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MEMORANDUM

August 3, 2004

To Our Clients and Friends

Re: Federal Reserve Bank Holding Company Rating System

The Federal Reserve Board (the “Board”) has proposed a revised bank holding company (“BHC”) rating system which provides greater emphasis on risk management and a framework for assessing the potential impact of nondepository affiliates on the subsidiary depository institutions. The proposed system will more closely align BHC ratings to the Board’s shift in supervisory practices to an assessment of a BHC’s risk management and financial factors. Comments are due September 21, 2004.

The Board’s current BHC rating system, which is referred to as BOPEC/F-M,¹ was established in 1979. Since that time, BHC’s have expanded into a wider range of complex activities. Under the Board’s proposed rating system, each BHC will be assigned a composite rating (C) based on an evaluation and rating of three essential components and eight subcomponents of the institution’s financial condition and operations. The main components are risk management (R), financial condition (F) and potential impact (I) of the parent company and nondepository entities on subsidiary depository institutions. The subsidiary depository institutions will also have a component in the rating system (D) that will mirror the primary supervisor’s assessments.

¹ The current rating system reflects the Board’s assessment of the BHC’s bank subsidiaries (B), other nonbank subsidiaries (O), the parent (P), earnings (E), capital (C) and financial (F) and management (M) composite ratings.

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The risk management component (R) is supported by the following four subcomponents:

- competence of the board and senior management
- policies, procedures and limits
- risk monitoring and management information systems
- internal controls

The financial condition component (F) is supported by the following four subcomponents:

- capital adequacy
- asset quality
- earnings
- liquidity

The risk management subcomponents will be assigned a qualitative rating of strong, adequate or weak. Each of the other component and subcomponent ratings will be assigned a numeric rating of 1 to 5, with 1 indicating the highest rating.

The proposed rating system also includes guidance on the implementation of the system based on a BHC's size and complexity. In order to maintain the alignment of the new rating system with the Board's supervisory practices, the level of analysis and support will vary based upon whether a BHC has been determined to be a "complex" or "noncomplex" institution.

The Board's proposal can be found at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.