A SHORT REG F
(INTERBANK LIABILITIES) OVERVIEW

The Federal Reserve Regulation F (12 CFR 206) **requires** that all FDIC insured depository institutions develop and implement internal policies and procedures for managing (identifying and mitigating) exposure, i.e., potential loss, to other depository institutions with whom they do business.

Part of the regulation's scope of "Prudent Standards" for monitoring risk includes: credit and liquidity risks, operational risks, and capital standards for correspondent banks that are at least "Adequately Capitalized". In addition, **the bank's board must** establish policies and procedures that are reviewed on an annual basis [section 206.3(d)]. Improvement to existing policies and procedures are to be instituted based on periodic risk assessment reviews. **These policies must include** a quarterly [section 206.5(b)] monitoring of all correspondent institutions' capital levels. Well defined policies and procedures are required for any correspondent institution that falls below minimum standards including immediate termination.

Prudential Standards for selecting and monitoring correspondents should not only follow the regulation's guidelines but should strive for best practices. The regulation identifies credit risk in terms of the exposed bank's capital, problem assets, as well as liquidity and operational risks. However, there are other risks to be considered and monitored. Not only are the exposures as represented by the CAMELS acronym measured, but VERIBANC's risk assessment model goes beyond this CAMELS acronym. We look at regulatory risk ("source of strength doctrine") as well as opportunity risk. Our system provides the broadest coverage for monitoring risk on correspondent banks.

Quarterly Monitoring of capital levels is found in section 206.5(b) of the regulation. This section of the regulation focuses on watching correspondent banks' capital classifications so they do not fall or go below "Adequately Capitalized". This classification is the second (out of five) highest. The highest capital classification is "Well Capitalized". The other three, in descending order are: "Under Capitalized", "Significantly Undercapitalized", and "Critically Undercapitalized". Should an institution's classification go below "Adequately Capitalized" **then immediate termination of any relationship is required** under the regulation. These classifications are constructed from many items and a matrix of resulting ratio thresholds.

VERIBANC simplifies these intricate relationships by presenting the exact capital classifications for a quick-look review. The benefit to the compliance officer for this format is their ability to react immediately on any degradation in this area. In addition to the capital classification we also provide the corresponding core capital ratios. You can see a sample of VERIBANC's Reg. F data information here:
https://www.veribanc.com/PDFs/Sample%20Enhanced%20Reg%20F%20Report.pdf?

Operational Risk is often difficult to measure objectively and therefore may take a back burner to other risks that are easier to quantify. Some models may not address this risk at all. After in-depth studies VERIBANC developed a metric based on all federal banking regulators' published regulatory enforcement actions. Not all enforcement actions have the same severity and not all are levied against a financial institution. A large number are levied against bank personnel for embezzlement or fraud, often leading to individuals being jailed and/or prohibited from ever working in the banking industry again. This information regarding the most egregious enforcement actions levied against a correspondent institution and personnel does provide insight into the operational risk of that correspondent bank.

Cost of Monitoring not only includes the time to retrieve and organize the needed information but also includes the time needed to construct and test the model that will serve as a review of the financial condition of your correspondents. The format, design, and review of results and recommendations for the Board of Directors are another factor. The quarterly review process and procedures, as well as the annual policy review by the Board of Directors, are part of any time and cost considerations.

Actuarial soundness is the foundation of VERIBANC's entire methodology. All of our metrics are based on analysis performed on 1,000s of failed institutions, in other words back-testing. Many analysts use their favorite ratios to "analyze" whether an institution is failing or not. One must ask whether they ever tested their ratios against 10, 20, or 30 years of both failure and non-failure data. Intellectual honesty about the predictability and/or reliability, in other words – its value, of a test or ratio is achieved by contrasting a ratio or test results with both failure and non-failure groups. If the test or ratio "catches" all failures and throws 40 percent or more of the non-failure group in with this same cohort, then that test or ratio is just not that valuable. Without testing your "favorite" ratio against historical data its value can never be measured. Conversely, what good is a ratio or test that only yields an 80 percent detection rate? VERIBANC's value and transparency is unequaled and why several insurance companies have audited and approved our methodology

VERIBANC

800-837-4226 Beyond 'CAMELS'

Since 1993 banks have used our self-contained Reg. F package, issued on a quarterly basis, for a simple and cost effective way to comply with this regulation. Some clever bankers have added competitor institutions to their list so they can leverage the rich source of information provided when tracking them.

An added benefit, that generates constant positive feedback from our clients, is the specimen template for the Board of Directors. This carefully crafted document responds to the written policies and procedures requirement of the regulation. The template is included with our Reg. F package as well as a copy of the actual regulation.

Summarizing, the Fed's Reg. F **requires** that banks assess their interbank liabilities on a quarterly basis, with an annual review by the bank's Board of Directors. VERIBANC provides this information, plus additional data, in a succinct timely fashion that saves a bank time and money. For more detailed information see:

http://www.veribanc.com