitoring. Isolated or temporary problems with timeliness, accuracy or consistency of reports may exist. Outsourcing arrangements are adequately planned and controlled by management, and provide for a general understanding of vendor contracts, performance standards and services provided. Management and the board have demonstrated the ability to address existing IT problems and risks successfully.

A rating of ``3" indicates less than satisfactory performance by management and the board. Risk management practices may be weak and offer limited guidance for IT activities. Most IT risks are generally identified; however,

processes to measure and monitor risk may be flawed. As a result, management's ability to control risk is less than satisfactory. Regulatory and audit concerns may be addressed, but time frames are often excessive and the corrective action taken may be inappropriate. Management may be unwilling or incapable of addressing deficiencies. Technology plans, policies and procedures, and standards exist, but may be incomplete. They may not be formally adopted, effectively communicated, or enforced throughout the organization. IT systems provide requested reports to management, but periodic problems with accuracy, consistency and timeliness lessen the reliability and usefulness of reports and may adversely affect decision making and performance monitoring. Outsourcing arrangements may be entered into without thorough planning. Management may provide only cursory supervision that limits their understanding of vendor contracts, performance standards, and services provided. Management and the board may not be capable of addressing existing IT problems and risks, evidenced by untimely corrective actions for outstanding IT problems.

A rating of ``4" indicates deficient performance by management and the board. Risk management practices are inadequate and do not provide sufficient guidance for IT activities. Critical IT risk are not properly identified, and processes to measure and monitor risks are deficient. As a result, management may not be aware of and is unable to control risks. Management may be unwilling and/or incapable of addressing audit and regulatory deficiencies in an effective and timely manner. Technology plans, policies and procedures, and standards are inadequate, have not been formally adopted, or effectively communicated throughout the organization, and management does not effectively enforce them. IT systems do not routinely provide management with accurate, consistent, and reliable reports, thus contributing to ineffective performance monitoring and/or flawed decision making. Outstanding arrangements may be entered into without planning or analysis, and management may provide little or no supervision of vendor contracts, performance standards, or services provided. Management and the board are unable to address existing IT problems and risks, as evidenced by ineffective actions and longstanding IT weaknesses. Strengthening of management and its processes is necessary. The financial condition of the service provider may threaten its viability.

A rating of ``5" indicates critically deficient performance by management and the board. Risk management practices are severely flawed and provide inadequate guidance for IT activities. Critical IT risks are not identified, and processes to measure and monitor risks do not exist, or are not effective. Management's inability to control risk may threaten the continued viability of the institution or service provider. Management is unable and/or unwilling to correct audit and regulatory identified deficiencies and immediate action by the board is required to preserve the viability of the institution or service provider. If they exist, technology plans, policies and procedures, and standards are critically deficient. Because of systemic problems, IT systems do not produce management reports which are accurate, timely, or relevant. Outsourcing arrangements may have been entered into without management planning or analysis, resulting in significant losses to the financial institution or ineffective vendor services. The financial condition of the service provider presents an imminent threat to its viability.

Development and Acquisition

This rating reflects an organization's ability to identify, acquire, install, and maintain appropriate information technology solutions. Management practices may need to address all or parts of the business process for implementing any kind of change to the hardware or software used. These business processes include an institution's or service provider's purchase of hardware or software, development and programming performed by the institution or service provider, purchase of services from independent vendors or affiliated data centers, or a combination of these activities. The business process is defined as all phases taken to implement a change including researching alternatives available, choosing an appropriate option for the organization as a whole, and converting to the new system, or integrating the new system with existing systems. This rating reflects the adequacy of the institution's systems development methodology and related risk management practices for acquisition and deployment of information technology. This rating also reflects the boards and management's ability to enhance and replace information technology prudently in a controlled environment.

The performance of systems development and acquisition and related risk management practice is rated based upon an assessment of factors such as:

- The level and quality of oversight and support of systems development and acquisition activities by senior management and the board of directors;
- The adequacy of the organizational and management structures to establish accountability and responsibility for IT systems and technology initiatives. The volume, nature, and extent of risk exposure to the financial institution in the area of systems development and acquisition;
- The adequacy of the institution's Systems Development Life Cycle (SDLC) and programming standards;
- The quality of project management programs and practices which are followed by developers, operators, executive management/owners, independent vendors or affiliated servicers, and end-users;
- The independence of the quality assurance function and the adequacy of controls over program changes;
- The quality and thoroughness of system documentation;
- The integrity and security of the network, system, and application software;
- The development of information technology solutions that meet the needs of end users;
- The extent of end user involvement in the system development process.

