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**Effective Date:** 08-JUL-11

**Effect on Previous Action:** Amended by NV-11-15 (08-JUL-11).

**Source of Authority:** Sections [5.9](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%205.09.docx) and [5.17](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%205.17.docx) of the Farm Credit Act of 1971, as amended.

**THE FARM CREDIT ADMINISTRATION BOARD HEREBY ADOPTS THE FOLLOWING POLICY STATEMENT:**

**I. Policy**

The Financial Institution Rating System (FIRS) shall be the rating system used by Farm Credit Administration (FCA or Agency) examiners for evaluating and categorizing the safety and soundness of Farm Credit System (System) institutions on an ongoing, uniform, and comprehensive basis.

The FIRS will provide valuable information to the Agency for assessing risk and allocating resources based on the safety and soundness of regulated institutions. Ratings assigned to regulated institutions will be adjusted periodically so that they accurately reflect the condition of institutions.

**II. Standards and Implementation**

Based on the conclusions reached in the ongoing examination of an institution's financial, managerial, and operational condition, FCA examiners will assign ratings to each of the rating factor components and assign a composite rating that reflects the condition and overall safety and soundness of the System institution. These ratings shall be reported to the institution's Board of Directors and Chief Executive Officer.

Component and composite ratings are assigned on a 1 to 5 numerical scale. A 1-rating indicates the strongest performance and management practices and the least degree of supervisory and regulatory concern, while a 5-rating indicates an extremely high, immediate or near-term probability of failure and unsatisfactory management practices and, therefore, the highest degree of concern.

Although each institution has its own examination and supervisory issues and concerns, the FIRS is structured to evaluate all significant financial, asset quality, and management factors common to all System institutions. Examination criteria for each of the rating components are defined in the FCA Examination Manual, which is available to the public. The FCA Examination Manual also incorporates the evaluative criteria under which component and composite ratings are assigned.

**Composite Rating**

The FIRS provides a general framework for assimilating and evaluating all significant financial, managerial, and operational factors to assign a composite rating to each System institution. The composite rating is based on a qualitative and quantitative analysis of the factors comprising each of the following components, the interrelationships among components, and the overall level of concern for those risks that affect a System institution.

The composite rating does not assume a predetermined weight for each component nor does it represent an arithmetic average of assigned component ratings. The weight given to any individual component in determining composite ratings varies depending on the degree of concern associated with the component and the threat posed to the overall safety and soundness of the institution.

**Component Ratings**

Listed below is a brief description of the FIRS components and the more common evaluative criteria and factors considered under each component.

• Capital -- A System institution is expected to maintain capital and capital management practices 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 capital component is based on an evaluation of an institution's capacity to absorb losses and provide for future growth. An evaluation of capital relies on many factors such as regulatory capital requirements, trends, portfolio and institutional risk, growth, adequacy of risk funds, management capability, and other factors as appropriate.

• Assets -- This component is based on an assessment of both the quality of the current portfolio and the quality of the associated risk management processes that substantially impact the quality of assets. An assessment of assets relies on many factors such as loan portfolio management, investment portfolio management, loan portfolio trends, risk identification processes, credit administration, allowance for loan losses, and other factors that affect the quality, performance, income producing capacity, and stability of assets.

• Management -- The management component is based on an assessment of board and management performance against all factors considered necessary to operate the institution within accepted banking practices and in a safe and sound manner in accordance with applicable laws, regulations, and guidelines.

• Earnings -- This component is based on an evaluation of the quantity, quality, and sustainability of the institution's earning performance. An evaluation of earnings considers factors such as the level of earnings, composition and quality of net income, stability of earnings performance, relationship to portfolio risk, quality of earnings management, and other factors as deemed appropriate.

• Liquidity -- The liquidity component is based on an evaluation of an institution's capacity to promptly meet the demand for payment of its obligations, fund its loan portfolio, and readily meet the reasonable credit needs of the territory served. An evaluation of liquidity also considers continued access to funding, the existence of secondary sources of liquidity, and other factors as deemed appropriate.

• Sensitivity -- This component reflects the degree to which changes in interest rates may affect earnings or the market value of an institution's equity. An evaluation of this component considers such factors as the size and complexity of the institution's financial activities, the level of interest rate risk exposure relative to capital and earnings, investment and derivatives activities, management's ability to identify, measure, monitor, project, and control interest rate risk, and other factors as deemed appropriate.

**III. Responsibility**

It is the responsibility of the Chief Examiner to ensure that the components used to support the composite ratings are reviewed periodically to make certain they reflect the material matters that impact the safety and soundness of institutions. In this respect, the Chief Examiner shall make recommendations to the FCA Board to add or delete components as necessary. Specific evaluative criteria and factors for determining component and composite ratings shall be established by the Chief Examiner and incorporated in the FCA Examination Manual or by other means as appropriate. The Chief Examiner is responsible for ensuring that ratings assigned to institutions are commensurate with and accurately reflect the risk in the institutions.

**IV. Reporting**

At least quarterly, the Chief Examiner will provide the FCA Board a report of the composite rating of all FCS institutions.

**V. Implementation**

System institutions examined after the date this policy is adopted by the FCA Board will be assigned composite and component ratings in accordance with this Policy Statement.

**DATED THIS 8th DAY OF JULY, 2011**

**BY ORDER OF THE BOARD**

**Dale L. Aultman**

**Secretary to the Board**