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September 21, 2004

Jennifer J. Johnson, Secretary
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. OP-1207; Proposed Revisions to the Bank Holding Company Rating System; 69 Federal Register 43996; July 23, 2004

Dear Ms. Johnson:

The Federal Reserve Board (Board) proposes to completely revise its bank holding company (BHC) rating system to one that more reflects the risk-focus of the new bank and BHC examination procedures. The new rating system would apply to all BHCs examined by the Board. The American Bankers Association (ABA) brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Background

The current BHC rating system, known as BOPEC/F-M, is a supervisory tool for the Board that defines the condition of BHCs in a summary fashion. The current BOPEC/F-M rating system was adopted in 1979. The Board now proposes to completely revise the rating system, because, in the Board's words, "the banking industry has become increasingly concentrated and complex. These changes have prompted a fundamental shift in supervisory focus away from historical financial analyses toward more forward-looking assessments of risk management and financial factors." The current BHC rating system is interpreted as follows:

The **B** rating represents the condition of the banking subsidiary(ies).

The **O** rating represents the condition of the nonbank subsidiary(ies).

The **P** rating the condition of the parent company.

The **E** and **C** are the Board's evaluation of the consolidated capital and earnings position of the BHC.

The **F** rating represents the financial composite rating.

The **M** represents the management composite rating.

The proposed new rating consists of three essential components and eight subcomponents of an institution's financial condition and operations: **R F I/C (D)**, where **R** = risk management; **F** = financial condition; **I** = impact of the parent company and nondepository subsidiaries (collectively nondepository entities) on the subsidiary depository institutions, and **D** = the primary regulator's assessment of the subsidiary depository institutions.

Analysis

Although any change in a standard system poses some adjustment problems, it was the unanimous opinion of the bankers ABA consulted on this proposal that all of the federal banking regulators have changed their examination focus to a much more risk-based approach over the last decade. As a result, the examinations were emphasizing risk management and internal controls much more than the BOPEC rating system recognized. Overall, bankers do not object to the revision, since it will bring the Board's summary analysis of the BHC's condition into closer orientation with the actual examination practice. For example, the **R** rating has four subcomponents that are essentially taken from the current examination organization:

1. Competence of Board and Senior Management;
2. Policies, Procedures and Limits;
3. Risk Monitoring and MIS; and
4. Internal Controls

The **F** rating consists of four of the CAMEL components, evaluated along individual business lines, product lines, or on a legal entity basis, depending on what is most appropriate:

1. **C** (capital);
2. **A** (asset quality);
3. **E** (earnings); and
4. **L** (liquidity).

When implementing the new rating system, Board states that it will continue to assign only an R and C rating for all companies in the shell BHC program (that is, noncomplex BHCs with assets under \$1 billion). The R rating will be the M rating from the subsidiary depository institution's CAMELS rating. The rating will be changed from the current M to an R to provide consistent terminology. The C rating is the subsidiary depository institution's composite CAMELS rating. For all noncomplex, one-bank holding companies with assets of greater than \$1 billion, examination staff will assign all component and subcomponent ratings in the new rating system. Examination staff will continue to rely heavily on information and analysis contained in the report of examination for the subsidiary depository institution to assign the R and F ratings.

Some smaller bank holding companies were initially concerned that the revised system would make their examinations more burdensome, but the Board's stated implementation approach is consistent with reducing the burden on shell or noncomplex BHCs, an approach that the Board has followed for some years and that the ABA strongly supports.

Conclusion

The proposed revision of the BHC rating system makes it more consistent with the Board's approach to BHC examination, and ABA does not object to the proposed revision. ABA commends the Board for its use of a simplified system for one-bank, noncomplex bank holding companies. If the Board has any question about these comments, please call the undersigned.

Sincerely,

A handwritten signature in cursive script that reads "Paul Alan Smith". The signature is written in black ink and is positioned above the typed name.

Paul Smith
Senior Counsel