In addition to the above, factors such as the following are included in the assessment of development and acquisition at service providers:

- The quality of software releases and documentation;
- The adequacy of training provided to clients.

Ratings

A rating of ``1'' indicates strong systems development, acquisition, implementation, and change management performance. Management and the board routinely demonstrate successfully the ability to identify and implement appropriate IT solutions while effectively managing risk. Project management techniques and the SDLC are fully effective and supported by written policies, procedures and project controls that consistently result in timely and efficient project completion. An independent quality assurance function provides strong controls over testing and program change management. Technology solutions consistently meet end user needs. No significant weaknesses or problems exist.

A rating of ``2'' indicates satisfactory systems development, acquisition, implementation, and change management performance. Management and the board frequently demonstrate the ability to identify and implement appropriate IT solutions while managing risk. Project management and the SDLC are generally effective; however, weaknesses may exist that result in minor project delays or cost overruns. An independent quality assurance function provides adequate supervision of testing and program change management, but minor weaknesses may exist. Technology solutions meet end user needs. However, minor enhancements may be necessary to meet original user expectations. Weaknesses may exist; however, they are not significant and they are easily corrected in the normal course of business.

A rating of ``3'' indicates less than satisfactory systems development, acquisition, implementation, and change management performance. Management and the board may often be unsuccessful in identifying and implementing appropriate IT solutions; therefore, unwarranted risk exposure may exist. Project management techniques and the SDLC are weak and may result in frequent project delays, backlogs or significant cost overruns. The quality assurance function may not be independent of the programming function which may adversely impact the integrity of testing and program change management. Technology solutions generally meet end user needs, but often require an inordinate level of change after implementation. Because of weaknesses, significant problems may arise that could result in disruption to operations or significant losses.

A rating of ``4'' indicates deficient systems development, acquisition, implementation and change management performance. Management and the board may be unable to identify and implement appropriate IT solutions and do not effectively manage risk. Project management techniques and the SDLC are ineffective and may result in severe project delays and cost overruns. The quality assurance function is not fully effective and may not provide independent or comprehensive review of testing controls or program change management. Technology solutions

may not meet the critical needs of the organization. Problems and significant risks exist that require immediate action by the board and management to preserve the soundness of the institution.

A rating of "5" indicates critically deficient systems development, acquisition, implementation, and change management performance. Management and the board appear to be incapable of identifying, and implementing appropriate information technology solutions. If they exist, project management techniques and the SDLC are critically deficient and provide little or no direction for development of systems or technology projects. The quality assurance function is severely deficient or not present and unidentified problems in testing and program change management have caused significant IT risks. Technology solutions do not meet the needs of the organization. Serious problems and significant risks exist which raise concern for the financial institutions' or service providers' ongoing viability.

Support and Delivery

This rating reflects an organization's ability to provide technology services in a secure environment. It reflects not only the condition of IT operations but also factors such as reliability, security, and integrity, which may affect the quality of the information delivery system. The factors include customer support and training, and the ability to manage problems and incidents, operations, system performance, capacity planning, and facility and data management. Risk management practices should promote effective, safe and sound IT operations that ensure the continuity of operations and the reliability and availability of data. The scope of this component rating includes operational risks throughout the organization and service providers.

The rating of IT support and delivery is based on a review and assessment of requirements such as:

- The ability to provide a level of service that meets the requirements of the business;
- The adequacy of security policies, procedures, and practices in all units and at all levels of the financial institution and service providers;
- The adequacy of data controls over preparation, input, processing, and output;
- The adequacy of corporate contingency planning and business resumption for data centers, networks, service providers and business units;
- The quality of processes or programs that monitor capacity and performance;
- The adequacy of controls and the ability to monitor controls at service providers;
- The quality of assistance provided to users, including the ability to handle problems;
- The adequacy of operating policies, procedures, and manuals;
- The quality of physical and logical security, including the privacy of data;
- The adequacy of firewall architectures and the security of connections with public networks.

In addition to the above, factors such as the following are included in the assessment of support and delivery at service providers:

- The adequacy of customer service provided to clients;
- The ability of the entity to provide and maintain service level performance that meets the requirements of the client.

Ratings

A rating of "1" indicates strong IT support and delivery performance. The organization provides technology services that are reliable and consistent. Service levels adhere to well-defined service level agreements and routinely meet or exceed business requirements. A comprehensive corporate contingency and business resumption plan is in place. Annual contingency plan testing and updating is performed; and, critical systems and applications are recovered within acceptable time frames. A formal written data security policy and awareness program is communicated and enforced throughout the organization. The logical and physical security for all IT platforms is closely monitored and security incidents and weaknesses are identified and quickly corrected. Relationships with third-party service providers are closely monitored. IT operations are highly reliable, and risk exposure is successfully identified and controlled.

