BPI AND ABA, TABITHA EDGENS

Proposal and Comment Information

Title: LFI -Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, OP-1868

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On behalf of the Bank Policy Institute and the American Bankers Association, please find attached comments responding to Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations.

August 14, 2025

Via Electronic Mail

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations (Docket No. OP-1868)

Ladies and Gentlemen:

The Bank Policy Institute and American Bankers Association strongly support the Federal Reserve's proposed changes to the Large Financial Institution rating system.[1] These are necessary and common-sense changes that would rationalize the ratings process and should be adopted without delay. We also welcome the proposal's confirmation that the Federal Reserve is considering additional changes to the supervisory ratings system. We particularly urge the Federal Reserve to join the other Federal banking agencies to propose similar changes to the CAMELS rating system as an immediate next step to ensure the proposed changes to the LFI rating system have meaningful effect.

I. Introduction

The proposed targeted changes are necessary to provide more accurate ratings that correspond to firms' financial condition. Specifically, we strongly support the proposal to

[1] BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks and major foreign banks doing business in the United States.

The American Bankers Association is the voice of the nation's $24.5 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $19.5 trillion in deposits and extend $12.8 trillion in loans.

(1) allow banks with only one Deficient-1 (D-1) component rating and two component ratings of Conditionally Meets Expectations or better to be considered "well managed" and (2) to remove the presumption that a LFI that receives one or more D-1 component ratings will be subject to a formal or informal enforcement action.[2]

Ratings should accurately reflect an individual bank's condition, and the collective ratings for all banks should broadly reflect the condition of the banking system. Today, rather than reflecting a comprehensive assessment of a firm's safety and soundness, a bank's rating often merely reflects an isolated deficiency in a single component rating based on a subjective assessment. In many cases, the supervisory conclusion may be based on a hypothetical stress event or not even relate to a firm's financial or operational strength and resilience. As a result, under the current LFI rating system, two-thirds of large banks have been deemed less-than-satisfactory and not "well managed" while regulators have repeatedly said that LFIs, and the banking system as a whole, remain strong and resilient.[3]

The issue is not merely academic. Being deemed not well managed has lasting and significant effects. Under the current framework, holding companies that are considered not well managed are limited in their ability to invest in their core businesses and to expand their product offerings to meet customer needs. This hampers innovation and, ultimately, harms competitiveness and economic growth. The proposal's economic analysis, drawing on bank-specific ratings and financial data, finds: "the loss of 'well managed' status is associated with slower growth in assets and loans," and in the year following a downgrade to not well managed firms show a notable decline in both assets and loans.[4] Accordingly, we encourage the Federal Reserve to adopt the proposed changes without delay. Part II of this letter discusses these proposed targeted changes in more detail.

Furthermore, we appreciate the Federal Reserve's stated intention to pursue additional reforms to the ratings framework as part of the next stage of reforms. BPI has long advocated for reforms to ratings frameworks, both to focus bank supervision on material risks and to enhance due process.[5] Part III of this letter responds to the questions

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[2] *See* Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, 90 Fed. Reg. 31641 (July 15, 2025).

[3] See, BPI, Making Sense of the Federal Reserve's Report on Supervisory Developments (Nov. 19, 2024), https://bpi.com/making-sense-of-the-federal-reserves-report-on-supervisory-developments/#_ftnref5.

[4] 90 Fed. Reg. 31,649.

[5] *See* BPI comment letter regarding Application of the Uniform Financial Institution Rating System (Feb, 28, 2020) (the "February 2020 Letter"), available at https://bpi.com/wp-content/uploads/2020/02/Supplemental-BPI-Comment-Letter-re-UFIRS-RFI-Docket-No-OP-1681-RIN-3064-ZA08.pdf; BPI comment letter regarding Substantive Review and Revision of the Uniform Financial Institution Rating System (Jan. 10, 2020), available

in the proposal about additional, complementary changes to the ratings framework. We recommend the Federal Reserve pursue these reforms in parallel with adoption of the proposed changes:

- Additional LFI ratings reform
- CAMELS, RFI/C(D) and CUSO ratings-related reform
- Process and communications reforms to enhance due process and accuracy of ratings.

