

## **BANKING AND SUPERVISION ELEMENTS**

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### ***Type of Participant Targeted***

Banking and Supervision Elements (BASE) is intended for assistant examiners with approximately three to six months of on-the-job experience. *All assistant examiners involved in the consumer affairs, information technology, safety and soundness, and trust specialty areas must complete this course before becoming commissioned.*

### ***Prerequisites***

System Orientation Core Modules

Approximately 16 hours of precourse work:

- Bank accounting exercise
- Federal Reserve Act BEST module
- Loan Policy and Administration BEST Module
- Investment Portfolio BEST Module
- Introduction to Peoples' Bank and Trust Case Study

### ***Course Overview***

BASE addresses the skills and knowledge needed by all examination specialties, recognizes the underlying principles of risk management and integrated supervision, and encourages development of investigative and critical-thinking skills. The course emphasizes interactive and team learning by using the case study approach. A separate case study highlights each of the four examination specialties, and a unifying case study emphasizes integrated supervision.

### ***Course Objectives***

After completing this 9½-day blended format course, the participant, at a minimum, will be able to accomplish the following objectives.

## BANKING AND SUPERVISION ELEMENTS

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- Identify key examination issues of each banking supervision and regulation function, including the rating systems used for the various types of examinations and inspections.
- Identify the risk types reviewed in each examination specialty and areas of overlap among them.
- Discuss how concerns identified in one specialty's examination can affect another area.
- Recognize how the components of a bank's operations, lending function, information systems, and internal control affect banking products and the business of banking.
- Discuss how the examination process identifies the potential risks present in the deposit, investment, and lending functions of a financial institution.
- Describe the analytical process for evaluating an internal control system.
- Identify weaknesses in a bank's internal control structure.
- Discuss the concept of risk as it applies to banking, including how risk is measured, reported, and analyzed.
- Explain the importance of management information systems.
- Apply financial analysis and bank accounting concepts.
- Identify key supervisory issues related to integrated supervision.

### *Post-Course Intervention*

After completing BASE, the participant should be given on-the-job assignments that will improve the retention of the knowledge and skills presented during class. Such on-the-job assignments include the following examples.

- Assist in evaluating a bank's risk management process.
- Assist in evaluating a bank's internal/external audit procedures as related to the participant's specialty area.
- Assist in reviewing aspects of a bank's internal control system as applicable to the participant's specialty area.
- Assist in assessing the effectiveness of a bank's management reporting and management information systems as related to the participant's specialty.

In addition, each participant's manager or supervisor will receive diagnostic information derived from the course proficiency check and case studies that describes the participant's relative performance in the key content areas of the course. This information will also indicate those areas where the participant would benefit from additional on-the-job assignments and guidance.

## **BANKING AND SUPERVISION ELEMENTS**

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### *Learning Objectives*

After completing each section, the participant, at a minimum, will be able to demonstrate the following skills.

#### Applications

- Describe the various types of applications, the types of regulatory approvals, and the rationale for regulatory review;
- Recognize the most significant circumstances that require banks to submit applications under Regulations Y and H; and
- Explain the purpose of commitments in the application process and how they relate to the examination and inspection processes.

#### Asset Quality

- Explain the importance of asset quality to a bank's financial condition and its effects on earnings and capital
- Define asset classification and criticism categories and list the assets that are typically classified in an examination
- Classify a noncomplex problem loan
- Explain the concepts of past due and nonaccrual
- Calculate the examination-related asset quality ratios and discuss the level and trend of asset classifications
- Identify and interpret the asset quality ratios in the UBPR
- Discuss the purpose of the allowance for loan and lease losses and the factors considered when assessing its adequacy
- Discuss additional key factors that affect a bank's asset quality, including credit administration, lending policies, and internal credit review

#### BHC Inspections

- Identify activities in which bank holding companies (BHCs) engage;
- Describe the risks inherent in BHC activities;
- Recognize regulatory concerns common to BHCs; and
- Define the rating systems used in BHC inspections and explain how the rating systems are applied.

#### Business Law

- Identify and discuss business law concepts related to the regulation and supervision of financial institutions;

## **BANKING AND SUPERVISION ELEMENTS**

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- Describe common business organizational structures along with their advantages and disadvantages;
- Identify legal issues related to contracts;
- Explain the importance of adequate loan documentation; and
- Describe common loan documents.

### Capital

- Define capital;
- Identify sources of capital;
- Describe the purpose of capital;
- Discuss the concept of risk-based capital;
- Identify elements of tier-one and tier-two capital;
- Describe the methodology for risk-weighting assets;
- Calculate risk-based and leverage capital ratios;
- Describe regulatory minimum capital requirements;
- Describe laws and regulations related to capital;
- Discuss other significant evaluation factors that affect a bank's capital, including volume of classified assets, asset growth, off-balance sheet items, dividend payout and access to capital markets;
- Describe the importance of capital planning; and
- Explain the relationship between capital and the other CAMELS components.

