Highlights of the Supervisory Process for Community Banking Organizations
Welcome to the Federal Reserve System.

The mission of the Federal Reserve is to promote a safe, sound, and efficient banking and financial system and a fair and transparent consumer financial services market that supports the growth and stability of the U.S. economy.

The Federal Reserve has sought to ensure the safety and soundness of financial institutions for more than 100 years. Through its decentralized structure, use of technology, continuing examiner education programs, and partnership with state regulators, the Federal Reserve provides a transparent and efficient supervisory process for state member banks (SMB).

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

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

State Membership Benefits
Membership in the Federal Reserve System provides opportunities for community banking organizations to participate in efficient and tailored supervisory processes that are locally based, as well as
realize financial benefits and engage with peers, Reserve Bank officers and staff, and industry subject matter experts through outreach opportunities that the Atlanta Fed offers. These benefits are seamlessly incorporated into our supervisory process.

The Sixth District
Local presence for diverse economies

- Our structure fosters relationships with our bankers, which brings transparency to the regulatory/supervisory process.
- Institutional knowledge of our constituency allows us to tailor supervision to an institution’s size, complexity, and risk profile.
- We fully make use of technology and our regulatory partnerships to facilitate timeliness and efficiency in the work we conduct.
- Member banks own stock in their Reserve Bank that pays risk-free dividends.
- Community bankers are eligible to serve as directors of their Reserve Bank and local branch boards, and they have the opportunity to participate on a variety of System-sponsored committees intended to influence policies that affect them.
- Local supervision provides us with the agility to respond to
rapid market changes and immediate needs, while Reserve System resources and expertise remain readily available.

- Member banks can participate in a variety of outreach events, from formal conferences and forums to meetings with Reserve Bank senior management and board members at their own institutions.

Sixth District Supervision and Regulation Organizational Structure Overview

The Supervision, Regulation, and Credit (SRC) Division’s community banking area of the Atlanta Fed is responsible for supervising state member banks and holding companies with assets of less than $10 billion. The area has dedicated portfolio directors who are responsible for developing and executing the supervisory program, conducting continuous supervisory activities, and serving as the primary point of contact for an assigned portfolio of state member banking organizations and holding companies. Bankers also have ready access to the Atlanta Fed community banking officers with direct responsibility for their institution. This structure provides continuity and solid relationships.

The community banking area also works closely with other areas in SRC, such as consumer compliance and applications, to ensure a state member bank’s needs are identified, discussed, and coordinated across various business lines. Moreover, for state member banks owned by a bank or financial holding company, an inspection of the holding company is most often conducted off-site shortly after the bank’s examination, promoting a consistent supervisory approach for the entire organization and reducing regulatory burden on bank management.

Supervisory Process

The supervisory process for community banks begins with development of a supervisory plan that is tailored to its risk profile—low, moderate, or high. Key considerations in determining the bank’s risk profile are its financial, managerial and compliance condition, sophistication and complexity, and the nature of its business activities and products offered. The bank’s risk profile drives the supervisory process—higher risks receive commensurately greater supervisory attention.
Typically, state member banks have a full-scope examination once every 12 months. Examination frequency can be decreased for subsidiary de novo institutions if the parent bank holding company has consolidated assets greater than $3 billion. Additionally, state member banks with assets less than $3 billion that meet certain criteria may be examined once every 18 months. Banks in less-than-satisfactory condition are usually examined on an alternating six-month cycle of full-scope and target examinations.

The main objective of the supervisory process is to evaluate the overall safety and soundness of the banking organization, which includes an assessment of the bank’s financial condition, risk management systems, and compliance with applicable banking laws and regulations. Each bank is assigned a composite rating based on an evaluation and rating of six essential components. This is known as the “CAMELS” rating, which is explained in the Federal Reserve’s Supervision and Regulation (SR) Letter 96-38, Uniform Financial Institutions Rating System. These components address the adequacy of capital (C), quality of assets (A), management and administration (M), quality and level of earnings (E), adequacy of liquidity (L), and sensitivity to market risk (S). These factors focus on financial performance and risk management elements. Each bank is also assigned a separate risk management rating, which is described in SR Letter 95-51, Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies.

An information technology, or “URSIT” (Uniform Rating System for Information Technology), rating is also assigned at each full-scope bank examination led by the Atlanta Fed. This rating system, described in SR Letter 99-8, Uniform Rating System for Information
Technology, consists of a composite rating that is based on an evaluation of four component ratings: audit, management, development and acquisition, and support and delivery.