II. The Federal Reserve should adopt the proposed changes to the LFI Framework

A. The Federal Reserve should revise the definition of "well managed" as proposed

We support the purposes of the LFI rating system, which are clearly articulated, focused on fundamental safety and soundness, and aimed at promoting regulatory clarity and certainty. The Federal Reserve has said the LFI rating system is intended to:

- fully align with the Federal Reserve's current supervisory programs and practices, which are based upon the LFI supervision framework's core objectives of reducing the probability of LFIs failing or experiencing material distress and reducing the risk to U.S. financial stability;
- enhance the clarity and consistency of supervisory assessments and communications of supervisory findings and implications; and
- provide transparency related to the supervisory consequences of a given rating.[6]

Unfortunately, as the framework has been applied in practice, it has become disconnected from these original purposes, making it less effective and accurate and unnecessarily hindering the provision of financial services and economic growth.

1. The current framework results in a disconnect between ratings and financial condition.

The proposed reforms are necessary so that bank ratings reflect a complete view of a firm's financial condition rather than isolated issues. Data provided in the proposal

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at https://bpi.com/wp-content/uploads/2020/01/BPI-Comment-Letter-re-CAMELS-Docket-No-OP-1681-RIN-3064-ZA08-002.pdf.

[6] 90 Fed. Reg. at 31,652.

demonstrates the disconnect between the LFI framework and financial condition: The proposal notes that two-thirds of LFIs have at least one D-1 rating—and therefore are deemed not "well managed"—despite continued conclusions that the financial system is sound. These deficient ratings are largely based on highly subjective findings of weaknesses in Governance and Controls[7]—findings that often have little or no connection to a bank's financial condition.

BPI has frequently observed that there is a disconnect between the strength of LFIs and the financial system overall and the ratings produced by the LFI rating system (and similarly, the CAMELS system).[8] Supporting this observation, the proposal notes that there has been an upward trend in the number of LFIs considered not well managed since the first quarter of 2020, but over the same period, "the regulatory capital ratio of large financial institutions as a group remained generally stable around 13 percent."[9]

We agree with the position in the proposal that a key factor driving this result is that firms receiving a single D-1 component are no longer considered well managed under the current framework, even though they can maintain safe-and-sound operations through a range of conditions. In 2020, shortly after the LFI rating system was adopted, Federal Reserve Vice Chair for Supervision Randal Quarles presciently observed that this aspect of the framework should be monitored and possibly adjusted, referring to it as "the ascetic principle by which a firm's "well managed" status is **determined by its lowest component rating, no matter how good the bank is at everything else**." [10] The proposal indicates this aspect of the framework has turned out to yield inaccurate results in practice,[11] so it is essential that the Federal Reserve correct this flawed calibration.[12]

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[7] Federal Reserve Board, Supervision and Regulation Report (November 2024), available at *https://www.federalreserve.gov/publications/files/202411-supervision-and-regulation-report.pdf*.

[8] See, BPI, Making Sense of the Federal Reserve's Report on Supervisory Developments (Nov. 19, 2024), https://bpi.com/making-sense-of-the-federal-reserves-report-on-supervisory-developments/#_ftnref5; BPI, Comments Responding to Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Mar. 11, 2025), https://bpi.com/bpi-addresses-rising-compliance-responsibilities-for-banks-in-egrpra-response/; BPI, Myth vs. Reality: Bank Supervision (Mar. 25, 2025), https://bpi.com/myth-vs-reality-bank-supervision/.

[9] 90 Fed. Reg. 31,647.

[10] Randal Quarles, "*Spontaneity and Order: Transparency, Accountability, and Fairness in Bank Supervision*," Speech at the American Bar Association Banking Law Committee Meeting (January 17, 2020), available at *https://www.federalreserve.gov/newsevents/speech/quarles20200117a.htm* (emphasis added).

[11] 90 Fed. Reg. 31,642.

