Fields of Opportunities

STATE OF IOWA

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IOWA DEPARTMENT OF COMMERCE
DIVISION OF CREDIT UNIONS
JOANN JOHNSON, SUPERINTENDENT

Date: December 6, 2016

To: Iowa State Chartered Credit Unions

From: JoAnn M. Johnson, Superintendent JMJ

Re: Changes to the CAMEL Rating System Effective January 1, 2017

Addition of "S" Rating for Market Sensitivity

The Iowa Division of Credit Unions (IDCU) uses the CAMEL examination rating system which is an acronym for component ratings of Capital, Asset Quality, Management, Earnings and Liquidity. Each of the CAMEL components is evaluated separately, as well as in relationship to each other. In addition, the credit union is given an overall CAMEL composite rating. The CAMEL rating system is an examination tool to reflect the financial condition and overall operating soundness of the credit union.

Effective January 1, 2017, IDCU will begin using the CAMEL component "S" or "Sensitivity to Market Risk" rating at all examinations. The CAMELS rating system has been in place for many years. The Federal Financial Institutions Examination Council (FFIEC) adopted the Uniform Financial Institutions Rating System (UFIRS), commonly known as the CAMELS system, which is utilized in the federal banking system and with many state credit union regulators. Further background, as well as component and composite ratings definitions, can be found in the attached appendix.

Adding the "S" component or "Sensitivity to Market Risk" is being implemented to address the degree to which interest rate changes can impact a credit union's earnings or net worth. This component also focuses on a credit union's ability to measure, monitor and manage its interest rate risk exposure. The utilization of the "S" component also recognizes the increasing balance sheet complexity in Iowa credit unions and ensures improved assessment of supervisory communication regarding interest rate risk and liquidity risk.

The addition of the "S" component is not intended to add to the regulatory burden or require additional policies and procedures. The Division will continue to use the same examination procedures for examining liquidity and interest rate risks. The quality of management systems and expertise of management must be commensurate with risk exposure. The rating of the "S" component will be a combined assessment of both the level of market risk and the ability to manage market risk.

In the IDCU examination report the six CAMELS components, as well as the composite rating, will be assigned at each examination. .Since the NCUA has not yet adopted the "S" rating and made appropriate changes to the AIRES software and other reporting systems, we will use a workaround similar to other states who have adopted the "S" rating component. If the "L" and the "S" ratings are different, the lower of the two components will be input into AIRES in the "L" portion of the CAMEL rating. For example, if the "S" is rated a "3" and "L" a "2", then a "3" rating will be input into AIRES CAMEL rating under "L".

Disclosure of the CAMELS Ratings

Since 2006, the IDCU has utilized the Iowa Risk Rating System (IRRS) which focused on the financial risk areas with a primary emphasis on the management of those risk areas. The Division continued to issue an internal CAMEL rating at each examination.

IDCU's focus is on greater transparency in the examination and supervision processes. With increased focus on the CAMELS ratings for scheduling joint exams and other expansionary requests, IDCU will be disclosing the CAMELS and composite ratings at each exam beginning January I", 2017.

Examination staff will be disclosing the CAMELS and composite ratings assigned at each examination to the Board of Directors and management team. The examination process will continue to focus on the financial and operational trends and risks, with continued emphasis on the credit union's management of those risk areas. **The CAMELS and composite ratings are considered a confidential regulatory rating and should not be disclosed beyond the Board of Directors and management team.**

We hope the greater transparency of the "S" rating for market sensitivity and the full disclosure of the CAMELS and composite ratings will assist Iowa credit unions to continue to serve their members and prosper.

Please contact your Examiner in Charge or Supervisory Examiner Ann Mulcahy if you have any questions.

UNIFORM FINANCIAL INSTITUTIONS RATING SYSTEM

Introduction

The Uniform Financial Institutions Rating System (UFIRS) shall be the rating system used by IDCU examiners for evaluating and categorizing the safety and soundness on an ongoing, uniform, and comprehensive basis.