### Consumer Affairs

- Describe a financial institution's consumer compliance responsibilities.
- Describe the System's role in supervising an institution's compliance with fair lending regulations and the CRA.
- Describe the risks typically associated with fair lending and CRA.
- Describe the consumer compliance and CRA rating systems.
- Identify supervisory issues related to consumer compliance.
- Explain how compliance issues relate to other examination specialties.

### Earnings

- Explain the importance of earnings to a bank's overall financial condition;
- Identify the components of earnings;
- Explain how a bank's structure affects its earnings;
- Identify and interpret the earnings ratios presented in the in the UBPR; and
- Discuss additional factors that affect a bank's earnings including budget planning, rate sensitivity and external market conditions.

## **BANKING AND SUPERVISION ELEMENTS**

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### Financial Analysis

- Describe the quantitative and qualitative factors used to analyze the financial and managerial condition of a commercial bank
- Identify and describe the six safety and soundness risk areas
- Calculate the basic ratios used to analyze a bank's financial condition.
- Using a Uniform Bank Performance Report (UBPR), develop conclusions regarding a bank's financial condition and support its rating
- Identify the components of the CAMELS rating system and explain the interrelationship among them. Discuss how risks evaluated in each component can affect other areas of a bank.

### FBO

- Identify activities in which FBOs engage,
- Describe the risk inherent in FBO activities,
- Define the rating systems used in FBO examinations and explain how the rating systems are applied, and
- Recognize regulatory concerns common to FBOs.

### Information Technology

- Describe the risk fundamentals associated with information technology (IT) and identify IT risks;
- Describe the IT examination rating system;
- Explain the System's supervisory role for IT examinations;
- Explain the importance of internal control and audit concepts as they apply to information systems and technology;
- Distinguish between management information systems (MIS) and IT.
- Describe the importance of an adequate MIS program;
- Explain how IT risks are incorporated into the risk assessment process;
- Describe how IT deficiencies affect other examination areas; and
- Describe the technology environment common in community banks.

### Integrated Supervision

- Discuss the concept of integrated supervision
- Distinguish the various aspects of a financial institution's activities and describe the applicable supervisory process

## **BANKING AND SUPERVISION ELEMENTS**

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- Describe the risk management process, including identification, measurement, monitoring, and control of risk
- Discuss the importance of assessing risk and identify the various risk components
- Explain risk assessment as it pertains to examination structure, process, and ratings
- List the risks relevant to each type of examination specialty
- Identify common regulatory concerns and how they affect the various examination types
- Identify the ratings used by each examination specialty
- Discuss supervisory tools used for off-site monitoring

### Internal Controls and Audit

- Define internal controls;
- List the five elements of an internal control system;
- Discuss the relationship between internal controls and management responsibilities;
- Identify the risk potential of an inadequate internal control system;
- Identify actions that can reduce or eliminate the risk potential of inadequate internal controls;
- Discuss what an examiner should look for when evaluating internal controls; and
- Apply the concept of materiality to the review of internal controls.
- Describe the roles of internal and external audit as elements of an internal control system;
- Distinguish between the responsibilities of internal and external auditors and examiners and identify areas of overlap between the functions;
- Describe the elements of an effective audit function;
- Discuss issues surrounding the outsourcing of internal audit; and
- Describe FDICIA regulatory requirements regarding audit.

### Liquidity

- Identify sources of asset and liability liquidity on a bank's balance sheet,
- Discuss the trade-off between earnings and liquidity,
- Describe the funding sources typically available to a financial institution,
- Describe the effect of contingent liabilities upon liquidity, and
- Identify and interpret the liquidity ratios in the Uniform Bank Performance Report

### Management

- Discuss the roles and responsibilities of an institution's management and its board of directors,
- Describe the effect of the CAMELS ratings on the management rating, and
- List the significant areas considered when evaluating management.

## **BANKING AND SUPERVISION ELEMENTS**

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### Sensitivity

- Define rate sensitivity,
- List the types of market risk,
- Identify the areas of a financial institution that are affected by market risk,
- List the methods financial institutions typically use to measure market sensitivity, and
- Discuss a financial institution's responsibility to identify, measure, monitor and control risk.

### Trust

- Identify the major functions of a financial institution engaging in trust activities and the common types of trusts;
- List an institution's duties and responsibilities related to its fiduciary activities;
- Discuss the risks typically associated with fiduciary activities;
- Explain the System's authority over a financial institution engaging in trust activities;
- Describe the rating system applied to trust examinations;
- Recognize supervisory issues relating to nondeposit investment products; and
- Explain how risks arising from trust activities can affect other examination specialties.

### *Class Size*

The optimal class size for BASE is approximately 20 participants. To provide sufficient variety of interaction among class participants, the minimum class size should be 16 participants. Because Week 2 of BASE relies on case study work to present hands-on experience with the material, sufficient instructors are necessary to assist individual groups. Accordingly, to ensure a manageable instructor workload and maintain a reasonable participant-to-instructor ratio, the maximum class size is 25 participants.

### *Instructors*

BASE includes one lead instructor and three additional instructors with safety and soundness background to instruct both during the Week 1 on-line and week 2 in-class portions of the course. In addition, the class requires a Consumer Affairs, an Information Technology and a Fiduciary instructor.