[12] In connection with adopting the proposed changes, we request that the Federal Reserve clarify if the changes will apply automatically to current ratings or they will be implemented during the next exam cycle

2. Ratings downgrades have severe negative consequences for individual institutions and economic growth.

As the proposal observes, the consequences of this disconnect between ratings and financial condition have been negative and concrete: banking organizations have been limited in their ability to make new investments or acquisitions, expand their products, services or branch networks, and carry out internal reorganizations. These limitations apply even if the issue cited to support the bank's downgrade is wholly unrelated to the activities that are limited as a result of the downgrade.

For large bank holding companies, the consequences of downgrades in the LFI rating system are profound. These consequences include:

- **Loss of authority to engage in financial activities.** Under section 4(k) of the Bank Holding Company Act, BHCs that meet certain criteria may elect treatment as an FHC and engage in a wide range of permissible activities that are "financial in nature," or incidental or complementary to a financial activity. FHCs that fail to meet the criteria to maintain FHC status—including well managed status for both the BHC and its IDI subsidiaries—are subject to automatic consequences under section 4(m) of the Bank Holding Company Act. This limits the holding company's ability to engage in a variety of markets and investment activities including securities underwriting and dealing, insurance and merchant banking.
- **Loss of ability to engage in banking M&A activity.** Under Federal Reserve guidance, which is treated as a rule in practice, banks with a less-than-satisfactory rating are essentially barred from mergers and acquisitions. Supervisory Letter 14-2, issued in 2014, describes factors the Federal Reserve will consider in acting upon bank applications to engage in a wide range of proposed transactions, including mergers, acquisitions, asset purchases, investments, new activities and branching.[13] The letter states that banking organizations "are generally expected to resolve their outstanding substantive supervisory issues" prior to filing an application.[14] Such

after any changes are adopted. We recommend that the changes take effect immediately and any restrictions for firms that become well managed after adoption of the proposed changes should be automatically lifted.

[13] SR 14-2/CA14-1: "Enhancing Transparency in the Federal Reserve's Applications Process" (Feb. 24, 2014). Most large transactions involve a Federal Reserve review and therefore SR 14-2 may well directly affect many bank-level (in addition to bank holding company level) applications in that context.

[14] For more information see Sarah Flowers, "The 10 Bank M&A Policy Reforms We Need Now, and Later" (Jan. 22, 2025), https://bpi.com/the-10-bank-ma-policy-reforms-we-need-now-and-later/#_ftn10.

"supervisory issues" include, but are not limited to, below satisfactory ratings and outstanding enforcement actions. The Federal Reserve should rescind SR 14-2 and replace it with new guidance focused on material financial condition; until it is rescinded, this guidance will continue to be a gating concern for beneficial transactions.

- **Prolonged processing of nonbanking proposals.** Under the Federal Reserve's Regulation Y, a BHC must be considered well managed to utilize expedited processing of nonbanking proposals, which may be proposed as part of an acquisition. The activities covered by this section include activities related to extending credit, financial and investment advisory activities and securities brokerage activities.[15] Even if a bank were prepared to submit an application to engage in these activities, the prospect of processing delays may limit the applicant's ability to act on market opportunities in a timely manner and to realize the full benefits of the opportunity. Furthermore, this path also effectively discloses that the applicant is treated as not well managed, making it an infeasible option.
- **Internal corporate reorganizations.** To satisfy the exemption from quantitative limits under Regulation W for a corporate reorganization transaction, a holding company and all its subsidiary depository institutions must be well capitalized and well managed.[16]
- **Loss of general consent to make international investments**. Under the Federal Reserve's Regulation K, to make investments under the general consent procedures, a holding company must be well capitalized and well managed.[17] Applications to establish branches in new foreign jurisdictions are also generally not approved if the bank is not considered well managed.

Restricting banking organizations' ability to engage in these activities limits their capacity to serve their customers and compete in the dynamic and evolving financial services landscape. The proposal cites evidence of this fact, showing that loss of well managed status is associated with a decline in the growth of an institution's total assets and total loans.[18] The consequences of loss of well managed status are disproportionate to isolated supervisory findings; such severe business restrictions should be reserved for material failures under clearly defined standards. Adopting the proposal's approach to

[15] 12 C.F.R. § 225.23.

[16] 12 CFR § 223.41(d).

[17] 12 C.F.R. § 211.9(b).

[18] 90 Fed. Reg. 31,649.