A rating of ``2'' indicates satisfactory IT support and delivery performance. The organization provides technology services that are generally reliable and consistent, however, minor discrepancies in service levels may occur. Service performance adheres to service agreements and meets business requirements. A corporate contingency and business resumption plan is in place, but minor enhancements may be necessary. Annual plan testing and updating is performed and minor problems may occur when recovering systems or applications. A written data security policy is in place but may require improvement to ensure its adequacy. The policy is generally enforced and communicated throughout the organization, e.g. via a security awareness program. The logical and physical security for critical IT platforms is satisfactory. Systems are monitored, and security incidents and weaknesses are identified and resolved within reasonable time frames. Relationships with third-party service providers are monitored. Critical IT operations are reliable and risk exposure is reasonably identified and controlled.

A rating of ``3'' indicates that the performance of IT support and delivery is less than satisfactory and needs improvement. The organization provides technology services that may not be reliable or consistent. As a result, service levels periodically do not adhere to service level agreements or meet business requirements. A corporate contingency and business resumption plan is in place but may not be considered comprehensive. The plan is periodically tested; however, the recovery of critical systems and applications is frequently unsuccessful. A data security policy exists; however, it may not be strictly enforced or communicated throughout the organization. The logical and physical security for critical IT platforms is less than satisfactory. Systems are monitored; however, security incidents and weaknesses may not be resolved in a timely manner. Relationships with third-party service providers may not be adequately monitored. IT operations are not acceptable and unwarranted risk exposures exist. If not corrected, weaknesses could cause performance degradation or disruption to operations.

A rating of ``4'' indicates deficient IT support and delivery performance. The organization provides technology services that are unreliable and inconsistent. Service level agreements are poorly defined and service performance usually fails to meet business requirements. A corporate contingency and business resumption plan may exist, but its content is critically deficient. If contingency testing is performed, management is typically unable to recover critical systems and applications. A data security policy may not exist. As a result, serious supervisory concerns over security and the integrity of data exist. The logical and physical security for critical IT platforms is deficient. Systems may be monitored, but security incidents and weaknesses are not successfully identified or resolved. Relationships with third-party service providers are not monitored. IT operations are not reliable and significant risk exposure exists. Degradation in performance is evident and frequent disruption in operations has occurred.

A rating of ``5'' indicates critically deficient IT support and delivery performance. The organization provides technology services that are not reliable or consistent. Service level agreements do not exist and service performance does not meet business requirements. A corporate contingency and business resumption plan does not exist. Contingency testing is not performed and management has not demonstrated the ability to recover critical systems and applications. A data security policy does not exist, and a serious threat to the organization's security and data integrity exists. The logical and physical security for critical IT platforms is inadequate, and management does not monitor systems for security incidents and weaknesses. Relationships with third-party service providers are not monitored, and the viability of a service provider may be in jeopardy. IT operations are severely deficient, and the seriousness of weaknesses could cause failure of the financial institution or service provider if not addressed.

BANK SECRECY ACT / ANTI-MONEY LAUNDERING

Bank Secrecy Act and Anti-Money Laundering programs are rated:

- Satisfactory
- Unsatisfactory

The Federal Financial Institutions Examination Council (FFIEC) provides guidance for BSA/AML compliance programs. An effective compliance program should focus on sound risk management. The expectations for a sound BSA/AML compliance program and competent risk management can be found in the FFIEC's Bank Secrecy Act / Anti-Money Laundering Examination Manual.

The examination program will focus on the risk assessment and compliance program for the following:

- Customer Identification Program
- Customer Due Diligence
- Suspicious Activity Reporting
- Currency Transactions Reporting
- Currency Transactions Reporting Exemptions
- Information Sharing
- Purchase and Sale of Monetary Instruments Recordkeeping
- Funds Transfer Recordkeeping
- Foreign Correspondent Accounts Recordkeeping, Reporting, and Due Diligence
- Private Banking Due Diligence Program
- Special Measures
- Foreign Bank and Financial Accounts Reporting
- International Transportation of Currency or Monetary Instruments Reporting
- Office of Foreign Assets Control

Should a regulated entity be deemed more complex, the aforementioned areas could receive expanded examination procedures. Expanded procedures for products and services exist for:

