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### CRIS COMPOSITE AND COMPONENT RATING DEFINITIONS AND EVALUATION FACTORS

#### FINANCIAL RISK COMPOSITE RATING

The Financial Risk Composite Rating is based on a careful evaluation of a corporate's financial performance. The five key components used to assess an institution's financial strength are empirical capital measures, credit risk exposure, interest rate risk exposure, liquidity risk exposure, and level and composition of earnings.

The composite rating scale ranges from 1 to 5, with a rating of 1 indicating the strongest level of financial performance relative to the institution's complexity, risk profile, and approved expanded authorities (as applicable); and the level of least supervisory concern. A rating of 5 indicates a critically deficient level of financial performance and an excessive risk profile given approved expanded authorities (as applicable); and the greatest supervisory concern. The composite ratings are defined as follows:

1. Corporate credit unions in this group exhibit a strong financial condition in every respect and generally have financial risk component ratings of 1 or 2. Any financial weaknesses are minor and can be corrected or improved in a routine manner by the board of directors and management. These corporate credit unions are the most capable of withstanding economic instability and market interest rate fluctuation. These corporates are in compliance with all regulations pertaining to the accumulation of capital and management of interest rate, credit, and liquidity risks. As a result, these corporate credit unions exhibit the strongest financial performance and risk profile relative to the complexity of operations and approved expanded authorities (as applicable).
2. Corporate credit unions in this group are fundamentally sound. For a corporate to receive this rating, no component rating will be more severe than 3. Only moderate financial weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These corporate credit unions are stable and are capable of withstanding business fluctuations. These corporate credit unions are in substantial compliance with all regulations pertaining to the accumulation of capital and management of interest rate, credit, and liquidity risks. Risk exposures are acceptable relative to the complexity of the corporate's operations and expanded authorities granted (if applicable).
3. Corporate credit unions in this group exhibit a degree of supervisory concern in one or more of the component areas. These corporates exhibit a combination of financial weaknesses that may range from moderate to severe; however, the individual components are not rated more severely than 4. Corporate credit unions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside

influences than those corporates rated a composite 1 or 2. These corporates may be in significant noncompliance with regulations pertaining to the accumulation of capital and management of interest rate, credit, and liquidity risks. The overall risk profile of the corporate is less than satisfactory relative to the complexity of operations, and expanded authorities granted (if applicable).

**4.** Corporate credit unions in this group generally exhibit serious financial deficiencies resulting in unacceptable performance. The problems range from severe to critically deficient. Corporate's in this group are generally not capable of withstanding business fluctuations. There may be significant noncompliance with regulations pertaining to the accumulation of capital and management of interest rate, credit, and liquidity risks. The corporate's overall risk profile is unacceptable relative to the complexity of operations and expanded authorities granted (if applicable). Institutions in this group pose a risk to the National Credit Union Share Insurance Fund (NCUSIF).

**5.** Corporate credit unions in this group exhibit critically deficient performance and risk profiles relative to the complexity of operations and expanded authorities granted (if applicable). The volume and severity of problems are beyond the board and management's ability or willingness to control or correct. Immediate NCUSIF financial or other assistance is needed in order for the corporate to be viable. Continual supervisory attention is necessary. Institutions in this group pose a significant risk to the NCUSIF and failure is highly probable.

### **RISK MANAGEMENT COMPOSITE RATING**

The Risk Management Composite Rating is based on a careful evaluation of a corporate's risk management policies, practices, and expertise. The seven key components used to assess an institution's managerial strength are: Capital Accumulation and Planning, Profit Planning and Control, Interest Rate Risk Management, Liquidity Risk Management, Credit Risk Management, Board Oversight Audit & Compliance, and Operations.

