

Federal Reserve Board

# Course Description for Financial Analysis and Risk Management (FARM)

Course Catalog Detail

## Financial Analysis and Risk Management (FARM)

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### Type of Participant Targeted

Financial Analysis and Risk Management (FARM) School is intended for assistant safety and soundness examiners who are beginning to assess the financial condition and risk profile of commercial financial institutions (banks), bank holding companies (BHCs), and U.S. operations of foreign banking organizations (FBOs). Participants generally should have 12 to 15 months of relevant experience. All safety and soundness assistant examiners must complete FARM prior to commissioning.

### Prerequisites

Prior to taking this course, the participant will have completed Orientation, Banking and Supervision Elements (BASE) and Self-Study Program #1. The pre-course work for FARM takes approximately 40 hours to complete. Moreover, participants must also complete and obtain at least 75 percent scored to pass a pre-course knowledge assessment that is available on FedWeb. Successful completion of the knowledge assessment is essential, as participants will be expected to demonstrate familiarity with regulatory and financial analysis concepts starting on the first day of class.

### Course Overview

FARM is based on the concept that four areas of supervision -- examinations, inspections, applications, and surveillance -- require similar analytical tools, involve similar supervisory issues, and require information from all of supervision's specialty areas. Accordingly, the program emphasizes financial analysis concepts for banks, BHCs, and FBOs; The course also introduces concepts of risk management, from the perspective of both bank management and bank supervisor. In the context of guided reviews, small group activities, and two case studies, participants evaluate financial condition and risk, and then assign ratings using CAMELS and RFIC (D) frameworks. Participants review the ROCA rating framework for FBOs as well. Group presentations followed by a class debrief at the conclusion of each topical area provide for an interactive learning experience.

## Course Objectives

After completing this 9½-day course, the participant, at a minimum, will be able to accomplish the following objectives.

- Given theories of risk management, a Uniform Bank Performance Report (UBPR), and basic structural and managerial information, perform a risk assessment and assign risk ratings to a bank.
- Given a UBPR and basic structural and managerial information regarding a bank, analyze the bank, assign a rating to each of the CAMELS components, and prepare a written analysis supporting the ratings.
- Given a Bank Holding Company Performance Report (BHCPR) and basic structural and managerial information regarding a BHC, analyze the company, assign a rating to each of the RFI/C (D) components and subcomponents, and prepare a written analysis supporting the ratings.
- Given a BHCPR and basic structural and managerial information regarding the BHC, prepare a scope memorandum for an upcoming inspection of the company.
- Given information regarding policies and procedures in a bank, BHC, or an FBO, provide written comments regarding internal controls and operational risks and how such factors affects the overall assessment of management.
- Using the findings from the analyses of the bank and BHC mentioned above, synthesize the information into a risk-focused oral presentation suitable for a board of directors.
- Given a Strength-of-Support Assessment (SOSA), identify significant supervisory concerns relative to the planning and completion of an examination of a U.S. branch or agency of an FBO.

## Post-Course Intervention

After completing FARM, the participant should be given on-the-job assignments that will increase the retention of the competencies presented during class. Such on-the-job assignments include the following examples:

- Analyze and draft CAMELS component write-ups.
- Analyze and draft RFI/C (D) component write-ups.
- Assist in analyzing and preparing risk-focused planning documents.
- Serve as or assist detail-in-charge on examinations or inspections.
- Perform off-site risk assessments using procedures for small BHCs.