- Correspondent Accounts (Domestic and Foreign)
- Bulk Shipments of Currency
- U.S. Dollar Drafts
- Payable Through Accounts
- Pouch Activities
- Electronic Banking
- Funds Transfers
- Automated Clearing House Transactions
- Prepaid Access
- Third-Party Payment Processors
- Purchase and Sale of Monetary Instruments
- Brokered Deposits
- Privately Owned Automated Teller Machines
- Non Deposit Investment Products
- Insurance
- Concentration Accounts
- Lending Activity
- Trade Finance Activity
- Private Banking
- Trust and Asset Management Services

TRUST

Uniform Interagency Trust Rating System (UITRS) Composite and Component Ratings

Composite Ratings

Composite 1

Administration of fiduciary activities is sound in every respect. Generally all components are rated 1 or 2. Any weaknesses are minor and can be handled in a routine manner by management. The institution is in substantial compliance with fiduciary laws and regulations. Risk management practices are strong relative to the size, complexity, and risk profile of the institution's fiduciary activities. Fiduciary activities are conducted in accordance with sound fiduciary principles and give no cause for supervisory concern.

Composite 2

Administration of fiduciary activities is fundamentally sound. Generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Composite 3

Administration of fiduciary activities exhibits some degree of supervisory concern in one or more of the component areas. A combination of weaknesses exists that may range from moderate to severe; however, the magnitude of the deficiencies generally does not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Additionally, fiduciary activities may reveal some significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. While problems of relative significance may exist, they are not of such importance as to pose a threat to the trust beneficiaries generally, or to the soundness of the institution. The institution's fiduciary activities require more than normal supervision and may include formal or informal enforcement actions.

Composite 4

Fiduciary activities generally exhibit unsafe and unsound practices or conditions, resulting in unsatisfactory performance. The problems range from severe to critically deficient and may be centered around inexperienced or inattentive management, weak or dangerous operating practices, or an accumulation of unsatisfactory features of lesser importance. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the size, complexity, and risk profile of fiduciary activities. These problems pose a threat to the account beneficiaries generally and, if left unchecked, could evolve into conditions that could cause significant losses to the institution and ultimately undermine the public confidence in the institution. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems.

Composite 5

Fiduciary activities are conducted in an extremely unsafe and unsound manner. Administration of fiduciary activities is critically deficient in numerous major respects, with problems resulting from incompetent or neglectful administration, flagrant and/or repeated disregard for laws and regulations, or a willful departure from sound fiduciary principles and practices. The volume and severity of problems are beyond management's ability or willingness to control or correct. Such conditions evidence a flagrant disregard for the interests of the beneficiaries and may pose a serious threat to the soundness of the institution. Continuous close supervisory attention is warranted and may include termination of the institution's fiduciary activities.

Component Ratings

Each of the component rating descriptions is divided into three sections: a narrative description of the component; a list of the principal factors used to evaluate that component; and a 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 among components. The listing of evaluation factors is in no particular order of importance.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor and control the risks of an institution's fiduciary activities. It also reflects their ability to ensure that the institution's fiduciary activities are conducted in a safe and sound manner, and in compliance with applicable laws and regulations. Directors should provide clear guidance regarding acceptable risk exposure levels and ensure that appropriate policies, procedures and practices are established and followed. Senior fiduciary management is responsible for developing and implementing policies, procedures and practices that translate the board's objectives and risk limits into prudent operating standards.

Depending on the nature and scope of an institution's fiduciary activities, management practices may need to address some or all of the following risks: reputation, operating or transaction, strategic, compliance, legal, credit, market, 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 that consider the size and complexity of the institution's fiduciary activities; 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 fiduciary activities in which the institution is involved.

The management rating is based upon an assessment of the capability and performance of management and the board of directors, including, but not limited to, the following evaluation factors:

- The level and quality of oversight and support of fiduciary activities by the board of directors and management, including committee structure and adequate documentation of committee actions;
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the introduction of new activities or products;
- The adequacy of, and conformance with, appropriate internal policies, practices and controls addressing the operations and risks of significant fiduciary activities;
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and fiduciary risk profile;
- The overall level of compliance with laws, regulations, and sound fiduciary principles;
- Responsiveness to recommendations from auditors and regulatory authorities;
- Strategic planning for fiduciary products and services;
- The level of experience and competence of fiduciary management and staff, including issues relating to turnover and succession planning;
- The adequacy of insurance coverage;
- The availability of competent legal counsel;
- The extent and nature of pending litigation associated with fiduciary activities, and its potential impact on earnings, capital, and the institution's reputation;
- The process for identifying and responding to fiduciary customer complaints.

Ratings

A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board are

proactive, and have demonstrated the ability to promptly and successfully address existing and potential problems and risks.