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

Although a Reserve Bank can conduct surprise examinations, most are announced in advance. Prior to the start of the examination, management is asked to respond to a first-day letter and questionnaire tailored to the organization’s risks that requests information necessary to conduct the risk-focused examination. Examination activities, which typically last two weeks, occur both on- and off-site. Once the examination is complete, management typically holds an informal discussion on the last on-site day to discuss preliminary examination findings.

After discussions are conducted within the Atlanta Fed to ensure consistency in approach and appropriate application of ratings, management holds a final exit meeting to discuss the examination findings, along with the bank’s CAMELS, risk management, and IT ratings. The board of directors plays an essential role in the management of a bank’s operations and is directly responsible for the soundness of a bank. If significant problems are noted, or if the bank is in deteriorating or less than satisfactory condition or is operating under a supervisory enforcement action, a meeting is usually held with the bank’s board of directors.

The Federal Reserve provides tailored, risk-focused regulation for de novo institutions. An insured depository institution is considered to be in the de novo stage until it has been operating for at least three years (as laid out in SR 20-16). Full-scope examinations with ratings
THE FEDERAL RESERVE ACT creates the Federal Reserve System and specifies how Board members and Reserve Bank presidents are chosen.

PRESIDENT nominates members of the Board of Governors, the chief governing body of the Federal Reserve System, and nominates one Board member to be chair and one to be vice chair.

SENATE confirms Board members appointed by the president to staggered 14-year terms, and confirms the nominations of Board members to be either chair or vice chair.

BOARD OF GOVERNORS Seven Board members guide all aspects of the operation of the Federal Reserve System and its five key functions.

FEDERAL RESERVE BANKS Twelve Reserve Banks examine and supervise financial institutions, act as lenders of last resort, and provide U.S. payment system services, among other things.

FEDERAL OPEN MARKET COMMITTEE Seven Board members and 12 Reserve Bank presidents direct open market operations that set U.S. monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy.

How the Federal Reserve operates within the U.S. government framework
How the regulation and supervision process works

**Regulation**

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<th>CONGRESS</th>
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<th>AMERICAN PUBLIC</th>
<th>FEDERAL RESERVE</th>
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<td>votes to approve legislation; president signs into law.</td>
<td>drafts, proposes, and invites public comment on regulations that specify how laws are implemented.</td>
<td>institutions, individuals, and others review proposed regulations and respond with comments and suggestions.</td>
<td>considers public input, finalizes regulations, and issues and disseminates final regulations publicly, including rationale for actions.</td>
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**Supervision**

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<th>REGULATED INSTITUTIONS</th>
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<th>FEDERAL RESERVE BANKS</th>
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<td>implement internal practices to ensure that they are in compliance with regulations.</td>
<td>conduct on- and off-site examinations/inspections of regulated institutions to determine their compliance with regulations.</td>
<td>train examiners to evaluate institutions’ compliance with regulations.</td>
<td>issues and disseminates publicly the procedures Reserve Bank examiners will use to evaluate institutions’ compliance with laws and regulations.</td>
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begin only after this three-year period. The supervisory program is tailored to the institution, which allows Reserve Banks to determine the frequency of examinations based on the characteristics of a de novo institution. For subsidiary de novos, examinations occur less frequently if the parent bank holding company has consolidated assets greater than $3 billion (SR 20-16). The Federal Reserve’s streamlined application process allows for simultaneous filing of other necessary applications, like the Interagency Charter and Federal Deposit Insurance Application form (SR 08-5).

Additionally, increased coordination with the Federal Deposit Insurance Corporation and state banking agencies has helped to prevent duplicate requests for information on applications, which provides a more efficient application process for de novos (SR 08-5).

De novo SMB consolidated banking organizations are generally subject to an initial target exam, followed by two annual full-scope exams until the bank receives two consecutive overall satisfactory ratings. At that point, the bank is eligible to be examined under the statutorily required examination schedule.

Additional details on various specialty areas, including those for Bank Secrecy Act/Anti-Money Laundering laws, consumer compliance, and the Community Reinvestment Act, can be found under “Helpful References.”

Helpful References
Federal Reserve System: federalreserve.gov/

SR Letters: federalreserve.gov/bankinforeg/topics/topics.htm

Community Reinvestment Act: federalreserve.gov/communitydev/cra_about.htm

Supervision and Regulation Report, a semiannual publication covering a variety of regulatory and industry matters of interest: federalreserve.gov/publications/files/201911-supervision-and-regulation-report.pdf
Community Banking Connections, a quarterly Federal Reserve System publication dedicated to addressing current banking issues: communitybankingconnections.org/

**Federal Reserve Bank of Atlanta**: frbatlanta.org/banking-and-payments/supervision-and-regulation.aspx

Reserve Bank SRC contacts: frbatlanta.org/about/atlantafed/officers/supreg.aspx