The rating scale ranges from 1 to 5. A rating of 1 indicates: the highest quality risk management, operational, and supervisory practices relative to the institution's complexity, risk profile, and approved expanded authorities; and the level of least supervisory concern. A rating of 5 indicates: a critically deficient quality of risk management, operational, and supervisory practices given approved expanded authorities; and the greatest supervisory concern. Composite ratings are defined as follows:

- 1.** A rating of 1 indicates strong performance by management and the board of directors and strong risk management practices relative to the corporate's authorities granted under Part 704. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.
- 2.** A rating of 2 indicates satisfactory management and board performance and risk management practices relative to the corporate's authorities granted under Part 704. All operational policies and practices are deemed fundamentally sound. Minor weaknesses may exist, but are not material to the safety and soundness of the corporate and are being addressed.
- 3.** A rating of 3 indicates management and/or board performance requires improvement, or risk management practices are less than satisfactory given the corporate's expanded authorities under Part 704. The capabilities of management or the board of directors may be insufficient for this corporate. Financial and/or operational problems and significant risks may be inadequately identified, measured, monitored, or controlled.

4. A rating of 4 indicates deficient management and/or board performance or risk management practices are inadequate considering the corporate's expanded authorities under Part 704. The levels of financial and/or operational problems and risk exposures are excessive. Financial and/or operational problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate board and management action to preserve the corporate's soundness.
5. A rating of 5 indicates critically deficient management and board performance or risk management practices. Management and/or the board of directors have not demonstrated the ability to correct financial and/or operational problems and implement appropriate risk management practices. Financial and/or operational problems and significant risks are inadequately identified, measured, monitored, or controlled and now threaten the continued viability of the corporate.

## **INDIVIDUAL FINANCIAL RISK AND RISK MANAGEMENT COMPONENT RATINGS**

### **Empirical Capital Measure Component Ratings**

A rating of 1 indicates a strong capital level. No negative trends are apparent.

A rating of 2 indicates a satisfactory capital level. Some negative trends may be apparent; however, the retained earnings and capital ratios meet or exceed the minimum regulatory requirements. Generally, the corporate is not approaching a capital position that will require either an earnings retention requirement, under Section 704.3(i), or a capital restoration plan under Section 704.3(g).

A rating of 3 indicates retained earnings and capital ratios meet or exceed the minimum regulatory requirements of Section 704.3(i) and Section 704.3(d); however, the rating indicates the capital position is approaching a level where either earnings retention, under Section 704.3(i), or a capital restoration plan, under Section 704.3(g), will be required.

A rating of 4 indicates either the retained earnings and/or capital ratios are less than the minimum regulatory requirements of Sections 704.3(i) and 704.3(d), as applicable. Indications are the corporate will be subject to either Section 704.3(i) and/or a capital restoration plan for some time.

A rating of 5 indicates a critically deficient level of capital such that the corporate credit union's viability is threatened.

### **Capital Accumulation Planning Component Ratings**

A rating of 1 indicates the corporate has set forth reasonable plans for the continued maintenance or accumulation of capital in relation to other financial and operational risks incurred by the corporate, and has consistently achieved the objectives set forth in those plans.

A rating of 2 indicates the corporate has set forth reasonable plans for the continued maintenance or accumulation of capital in relation to other financial and operational risks incurred by the corporate, and has normally achieved the goals set forth in those plans.

A rating of 3 indicates capital accumulation plans set forth by management are weak in relation to the financial and operating risks incurred by the corporate, and goals and objectives set forth in those plans are frequently not achieved.

A rating of 4 indicates capital accumulation plans either are non-existent, or seriously deficient in relation to the corporate's current capital level, financial and operational risks.

A rating of 5 indicates corporate management is either unwilling or incapable of developing and implementing effective capital accumulation plans putting the future solvency of the institution in jeopardy.

### **Earnings and Profitability Component Ratings**

A rating of 1 indicates strong earnings. Earnings are more than sufficient to support operations and to accumulate adequate reserves and undivided earnings after considering credit risk, liquidity risk, interest rate risk, growth, composition of income and expense, and other factors affecting the quality, quantity, and trend of earnings.