## Overview of Curriculum

| <b>Subject</b>                                 | <b>In-Class Hours<sup>2</sup></b> | <b>Approximate Homework Hours<sup>3</sup></b> |
|--|-----------------------------------|---|
| Introduction and Group Dynamics                | 1.00                              | --  |
| Risk-focused Examination Process               | 1.00                              | --  |
| Bank: Asset Quality                            | 2.50                              | 2-3   |
| Bank: Earnings                                 | 2.50                              | 2-3   |
| Bank: Capital                                  | 1.50                              | 2-3   |
| Bank: Liquidity                                | 2.00                              | 2-3   |
| Bank: Sensitivity                              | 3.50                              | 2-3   |
| Bank Operations                                | 2.50                              | --  |
| Bank: Management                               | 2.00                              | 2-3   |
| Bank: Risk-focused Products                    | 1.50                              |   |
| Bank: Graded team case study and presentations | 16.00                             |   |
| BHC Overview                                   | 1.50                              | --  |
| BHC: F Component                               | 2.25                              | 2-3   |
| BHC: R Component                               | 3.50                              | 2-3   |
| BHC: I Component                               | 4.00                              | 2-3   |
| BHC: In-class review of RFI/C (D)              | 1.00                              | --  |
| BHC: Graded team case study and presentations  | 12.00                             | --  |
| BHC: Enforcement Actions                       | 0.75                              | --  |
| FBO: Using SOSA & ROCA                         | 2.00                              | --  |
| Test and Review                                | 4.00                              | --  |
| <hr/>  |                                   |   |
| <b>Totals</b>                                  | <b>67.00</b>                      | <b>8-27</b>                                   |

<sup>2</sup> Class hours include team break-out sessions where most of the analysis for the in-class case study is completed. There are also blocks of time allocated for the graded team case studies (bank and BHC).

<sup>3</sup> Participants should plan on spending an additional 2-3 hours outside of class working on each component of the case studies that receive a team grade. This work may be done within the assigned teams. Homework hours do not include studying for the final examination.

## Learning Objectives

After completing each section, the participant, at a minimum, will be able to demonstrate the following skills:

## **Risk-focused Examinations**

- Describe the examination preplanning process
- Evaluate the risk appetite of a small or large complex financial institution
- Assess the risk to be reviewed during an examination, incorporating the risks associated with specialty areas such as information technology, trust, and consumer affairs
- Evaluate preliminarily the ability of management and the directorate to identify, measure, monitor, and control the risks inherent in the institution's activities

## **Rating Systems for Financial Institutions**

- Recognize the similarities, differences, and applicability of CAMELS, RFI/C (D), ROCA, and the Risk Management rating.

## **Analysis of Banks (CAMELS)**

- Evaluate risks and assign ratings for each of the CAMELS components.
- Calculate and analyze pertinent ratios that apply to the CAMELS components, providing comments on the level, trend, peer, and reasons why ratios change.
- Relate each of the following topics to the overall condition of the bank

### Asset Quality

- Distinguish the credit culture and risk appetite of the bank.
- Evaluate the credit risk management process by appraising the quality of loan administration including policies, processes, loan review, and the internal risk rating system.
- Determine the quality of assets by evaluating existing and potential credit risk associated with loans, investments, and contingent liabilities.
- Assess the level of credit concentration and the effect of the economic and competitive environment on such concentrations.
- Assess the adequacy of the loan loss reserve.

### Earnings

- Evaluate the adequacy and sustainability of earnings.
- Assess the impact of liquidity, asset quality, and interest rate sensitivity on earnings.
- Appraise budgeting, strategic planning and internal controls as they relate to earnings.
- Differentiate the earnings characteristics and internal control issues of banks with varying lines of business (banks focused on wholesale lending, retail lending, boutique banking services, credit cards, or agricultural lending).

### Sensitivity

- Evaluate and rate management's ability to identify, measure, monitor, and control balance sheet exposure to market risk.
- Calculate and assess sensitivity of earnings to market risk or economic value of capital to market risk.
- Identify market risks and assess mitigating controls associated with trading activities.
- Determine the nature and assess the complexity of interest rate risk exposure arising from nontrading positions.

- Compare and contrast financial contracts used for hedging purposes.
- Describe static gap, income simulation, and economic value of equity models of interest rate risk, and evaluate the adequacy of these models depending on the complexity of the interest rate risk exposure.
- Calculate and apply present value and duration concepts.