"well managed" without delay would promote economic growth by allowing institutions without material safety and soundness concerns more latitude to invest resources to serve customers and to compete within the financial sector.

3. The proposed changes are consistent with the Bank Holding Company Act.

The proposal is consistent with the BHC Act and, in fact, better aligns the Federal Reserve's approach to determining when a large bank holding company is "well managed" with the relevant statutory authority.

Under the BHC Act, "well managed'' means a company or depository institution that has achieved (i) "a CAMEL composite rating of 1 or 2 (or an equivalent rating under an equivalent rating system),'' and (ii) "at least a satisfactory rating for management, if such a rating is given.''[19] The Federal Reserve has not designated any of the individual LFI rating components as a management rating, but instead has noted that each component evaluates different aspects of a firm's management.[20] Designating a single component of the framework as a "Management" rating would arbitrarily over-emphasize certain aspects of management while discounting the management considerations in the other two components. It would also allow one rating among the three to dictate an institution's overall rating, an outcome the proposal appropriately seeks to avoid. We recommend that the Federal Reserve explicitly confirm in finalizing any changes that the LFI framework is an equivalent rating system to CAMELS for purposes of the BHC Act and that no separate management rating is given, for the avoidance of any doubt on that point.

B. The Federal Reserve should eliminate the presumption of formal or informal enforcement actions

We support the proposal to eliminate the presumption of formal or informal enforcement actions for banks that receive a D-1 component rating. This is particularly important given other aspects of the guidance that provide broad latitude for examiners to downgrade a component rating.[21] Currently, the subjective D-1 standard may be met in situations that do not meet the legal standard for an enforcement action. Therefore, the presumption of an enforcement action should be eliminated, especially while the current definitions remain in place.

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[19] 12 U.S.C. § 1841(o)(9).

[20] 90 Fed. Reg. 31,642, note 17 ("The LFI Framework does not designate any of the three component ratings as a management rating, because each component evaluates different aspects of a firm's management.")

[21] See Section III.A below.

The Federal Deposit Insurance Act (12 U.S.C. § 1818) permits the Federal banking agencies to issue a cease and desist order or take other enforcement action if a BHC or bank is engaging in, or is about to engage in, an "unsafe or unsound practice" or violation of law.[22] Courts have interpreted unsafe and unsound practices or conditions to require a threat to the financial integrity of the bank, or an abnormal risk of loss or damage to the bank's financial stability. This is a high bar that has been interpreted by several federal courts over decades.[23] The current presumption runs afoul of this statutory framework because the standard for a D-1 rating does not require the examiner to show the bank is engaged in an unsafe or unsound practice (as defined by case law) or a violation of law.

First, supervisory "expectations" under the LFI rating framework oftentimes relate to granular operational, compliance, and other issues that are highly unlikely, on their own, to affect bank safety and soundness. The considerations are also highly subjective. With respect to the Governance and Controls component (see section III.A.1 below), the framework evaluates such considerations as "the extent to which the board exhibits attributes that are consistent with those of effective boards in carrying out its core roles and responsibilities," "the extent to which senior management effectively and prudently manages the day-to-day operations of the firm and provides for ongoing resiliency," and the extent to which "business line management executes business line activities consistent with the firm's strategy and risk appetite…and ensures an effective system of internal controls for its operations."[24] In our members' experience, this component provides broad examiner latitude and often results in emphasis on policies and procedures and documentation rather than concerns that rise to the level of unsafe or unsound practices or violations of law. Further, there is little clarity in how examiners weigh various subcomponents. This combination of granular considerations and examiner discretion to decide if a practice is a deficiency means institutions can receive a D-1 rating even when there is no indication the bank is engaged in an unsafe and unsound practice within the meaning of the statutory term.

Second, under the proposal, like under the current rule, the standard for a D-1 rating is lower than the statutory standard for issuing an enforcement action. The standard for a

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[22] 12 U.S.C. § 1818(b).

[23] As interpreted over time by the federal courts, an unsafe or unsound practice is one that "threatens the financial integrity of the institution" or that "would be contrary to generally accepted standards of prudent operation (that is, it constituted an imprudent act), the possible consequences of which, if continued, created an abnormal risk or loss or damage to the financial stability of [a bank]." *See Johnson v. OTS*, 81 F.3d 195, 204 (D.C. Cir. 1996); *Gulf Federal Savings & Loan Association v. Federal Home Loan Bank Board*, 651 F.2d 259, 264 (5th Cir. 1981).