A rating of 2 indicates the level of earnings is satisfactory. Earnings are sufficient to support operations and maintain the accumulation of adequate reserves and undivided earnings after considering credit risk, liquidity risk, interest rate risk, growth, composition of income and expense, and other factors affecting the quality, quantity, and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the corporate credit union's level of earnings is adequate in relation to the core capital and retained earnings ratios.

A rating of 3 indicates a level of earnings that needs improvement. Earnings may not fully support operations and provide for retained earnings growth commensurate with asset growth after considering credit risk, liquidity risk, interest rate risk, composition of income and expense, and other factors affecting the quality, quantity, and trend of earnings.

A rating of 4 indicates a deficient level of earnings. Earnings are insufficient to maintain appropriate retained earnings. Corporate credit unions so rated may be characterized by erratic fluctuations in net income or net interest margin, the development of significant negative trends, nominal or unsustainable earnings, intermittent losses, or a substantive drop in earnings from previous reporting periods.

A rating of 5 indicates critically deficient earnings. A corporate credit union with earnings rated 5 is experiencing losses representing a distinct threat to its viability through the erosion of capital.

### **Profit Planning and Control Component Ratings**

A rating of 1 indicates management has set forth a reasonable and accurate budgeting and cost accounting process that allows for the effective management of fee income and operating expenses in relation to net-interest margin, asset growth, and capital accumulation objectives. Budgeted goals and objectives are consistently obtained with no major variances or revisions to projections required.

A rating of 2 indicates management has set forth a reasonable and accurate budgeting and cost accounting process enabling the effective management of fee income and operating expenses in relation to net-interest margin, asset growth, and capital accumulation objectives. Budgeted goals and objectives are normally obtained. Minor variances and revisions are sometimes incurred.

A rating of 3 indicates management's budgeting and cost accounting processes are weak and normally ineffective in measuring, monitoring, and controlling corporate earnings.

A rating of 4 indicates management's budgeting and cost accounting processes are unreasonable, inaccurate, and critically deficient in measuring, monitoring, and controlling corporate earnings.

A rating of 5 indicates management is unwilling or unable to develop and implement effective budgetary and cost accounting systems.

### **Interest Rate Risk Exposure Component Ratings**

A rating of 1 indicates NEV is strong and well controlled and there is minimal potential financial performance will be adversely affected or regulatory requirements will be violated. The level of earnings and the NEV ratio provide substantial support for the degree of market risk taken by the corporate credit union.

A rating of 2 indicates interest rate sensitivity is acceptable and adequately controlled. There is only moderate potential financial performance will be adversely affected or regulatory requirements will be violated.

A rating of 3 indicates control of interest rate exposure needs improvement or there is significant potential the NEV ratio will be in violation of the regulatory limits of Section 704.8, or the applicable part of Appendix B of Part 704. The level of earnings and the NEV ratios may not adequately support the degree of NEV exposure.

A rating of 4 indicates the corporate's interest rate sensitivity is in violation of the regulatory limits of Section 704.8, or the applicable part of Appendix B of Part 704. The NEV or NEV ratio reflect an immediate need to plan and take action to restructure the balance sheet to bring the corporate into compliance.

A rating of 5 indicates a corporate's interest rate sensitivity is in violation of the regulatory limits of Section 704.8, or the applicable part of Appendix B of Part 704. The level of risk is unacceptable and/or an imminent threat to the corporate's viability.

### **Interest Rate Risk Management Component Ratings**

A rating of 1 indicates interest rate risk management practices are strong for the expanded authorities approved (if applicable), sophistication, and level of interest rate exposure of the corporate. No weaknesses are noted, and no supervisory concerns exist.

A rating of 2 indicates interest rate risk management practices are satisfactory for the expanded authorities approved (if applicable), sophistication, and level of interest rate exposure of the corporate. Some minor weaknesses may be noted with limited supervisory concern.

A rating of 3 indicates interest rate risk management practices need to be improved given the expanded authorities approved (if applicable), sophistication, and level of interest rate exposure of the corporate. Major weaknesses are noted, and a high degree of supervisory concern exists regarding the adequacy of interest rate risk management policies and practices.