A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the size, complexity and risk profile of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material to the sound administration of fiduciary activities, and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

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

A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the size, complexity, and risk profile of the institution's fiduciary activities. 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 protect the assets of account beneficiaries and to prevent erosion of public confidence in the institution. Replacing or strengthening management or the board may be necessary.

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 or its administration of fiduciary activities, and pose a threat to the safety of the assets of account beneficiaries. Replacing or strengthening management or the board of directors is necessary.

Operations, Internal Controls & Auditing

This rating reflects the adequacy of the institution's fiduciary operating systems and internal controls in relation to the volume and character of business conducted. Audit coverage must assure the integrity of the financial records, the sufficiency of internal controls, and the adequacy of the compliance process.

The institution's fiduciary operating systems, internal controls, and audit function subject it primarily to transaction and compliance risk. Other risks including reputation, strategic, and financial risk may also be present. The ability of management to identify, measure, monitor and control these risks is reflected in this rating.

The operations, internal controls and auditing rating is based upon, but not limited to, an assessment of the following evaluation factors:

Operations and Internal Controls, including the adequacy of:

- Staff, facilities and operating systems;
- Records, accounting and data processing systems (including controls over systems access and such accounting procedures as aging, investigation and disposition of items in suspense accounts);
- Trading functions and securities lending activities;
- Vault controls and securities movement;
- Segregation of duties;
- Controls over disbursements (checks or electronic) and unissued securities;
- Controls over income processing activities;
- Reconciliation processes (depository, cash, vault, sub-custodians, suspense accounts, etc.);
- Disaster and/or business recovery programs;

- Hold-mail procedures and controls over returned mail; and,
- Investigation and proper escheatment of funds in dormant accounts.

Auditing, including:

- The independence, frequency, quality and scope of the internal and external fiduciary audit function relative to the volume, character and risk profile of the institution's fiduciary activities;
- The volume and/or severity of internal control and audit exceptions and the extent to which these issues are tracked and resolved; and
- The experience and competence of the audit staff.

Ratings

A rating of 1 indicates that operations, internal controls, and auditing are strong in relation to the volume and character of the institution's fiduciary activities. All significant risks are consistently and effectively identified, measured, monitored, and controlled.

A rating of 2 indicates that operations, internal controls and auditing are satisfactory in relation to the volume and character of the institution's fiduciary activities. Moderate weaknesses may exist, but are not material. Significant risks, in general, are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates that operations, internal controls or auditing need improvement in relation to the volume and character of the institution's fiduciary activities. One or more of these areas are less than satisfactory. Problems and significant risks may be inadequately identified, measured, monitored, or controlled.

A rating of 4 indicates deficient operations, internal controls or audits. One or more of these areas are inadequate or the level of problems and risk exposure is excessive in relation to the volume and character of the institution's fiduciary activities. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action. Institutions with this level of deficiencies may make little provision for audits, or may evidence weak or potentially dangerous operating practices in combination with infrequent or inadequate audits.

A rating of 5 indicates critically deficient operations, internal controls or audits. Operating practices, with or without audits, pose a serious threat to the safety of assets of fiduciary accounts. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of the institution to continue engaging in fiduciary activities.

Earnings

This rating reflects the profitability of an institution's fiduciary activities and its effect on the financial condition of the institution. The use and adequacy of budgets and earnings projections by functions, product lines and clients are reviewed and evaluated. Risk exposure that may lead to negative earnings is also evaluated.

An evaluation of earnings is required for all institutions with fiduciary activities. An assignment of an earnings rating, however, is required only for institutions that, at the time of the examination, have total trust assets of more than \$100 million, or are a non-deposit trust company (those institutions that would be required to file Schedule E of FFIEC 001).

For institutions where the assignment of an Earnings rating is not required by the UITRS, the Federal supervisory agency has the option to assign an earnings rating using an alternate set of ratings. A rating will be assigned in accordance with implementing guidelines adopted by the supervisory agency. The definitions for the alternate ratings are included in the revised UITRS and may be found in the section immediately following the definitions for the required ratings.

The evaluation of earnings is based upon, but not limited to, an assessment of the following factors:

- The profitability of fiduciary activities in relation to the size and scope of those activities and to the overall business of the institution;
- The overall importance to the institution of offering fiduciary services to its customers and local community;
- The effectiveness of the institution's procedures for monitoring fiduciary activity income and expense relative to the size and scope of these activities and their relative importance to the institution, including the frequency and scope of profitability reviews and planning by the institution's board of directors or a committee thereof.

