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APPEALS PROCESS

# APPEALS PROCESS

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## Appeal of the Composite CAMELSI Rating

### Background

A bank formally appealed the composite CAMELSI (capital, asset quality, management, earnings, liquidity, sensitivity to market risk, and information technology) rating of 3 assigned at the most recent examination and asked the ombudsman to restore the composite rating to 2.

### Discussion

The basis of the appeal is the most recent safety and soundness examination in which the bank's composite rating was downgraded from 2 to 3. The bank did not dispute all of the examination conclusions and stated that the primary conflict with the supervisory office was the difference in computing the impact of a 3-percent shock to the agency step-up bonds held in its portfolio. According to the appeal, the supervisory office's computations did not consider the step-up features and thus produced an unfavorable result regarding earnings at risk and interest rate risk (IRR) management. The appeal further states that the bank's computations were done by Bloomberg, resulting in a more favorable outcome than those produced by the supervisory office.

The supervisory office stated that the board of directors was advised, as far back as 1998, about the need to improve its IRR management systems and controls. The supervisory office further stated that neither management nor the board demonstrated sufficient knowledge of step-up bond features and the impact to earnings at risk. As such, this made it difficult for them to assess the aggregate level of IRR. Additionally, weak earnings performance and deficiencies in risk management of information technology also factored into the composite downgrade.

### Conclusion

The ombudsman acknowledged that the bank's risk exposure resulting from a 3-percent shock to the agency step-up bonds, as computed by the supervisory office and Bloomberg, was not an absolute. However, the bank's risk management processes relative to IRR did not provide management with the assurances that it could withstand significant fluctuations associated with this product. Additionally, the ombudsman's review noted a combination of weaknesses in the areas of IRR and information technology that reflected a need for enhanced supervision by the board and management.

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The ombudsman opined that the conclusions reached by the supervisory office were well supported by the facts at the time of the examination and met the definition of a composite 3 bank as prescribed by the Uniform Financial Institutions Rating System.