The UFIRS was adopted by the Federal Financial Institutions Examination Council (FFIEC) in1979 and updated in December of 1996. The 1996 revisions to UFIRS include the addition of a sixth component addressing sensitivity to market risks, the explicit reference to the quality of risk management processes in the management component, and the identification of risk elements within the composite and component rating descriptions.

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

Overview

Under the UFIRS, each credit union is assigned a composite rating based on an evaluation and rating of six essential components of an institution's financial condition and operations. These component factors address the adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risk. Evaluations of the components take into consideration the credit union's size and sophistication, the nature and complexity of its activities, and its risk profile.

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

A credit union's composite rating generally bears a close relationship to its component ratings. However, the composite rating is not derived by averaging the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. Assigned composite and component ratings are disclosed to the credit union's board of directors and senior management.

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

The ability of management to identify, measure, monitor, and control the risks of its operations is also taken into account when assigning each component rating. All credit unions are expected to properly manage their risks; however, it is recognized that appropriate management practices vary among credit unions depending on their size, complexity and risk profile. For less complex credit unions engaging in traditional credit union activities and whose directors and senior management are activity involved in the oversight and management of day-to-day operations may use relatively basic risk assessment, risk management and internal control systems. At more complex credit unions, formal, multifaceted systems and internal controls are needed to address their broader range of financial activities and to provide senior management and board of directors with the information they need to monitor and direct activities.

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

Composite Ratings

Composite ratings are based on a careful evaluation of a credit union’s managerial, operational, financial, and compliance performance. The six key components used to assess a credit union’s financial condition and operations are: capital adequacy, asset quality, management capability, earnings quantity and quality, the adequacy of liquidity, and sensitivity to market risk. The rating scale ranges from 1 to 5, with a rating of 1 indicating: the strongest performance and risk management practices relative to the institution's size, complexity, and risk profile; and the level of least supervisory concern. A 5 rating indicates: the most critically deficient level of performance; inadequate risk management practices relative to the institution's size, complexity, and risk profile; and the greatest supervisory concern. The composite ratings are defined as follows:

Composite 1
Credit unions 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 credit unions are the most capable of withstanding erratic and unpredictable business conditions and are resistant to outside influences such as economic instability in their trade area. These credit unions are in substantial compliance with laws and regulations. As a result, these credit unions exhibit the strongest performance and risk management practices relative to the credit union’s size, complexity, and risk profile, and give no cause for supervisory concern.

Composite 2
Credit unions in this group are fundamentally sound. For a credit union 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 credit unions are stable and are capable of withstanding business fluctuations. These credit unions are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the credit union’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
Credit unions in this group exhibit some degree of supervisory concern in one or more of the component areas. These credit unions 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. Credit unions 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 credit unions 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 credit unions 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
Credit unions 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. Credit unions 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 NCUSIF Share Insurance Fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.

Composite 5

Credit unions 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. Credit unions in this group pose a significant risk to the NCUSIF Share Insurance Fund and failure is highly probable.

Component Ratings

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

Capital Adequacy

A credit union 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 credit union’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 a credit union 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 allowances for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- Risk exposure represented by off-balance sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.

Ratings

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

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

3 A rating of 3 indicates a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institution's capital level exceeds minimum regulatory and statutory requirements.

4 A rating of 4 indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened.

5 A rating of 5 indicates a critically deficient level of capital such that the institution's viability is threatened.

Asset Quality

The asset quality is one of the most critical areas in determining the overall condition of a credit union. The 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 counterparty, 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 credit union 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 counterparties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal controls and management information systems.
- The volume and nature of credit documentation exceptions.

Ratings

1 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 credit unions is of minimal supervisory concern.

2 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.

3 A rating of 3 is assigned when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices.

4 A rating of 4 is assigned to credit unions 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.

5 A rating of 5 represents critically deficient asset quality or credit administration practices that present an imminent threat to the institution's viability.