For those institutions for which a rating of earnings is mandatory, additional factors should include the following:

- The level and consistency of profitability, or the lack thereof, generated by the institution's fiduciary activities in relation to the volume and character of the institution's business;
- Dependence upon non-recurring fees and commissions, such as fees for court accounts;
- The effects of charge-offs or compromise actions;
- Unusual features regarding the composition of business and fee schedules;
- Accounting practices that contain practices such as (1) unusual methods of allocating direct and indirect expenses and overhead, or (2) unusual methods of allocating fiduciary income and expense where two or more fiduciary institutions within the same holding company family share fiduciary services and/or processing functions;
- The extent of management's use of budgets, projections and other cost analysis procedures;
- Methods used for directors' approval of financial budgets and/or projections;
- Management's attitude toward growth and new business development;
- New business development efforts, including types of business solicited, market potential, advertising, competition, relationships with local organizations, and an evaluation by management of risk potential inherent in new business areas.

Ratings

A rating of 1 indicates strong earnings. The institution consistently earns a rate of return on its fiduciary activities that is commensurate with the risk of those activities. This rating would normally be supported by a history of consistent profitability over time and a judgement that future earnings prospects are favorable. In addition, management techniques for evaluating and monitoring earnings performance are fully adequate and there is appropriate oversight by the institution's board of directors or a committee thereof. Management makes effective use of budgets and cost analysis procedures. Methods used for reporting earnings information to the board of directors, or a committee thereof, are comprehensive.

A rating of 2 indicates satisfactory earnings. Although the earnings record may exhibit some weaknesses, earnings performance does not pose a risk to the overall institution nor to its ability to meet its fiduciary obligations. Generally, fiduciary earnings meet management targets and appear to be at least sustainable. Management processes for evaluating and monitoring earnings are generally sufficient in relationship to the size and risk of fiduciary activities that exist, and any deficiencies can be addressed in the normal course of business. A rating of 2 may also be assigned to institutions with a history of profitable operations if there are indications that management is engaging in activities with which it is not familiar, or where there may be inordinately high levels of risk present that have not been adequately evaluated. Alternatively, an institution with otherwise strong earnings performance may also be assigned a 2 rating if there are significant deficiencies in its methods used to monitor and evaluate earnings.

A rating of 3 indicates less than satisfactory earnings. Earnings are not commensurate with the risk associated with the fiduciary activities undertaken. Earnings may be erratic or exhibit downward trends, and future prospects are unfavorable. This rating may also be assigned if management processes for evaluating and monitoring earnings

exhibit serious deficiencies, provided the deficiencies identified do not pose an immediate danger to either the overall financial condition of the institution or its ability to meet its fiduciary obligations.

A rating of 4 indicates earnings that are seriously deficient. Fiduciary activities have a significant adverse effect on the overall income of the institution and its ability to generate adequate capital to support the continued operation of its fiduciary activities. The institution is characterized by fiduciary earnings performance that is poor historically, or faces the prospect of significant losses in the future. Management processes for monitoring and evaluating earnings may be poor. The board of directors has not adopted appropriate measures to address significant deficiencies.

A rating of 5 indicates critically deficient earnings. In general, an institution with this rating is experiencing losses from fiduciary activities that have a significant negative impact on the overall institution, representing a distinct threat to its viability through the erosion of its capital. The board of directors has not implemented effective actions to address the situation.

Alternate Rating of Earnings

Alternate ratings are assigned based on the level of implementation of four minimum standards by the board of directors and management. These standards are:

Standard No. 1--The institution has reasonable methods for measuring income and expense commensurate with the volume and nature of the fiduciary services offered.

Standard No. 2--The level of profitability is reported to the board of directors, or a committee thereof, at least annually.

Standard No. 3--The board of directors periodically determines that the continued offering of fiduciary services provides an essential service to the institution's customers or to the local community.

Standard No. 4--The board of directors, or a committee thereof, reviews the justification for the institution to continue to offer fiduciary services even if the institution does not earn sufficient income to cover the expenses of providing those services.

Ratings

A rating of 1 may be assigned where an institution has implemented all four minimum standards. If fiduciary earnings are lacking, management views this as a cost of doing business as a full service institution and believes that the negative effects of not offering fiduciary services are more significant than the expense of administering those services.

A rating of 2 may be assigned where an institution has implemented, at a minimum, at least three of the four standards. This rating may be assigned if the institution is not generating positive earnings or where formal earnings information may not be available.

A rating of 3 may be assigned if the institution has implemented at least two of the four standards. While management may have attempted to identify and quantify other revenue to be earned by offering fiduciary services, it has decided that these services should be offered as a service to customers, even if they cannot be operated profitably.