#### Liquidity

- Evaluate the funding sources in terms of a bank's current and prospective needs, including its deposit base and its access to markets.
- Analyze sources of asset liquidity and liability liquidity by studying the bank's balance sheet structure.
- Assess the adequacy of funds management practices relative to the bank's size, complexity, and risk profile.
- Assess management's liquidity planning policies including monitoring and reporting systems and contingency planning.
- Demonstrate an awareness of safe and sound banking practices regarding liquidity.

#### Capital

- Analyze the effect of credit, market, reputation, and legal risks on a bank's capital position.
- Appraise the capital planning process in relation to overall strategic planning.
- Calculate Securities Exchange Commission filing requirement thresholds for capital.
- Calculate the required investment in Federal Reserve Bank stock.
- Calculate and analyze the capital requirements related to bank premises.
- Assess the level of dividend payments for compliance with laws, regulations, and safety and soundness issues.

#### Management

- Evaluate the strength of board and senior management oversight as it results from its structure, qualifications, and risk appetite.
- Evaluate the policies, procedures and limits the board and management have put in place.
- Evaluate the quality of management's risk measuring and monitoring systems.
- Evaluate the strength of internal controls, including the strength and independence of the internal audit program.

#### Analysis of BHCs (RFI/C (D))

- Explain and apply the RFI/C (D) rating system, and assign ratings using a 1-5 scale, for each of the following components and subcomponents.

#### Risk Management

- Board and senior management oversight: Assign a rating of the adequacy and effectiveness of the board and senior management's understanding and management of risk inherent in the BHC's activities.
- Policies: Assign a rating that reflects the adequacy of the company's policies, procedures, and limits.
- Management information systems. Assign a rating that reflects the adequacy of management's risk monitoring systems.

- Internal Controls: Assign a rating of the strength of internal controls and internal audit procedures, including the strength and independence of the internal audit team.

#### Financial Condition

- Capital: Evaluate and assign a rating to the strength of the organization's consolidated capital position.
- Asset Quality: Assign a rating to the quality of consolidated asset quality, including assets within both depository and non-depository entities.
- Earnings: Evaluate and assign a rating to the level and quality of consolidated earnings.
- Liquidity: Evaluate and assign a rating to the quality of consolidated liquidity.

#### Impact

- Evaluate and rate the likelihood that the non-depository entities will have a significant negative impact on the depository institution(s).
- The Impact rating is composed of two main considerations – risk management factors and financial factors.
- With respect to risk management, considerations include the following: strategic, operational, legal and reputational, and concentration risks.
- With respect to financial factors, considerations include capital distribution, intra-group exposures, and parent company cash flow and leverage.

#### Analysis of FBOs (ROCA)

- Recognize the differences in supervisory issues for U.S. branches and agencies, including differences in accounting, regulatory reporting, offshore activities, and management structure.
- Apply a SOSA rating to the examination process by demonstrating an understanding of the effects of the parent organization's financial strength on its U.S. operations.
- Interpret a ROCA rating and discuss the relative importance of each component to the composite rating.
- Using SOSA rating and relevant examination information, identify key risks to review during an examination of a U.S. branch or agency.

## **Class Size**

FARM classes range in size from 18 to 24 participants. In order to simulate the dynamics of an examination, the class is divided into working teams of 5 or 6 participants. Each team has one instructor guide who acts as banker, mentor, and resource throughout the course. The two-week schedule for FARM is based on four working teams. In certain unusual circumstances, when adequate classroom space, breakout rooms, and instructors are available, classes larger than 24 can be accommodated.

## Instructors

One FARM instructor is provided for every 5 or 6 participants to ensure one guide for each working team. Each FARM session will have one lead instructor and four regular instructors, who will serve for both weeks of the class. The lead instructor's main responsibility is to coordinate all administrative responsibilities and be a source of overall guidance. All instructors *must* have safety and soundness expertise. Also, for sessions hosted by Reserve Banks without FBO or international specialists, at least one instructor *must* have experience with international examinations or FBO monitoring. It is also important for the host bank to provide an instructor with sensitivity experience. The FBO and sensitivity instructors are not needed for the entire class but only for the day of their presentation. Hopefully I will hear from the banks today.