A rating of 4 indicates interest rate risk management practices are deficient under any expanded authorities approved (if applicable). Severe weaknesses are noted. Management lacks the expertise to set forth appropriate risk management strategies and practices, and major supervisory concerns exist regarding the adequacy of interest rate risk management policies and practices and regulatory intervention may be necessary.

A rating of 5 indicates interest rate risk management practices are wholly inadequate for the authority, sophistication, and level of interest rate exposure of the corporate. Critical deficiencies are noted. Management lacks the willingness and expertise to set forth



appropriate risk management strategies and practices. Supervisory intervention is required.

### **Liquidity Risk Exposure Component Ratings**

A rating of 1 indicates strong liquidity levels and reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

A rating of 2 indicates satisfactory liquidity levels and funds management practices. The corporate has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs.

A rating of 3 indicates a weak level of liquidity in relation to short- and long-term cash funding needs. Corporates rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.

A rating of 4 indicates deficient liquidity levels, and the need for frequent borrowing to fund daily cash needs. Corporates rated 4 may not have, or be able to obtain, a sufficient volume of funds on reasonable terms to meet liquidity needs.

A rating of 5 indicates liquidity levels or funds management practices so critically deficient the continued viability of the corporate is threatened. Corporates rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs.

### **Liquidity Risk Management Component Ratings**

A rating of 1 indicates liquidity management policies and practices are strong. Management has developed and maintained reasonable and accurate processes to measure, monitor, and control short- and long-term access to funds. Effective policies have been set forth, identifying effective liquidity contingency plans. No supervisory concerns are noted.

A rating of 2 indicates liquidity management policies and practices are adequate. Management has developed and maintained processes to measure, monitor, and control short- and long-term access to funds. Liquidity contingency plans have been developed. Some minor weaknesses in these plans, policies, and practices may be noted. Some minor supervisory concerns may be noted.

A rating of 3 indicates liquidity management policies and practices are weak. Management's policies and processes for measuring, monitoring, and controlling short- and long-term access to funds may be unreasonable or inaccurate. There is normally a lack of sufficient liquidity contingency plans in place. A high degree of supervisory concern exists.

A rating of 4 indicates liquidity management policies and practices are deficient. Management may lack the appropriate expertise to develop and maintain reasonable and effective processes to measure, monitor, and control short- and long-term access to funds. Major supervisory concerns exist.

A rating of 5 indicates liquidity management policies and practices are critically deficient. Management lacks the ability and willingness to set forth appropriate liquidity management strategies, and regulatory intervention is necessary.

### **Credit Risk Exposure Component Ratings**

A rating of 1 indicates a low level of credit risk exposure with respect to corporate capital and regulatory requirements. No supervisory concern is noted.

A rating of 2 indicates a satisfactory level of credit risk exposure with respect to capital and regulatory requirements. Some concentrations, watch list assets, and other credit weaknesses may exist. However, only minor supervisory concern exists.

A rating of 3 indicates a high degree of credit risk exposure. There may be a significant level of concentrations, watch list assets, and other credit weaknesses apparent. The severity of these risks requires an elevated level of supervisory concern.

A rating of 4 indicates the corporate's assets have a deficient level of credit quality. Significant credit concentrations, watch list assets, and other credit risks are apparent that may subject the corporate to potential losses and threaten its viability. Major supervisory concerns exist.

A rating of 5 indicates a severely high degree of credit risk. Losses have been incurred due to these weaknesses, and the viability of the corporate is threatened. Major supervisory concern and follow up are required.

### **Credit Risk Management Component Ratings**

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## **CRIS COMPOSITE AND COMPONENT RATINGS DEFINITIONS**

A rating of 1 indicates strong credit analysis practices. The expertise of management and staff as well as sophistication of policies and practices are commensurate with approved expanded authorities (if applicable). Credit risk is of minimal supervisory concern.

A rating of 2 indicates satisfactory credit administration policies and practices commensurate with approved expanded authorities (if applicable). Some minor weaknesses may be noted; however, management has demonstrated the ability and willingness to correct them in an expedient and effective manner. Only limited supervisory concern is required.