A rating of 4 may be assigned if the institution has implemented only one of the four standards. Management has undertaken little or no effort to identify or quantify the collateral advantages, if any, to the institution from offering fiduciary services.

A rating of 5 may be assigned if the institution has implemented none of the standards.

Compliance

This rating reflects an institution's overall compliance with applicable laws, regulations, accepted standards of fiduciary conduct, governing account instruments, duties associated with account administration, and internally established policies and procedures. This component specifically incorporates an assessment of a fiduciary's duty of undivided loyalty and compliance with applicable laws, regulations, and accepted standards of fiduciary conduct related to self-dealing and other conflicts of interest.

The compliance component includes reviewing and evaluating the adequacy and soundness of adopted policies, procedures, and practices generally, and as they relate to specific transactions and accounts. It also includes reviewing policies, procedures, and practices to evaluate the sensitivity of management and the board of directors to refrain from self-dealing, minimize potential conflicts of interest, and resolve actual conflict situations in favor of the fiduciary account beneficiaries.

Risks associated with account administration are potentially unlimited because each account is a separate contractual relationship that contains specific obligations. Risks associated with account administration include: failure to comply with applicable laws, regulations or terms of the governing instrument; inadequate account administration practices; and inexperienced management or inadequately trained staff. Risks associated with a fiduciary's duty of undivided loyalty generally stem from engaging in self-dealing or other conflict of interest transactions. An institution may be exposed to compliance, strategic, financial and reputation risk related to account administration and conflicts of interest activities. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. Policies, procedures and practices pertaining to account administration and conflicts of interest are evaluated in light of the size and character of an institution's fiduciary business.

The compliance rating is based upon, but not limited to, an assessment of the following evaluation factors:

- Compliance with applicable federal and state statutes and regulations, including, but not limited to, federal and state fiduciary laws, the Employee Retirement Income Security Act of 1974, federal and state securities laws, state investment standards, state principal and income acts, and state probate codes;
- Compliance with the terms of governing instruments;
- The adequacy of overall policies, practices, and procedures governing compliance, considering the size, complexity, and risk profile of the institution's fiduciary activities;
- The adequacy of policies and procedures addressing account administration;
- The adequacy of policies and procedures addressing conflicts of interest, including those designed to prevent the improper use of "material inside information";
- The effectiveness of systems and controls in place to identify actual and potential conflicts of interest;
- The adequacy of securities trading policies and practices relating to the allocation of brokerage business, the payment of services with "soft dollars" and the combining, crossing, and timing of trades;
- The extent and permissibility of transactions with related parties, including, but not limited to, the volume of related commercial and fiduciary relationships and holdings of corporations in which directors, officers, or employees of the institution may be interested;
- The decision making process used to accept, review, and terminate accounts; and,
- The decision making process related to account administration duties, including cash balances, overdrafts, and discretionary distributions.

Ratings

A rating of 1 indicates strong compliance policies, procedures and practices. Policies and procedures covering conflicts of interest and account administration are appropriate in relation to the size and complexity of the institution's fiduciary activities. Accounts are administered in accordance with governing instruments, applicable laws and regulations, sound fiduciary principles, and internal policies and procedures. Any violations are isolated, technical in nature and easily correctable. All significant risks are consistently and effectively identified, measured, monitored and controlled.

A rating of 2 indicates fundamentally sound compliance policies, procedures and practices in relation to the size and complexity of the institution's fiduciary activities. Account administration may be flawed by moderate weaknesses in policies, procedures or practices. Management's practices indicate a determination to minimize the instances of conflicts of interest. Fiduciary activities are conducted in substantial compliance with laws and regulations, and any violations are generally technical in nature. Management corrects violations in a timely manner and without loss to fiduciary accounts. Significant risks are effectively identified, measured, monitored, and controlled.

A rating of 3 indicates compliance practices that are less than satisfactory in relation to the size and complexity of the institution's fiduciary activities. Policies, procedures and controls have not proven effective and require strengthening. Fiduciary activities may be in substantial noncompliance with laws, regulations or governing instruments, but losses are no worse than minimal. While management may have the ability to achieve compliance, the number of violations that exist, or the failure to correct prior violations, are indications that management has not devoted sufficient time and attention to its compliance responsibilities. Risk management practices generally need improvement.