Management

The quality of management is probably the single most important element in the successful operation of a credit union. For purposes of this section, management includes both the board of directors, which is elected by the membership and senior management, who are appointed to their positions by the board. In the complex, competitive, and rapidly changing environment of credit unions, it is extremely important for all members of the credit union management to be aware of their responsibilities and to discharge those responsibilities in a manner which will ensure stability and soundness of the credit union, so that it many continue to provide the member the financial services for which it was created.

The capabilities of the board of directors and senior 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.

The board of directors is the source of authority and responsibility. In the broadest sense, the board is responsible for formulation of sound policies and objectives of the credit union, effective supervision of its affairs and promotion of its welfare. The primary responsibility of senior management is implementation of the board's policies, goals and objectives in the day-to-day operations.

Depending on the nature and scope of a credit union'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's and management's ability as it applies to all aspects of credit union 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 credit union 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.

• Avoidance of self-dealing.
• Demonstrated willingness to serve the legitimate needs of members.
• The overall performance of the credit union and its risk profile.

Ratings

1 A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the credit union'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.

2 A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the credit union'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.

3 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 credit union'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.

4 A rating of 4 indicates deficient management and board performance or risk management practices that are inadequate considering the nature of a credit union'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.

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

Earnings

From a regulator's standpoint, the essential purpose of credit union earnings, both current and accumulated, is to absorb and augment capital. Earnings is the initial safeguard against the risks of engaging in the credit union business, and represents the first line of defense against capital depletion resulting from shrinkage in asset value. Earnings performance should also allow the credit union to remain competitive by providing the resources to implement management's strategic initiatives.

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 allowance for loan and lease losses, or by high levels of market risk that may unduly expose a credit union'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 a credit union'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 allowances for loan and lease losses and other valuation allowance accounts.
• The earnings exposure to market risk such as interest rate and price risks.

Ratings

1 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.

2 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 credit union's level of earnings is adequate in view of the assessment factors listed above.

3 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.

4 A rating of 4 indicates earnings that are deficient. Earnings are insufficient to support operations and maintain appropriate capital and allowance levels. Credit unions 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.

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

Liquidity
Liquidity represents the ability to fund assets and meeting obligations as they become due. Liquidity is essential in a credit union to compensate for expected and unexpected balance sheet fluctuations and provide funds for growth. Liquidity risk is the risk of not being able to attain funds at a reasonable price within a reasonable time period to meet obligations as they become due. Because liquidity is critical to the ongoing viability of any credit union, liquidity management is among the most important activities that a credit union conducts.

In evaluating the adequacy of a credit union'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 credit union's size, complexity, and risk profile. In general, funds management practices should ensure that a credit union is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate needs of its community. Practices should reflect the ability of the credit union 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 credit union 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.
- The capability of management to properly identify, measure, monitor, and control the credit union's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

Ratings

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

2 A rating of 2 indicates satisfactory liquidity levels and funds management practices. The credit union 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.

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

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

5 A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the credit union is threatened. Credit unions 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 credit union'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 credit union'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 credit unions, the primary source of market risk arises from nontrading positions and their sensitivity to changes in interest rates. In some larger credit unions, 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 credit union's earnings or the economic value of its capital to adverse changes in interest rates and overall market conditions.

• The ability of senior management to identify, measure, monitor, and control exposure to market risk given the credit union’s size, complexity, and risk profile.
• The nature and complexity of interest rate risk exposure arising from investment positions.
• Where appropriate, the nature and complexity of market risk exposure arising from trading operations.

Ratings

1 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 credit union. The level of earnings and capital provide substantial support for the degree of market risk taken by the credit union.

2 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 credit union. The level of earnings and capital provide adequate support for the degree of market risk taken by the credit union.

3 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 credit union. The level of earnings and capital may not adequately support the degree of market risk taken by the credit union.

4 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 credit union. The level of earnings and capital provide inadequate support for the degree of market risk taken by the credit union.

5 A rating of 5 indicates that control of market risk sensitivity is unacceptable or that the level of market risk taken by the credit union 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 credit union.