A rating of 3 indicates administration practices are less than satisfactory, considering the corporate credit union's expanded authority (as applicable). There is generally a need to improve credit administration practices, and management has been slow to initiate improvement. Moderate supervisory concern is required.

A rating of 4 indicates a corporate with deficient credit administration practices under base or any expanded authority level. There is a definite need to improve credit administration practices, and management may not possess the necessary expertise to do so. Major supervisory concern and follow up are required.

A rating of 5 indicates critically deficient credit administration practices. The corporate may have significant exposures threatening viability. Management is unwilling or unable to initiate improvement and regulatory intervention is required.

### **Board Oversight, Audit & Compliance Component Ratings**

A rating of 1 indicates strong board, committee, and management oversight. Effective managerial policies and procedures are evident in all areas of operation. Effective succession and backup plans are in place. Appropriate position descriptions and responsibilities have been set, and management and staff continually receive relevant and effective education to enable them to effectively meet the responsibilities of those positions. The corporate has an active and effective audit and compliance program, commensurate with expanded authorities granted. No supervisory concerns exist.

A rating of 2 indicates satisfactory board, committee, and management oversight. Effective managerial policies and procedures are in place for material areas of operation. Some minor weaknesses may be noted. The officials have set forth succession and backup plans that are either completely adequate or exhibit only minor weaknesses. Position descriptions and responsibilities have been set forth, and management and staff generally receive relevant and effective education to enable them to meet their

responsibilities. The corporate has a satisfactory audit and compliance program, commensurate with expanded authorities granted (if applicable). In some cases only minor audit and compliance related weaknesses will be noted. Management is responsive to audit and supervision efforts and addresses any deficiencies noted in a timely and effective manner. Only minor supervisory concern exists.

A rating of 3 indicates generally weak board, committee, and/or management oversight. Managerial policies and procedures are not in place for material areas of operation. Weaknesses are noted in existing policies. The officials have either not set forth succession and backup plans, or the plans are considered unreasonable and ineffective. Position descriptions and responsibilities have not been set forth, and management and staff generally do not receive relevant and effective education to enable them to effectively meet their responsibilities. The corporate's audit and compliance program may be unsatisfactory commensurate with expanded authorities granted (if applicable). Management may not be responsive to audit and supervision efforts. Major supervisory concern exists.

A rating of 4 indicates serious managerial weaknesses. The board, committees, and senior management have demonstrated an inability to set forth adequate infrastructure and organizational policy and practice. Critical supervisory concern exists.

A rating of 5 indicates critically deficient management oversight. The board, committees, and senior management are unwilling or unable to address organizational weaknesses. Regulatory intervention is required.

### **Operations Component Ratings**

A rating of 1 reflects high quality operational policies, procedures and processes. Management's abilities, procedures, and practices are of minimal supervisory concern.

A rating of 2 reflects acceptable operational policies, procedures, and processes. Some minor weaknesses may be noted that management is willing and able to correct in an effective and efficient manner. Management's abilities, procedures, and practices warrant only a limited level of supervisory attention.

A rating of 3 reflects a moderate degree of weakness. Management's abilities, operational policies, procedures, and processes are less than satisfactory. The severity of these weaknesses and risks require an elevated level of supervisory review. There is a general need to improve management infrastructure and/or operational policies and practices.

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## **CRIS COMPOSITE AND COMPONENT RATINGS DEFINITIONS**

A rating of 4 reflects serious deficiencies with respect to management's abilities, operational policies, procedures, and processes. The unsatisfactory nature of abilities, policies, procedures, and practices have put the assets of the corporate, members, and the NCUSIF at a high level of risk of financial loss or interruption of service. There is a definite need to improve the quality of policies and practices. Extensive supervisory attention is warranted.

A rating of 5 reflects critical deficiencies with respect to management's abilities, operational policies, procedures, and practices. The unsatisfactory nature of policies and practices may have caused financial losses, and threatens the viability of the institution. Management is unwilling or unable to take effective corrective action.