A rating of 4 indicates an institution with deficient compliance practices in relation to the size and complexity of its fiduciary activities. Account administration is notably deficient. The institution makes little or no effort to minimize potential conflicts or refrain from self-dealing, and is confronted with a considerable number of potential or actual conflicts. Numerous substantive and technical violations of laws and regulations exist and many may remain uncorrected from previous examinations. Management has not exerted sufficient effort to effect compliance and may lack the ability to effectively administer fiduciary activities. The level of compliance problems is significant and, if left unchecked, may subject the institution to monetary losses or reputation risk. Risks are inadequately identified, measured, monitored and controlled.

A rating of 5 indicates critically deficient compliance practices. Account administration is critically deficient or incompetent and there is a flagrant disregard for the terms of the governing instruments and interests of account beneficiaries. The institution frequently engages in transactions that compromise its fundamental duty of undivided loyalty to account beneficiaries. There are flagrant or repeated violations of laws and regulations and significant departures from sound fiduciary principles. Management is unwilling or unable to operate within the scope of laws and regulations or within the terms of governing instruments and efforts to obtain voluntary compliance have been unsuccessful. The severity of noncompliance presents an imminent monetary threat to account beneficiaries and creates significant legal and financial exposure to the institution. Problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the ability of management to continue engaging in fiduciary activities.

Asset Management

This rating reflects the risks associated with managing the assets (including cash) of others. Prudent portfolio management is based on an assessment of the needs and objectives of each account or portfolio. An evaluation of asset management should consider the adequacy of processes related to the investment of all discretionary accounts and portfolios, including collective investment funds, proprietary mutual funds, and investment advisory arrangements.

The institution's asset management activities subject it to reputation, compliance and strategic risks. In addition, each individual account or portfolio managed by the institution is subject to financial risks such as market, credit, liquidity, and interest rate risk, as well as transaction and compliance risk. The ability of management to identify, measure, monitor and control these risks is reflected in this rating. The asset management rating is based upon, but not limited to, an assessment of the following evaluation factors:

- The adequacy of overall policies, practices and procedures governing asset management, considering the size, complexity and risk profile of the institution's fiduciary activities;

- The decision making processes used for selection, retention and preservation of discretionary assets including adequacy of documentation, committee review and approval, and a system to review and approve exceptions;
- The use of quantitative tools to measure the various financial risks in investment accounts and portfolios;
- The existence of policies and procedures addressing the use of derivatives or other complex investment products;
- The adequacy of procedures related to the purchase or retention of miscellaneous assets including real estate, notes, closely held companies, limited partnerships, mineral interests, insurance and other unique assets;
- The extent and adequacy of periodic reviews of investment performance, taking into consideration the needs and objectives of each account or portfolio;
- The monitoring of changes in the composition of fiduciary assets for trends and related risk exposure;
- The quality of investment research used in the decision-making process and documentation of the research;
- The due diligence process for evaluating investment advice received from vendors and/or brokers (including approved or focus lists of securities);
- The due diligence process for reviewing and approving brokers and/or counter parties used by the institution.

This rating may not be applicable for some institutions because their operations do not include activities involving the management of any discretionary assets. Functions of this type would include, but not necessarily be limited to, directed agency relationships, securities clearing, non-fiduciary custody relationships, transfer agent and registrar activities. In institutions of this type, the rating for Asset Management may be omitted by the examiner in accordance with the examining agency's implementing guidelines. However, this component should be assigned when the institution provides investment advice, even though it does not have discretion over the account assets. An example of this type of activity would be where the institution selects or recommends the menu of mutual funds offered to participant directed 401(k) plans.

Ratings

A rating of 1 indicates strong asset management practices. Identified weaknesses are minor in nature. Risk exposure is modest in relation to management's abilities and the size and complexity of the assets managed.

A rating of 2 indicates satisfactory asset management practices. Moderate weaknesses are present and are well within management's ability and willingness to correct. Risk exposure is commensurate with management's abilities and the size and complexity of the assets managed. Supervisory response is limited.

A rating of 3 indicates that asset management practices are less than satisfactory in relation to the size and complexity of the assets managed. Weaknesses may range from moderate to severe; however, they are not of such significance as to generally pose a threat to the interests of account beneficiaries. Asset management and risk management practices generally need to be improved. An elevated level of supervision is normally required.

A rating of 4 indicates deficient asset management practices in relation to the size and complexity of the assets managed. The levels of risk are significant and inadequately controlled. The problems pose a threat to account beneficiaries generally, and if left unchecked, may subject the institution to losses and could undermine the reputation of the institution.

A rating of 5 represents critically deficient asset management practices and a flagrant disregard of fiduciary duties. These practices jeopardize the interests of account beneficiaries, subject the institution to losses, and may pose a threat to the soundness of the institution.