## **CORPORATE RISK IDENTIFICATION SYSTEM (CRIS)**

### **Listing of CRIS Evaluation Factors by Component**

#### **Empirical Capital Component Ratings**

##### **Quantitative Empirical Capital Measures**

Retained Earnings Ratio

Core Capital Ratio

Capital Ratio

Trends

Ratio

Dollars

Other

##### **Qualitative Factors (i.e. Capital Accumulation Planning)**

Reasonableness of Capital Accumulation Plan in Relation to Current Capital Levels and Risk Profile

#### **Earnings Component Ratings**

##### **Quantitative Earnings Measures**

NI Level

Trends

Composition

Gross Income

Cost of Funds

Fee Income

Operating Expenses

Other

##### **Qualitative Profit Planning and Management Factors**

Budgeting and Reporting

Earnings in Relation to Capital Plans

Effectiveness of Cost Accounting Systems and Product Profitability

Pricing Strategies and Policies

Other

**Interest Rate Risk Component Ratings**

**Quantitative Interest Rate Risk Exposure Measures**

NEV Base Ratio

NEV Exposure Measure (worst case scenario relative to regulatory floor)

NEV Volatility Measure (change)

Other

**Qualitative Interest Rate Risk Management Evaluation Factors**

Robustness of Net Economic Value Simulation Models

Robustness of Net Interest Income Simulation Models

Additional NEV and Stress Testing

Expertise of Management and Staff - Interest Rate Risk Management

Modeling Process / Internal Control

ALCO Documented Strategies

Compliance Program and Third Party Validation (if applicable)

Policies/Procedures

Other

**Liquidity Component Ratings**

**Quantitative Liquidity Risk Exposure Evaluation Factors**

Concentration Risks  
Reasonableness of Core Funds Determination  
Liquidity Measures - cash budgeting  
Other:

**Qualitative Liquidity Risk Management Evaluation Factors**

Policies / Procedures  
    Objectives  
    Contingency Plans  
Alternative Funding Sources  
    Development  
    Maintaining Market Presence  
    Testing  
    CP  
    Repo  
Existence of Disintermediation Plan  
Existence and Reasonableness of Early Withdrawal Penalties  
Compliance / Monitoring  
Other

**Credit Risk Component Ratings**

**Quantitative Credit Risk Exposure Evaluation Factors**

Concentrations of Credit by Investment Type  
Concentrations of Credit by Issuer  
Concentrations of Lending, Commitments and Guarantees  
Third Party Credit Ratings  
Other

**Qualitative Credit Risk Management Evaluation Factors**

Quality of Credit Risk Management Policies (Investments and Loans)  
Quality of Credit Risk Management Procedures (written)  
Quality of Loan Underwriting Practices  
Quality of Credit Administration, Documentation, and Reporting (Investments)  
Quality of Assets  
Other



**Board Oversight, Audit & Compliance Component Rating**

Overall strategic planning process  
Appropriateness and completeness of succession planning  
Ability to attract and retain sufficiently qualified and experienced personnel  
Quality of policy-making activities in all areas of operations and at all levels of management  
Overall adequacy and effectiveness of the corporate's infrastructure  
Overall effectiveness of the board of directors  
Overall effectiveness of committees  
Overall effectiveness of senior management  
Independence and effectiveness of compliance functions  
Responsiveness to supervision  
Sufficiency of and response to the internal audit function  
Sufficiency of and response to the external audit  
Extent of cross training and backup  
Adequacy of continuing education and training for officials, senior management, and staff  
Effectiveness in addressing legal matters  
Effective use of consultants  
Effective use of vendors and outsourcing  
Other evaluation factors as applicable

**Operations Component Rating**

Overall completeness of documented procedures for all areas of operations  
Accuracy of financial reporting and accounting functions  
Adequacy of internal controls in all areas of operations  
Adequacy of management of MIS systems risk including the LAN, wires, ACH, and item processing  
Other evaluation factors as applicable