[24] 90 Fed. Reg. 31,656.

D-1 rating would continue to be "issues that put the firm's prospects for remaining safe and sound through a range of conditions at significant risk." However, as described above, the statutory authorization for issuing an enforcement action based on safety and soundness is that the bank "is engaging or has engaged, or the agency has reasonable cause to believe that…[the institution] is about to engage, in an unsafe or unsound practice…." There should be no presumption of an enforcement action for a finding that "the firm's prospects for remaining safe and sound through a range of conditions" is at "significant risk" when the statutory standard requires a bank to be *engaged in* or *about to engage in* an unsafe and unsound practice for an agency to issue an enforcement action. For example, examiners could use any range of hypothetical stressful conditions that are sufficiently adverse to conclude that even isolated procedural issues would put a firm's prospects for remaining safe and sound at significant risk. Accordingly, a D-1 rating that is premised on hypothetically stressed conditions does not equate to a determination that an institution is actually engaged, or on the verge of being engaged, in unsafe or unsound practices sufficient for an enforcement action based on safety and soundness concerns under the FDIA.

In addition, the framework allows that a D-1 rating applies when "the firm's current condition is **not** considered to be materially threatened."[25] Again, a D-1 rating on that basis would fall short of the standard for an enforcement action, which would require a threat to the financial integrity of the bank or an abnormal risk of loss or damage to the bank's financial stability.[26] Given that the D-1 rating standards were not designed to align with the standard for enforcement under the FDIA for "unsafe or unsound" conduct, it is appropriate and necessary for the presumption of enforcement action to be eliminated. Accordingly, we strongly support removal of the presumption that a holding company that receives one or more D-1 component ratings will be subject to an informal or formal enforcement action.

III. The Federal Reserve should adopt additional changes to the rating framework

The proposed changes are beneficial for all of the reasons described above and should be finalized without delay. In parallel with this reform, we urge the Federal Reserve to move quickly to pursue additional, complementary reforms to ensure the supervisory

[25] 90 Fed. Reg. 31,657 (emphasis added) (explaining with respect to a D-1 rating: "although the firm's current condition is not considered to be materially threatened, these deficiencies limit the firm's ability to align strategic business objectives with its risk appetite and risk management capabilities; maintain effective and independent risk management and control functions, including internal audit; promote compliance with laws and regulations (including those related to consumer protection); or otherwise provide for the firm's ongoing resiliency through a range of conditions").

[26] *See*, *supra*, note 23.

framework is accurate and focused on material financial condition. Our recommendations in this Part fall into three categories: Section III.A recommends additional substantive changes to the LFI rating system. Section III.B recommends similar changes to the CAMELS and RFI/C(D) and ROCA rating systems. Finally, Section III.C describes additional recommendations regarding supervisory process and communications to focus bank ratings on material risks, provide more transparency and enhance due process of ratings.

A. Substantive changes to the LFI rating system

1. Governance and Controls Component Rating

As part of the next phase of revisions to the LFI framework, the Federal Reserve should issue a proposal to revise the Governance and Controls component to make it more transparent and focused on issues that are material to financial condition. In practice, examiners often apply their subjective judgments to the Governance and Controls component, placing undue emphasis on issues immaterial to the financial condition of the firm. It is unsurprising, then, that the Federal Reserve has indicated that governance and controls considerations are often the basis for ratings downgrades.[27] We believe an accurate rating system would be more likely to result in correlated component ratings: Firms with strong capital and liquidity planning and positions would be expected to have strong governance and controls as well, *i.e.*, because strong capital and liquidity planning and positions are *prima facie* evidence that the firm is well managed.

There are several ways the Federal Reserve could improve the Governance and Controls component to address the misalignment between ratings and financial condition.

- First, the agencies should adopt a materiality standard that would prevent isolated issues not affecting financial condition, such as purely procedural or documentation issues, from being considered deficiencies that result in ratings downgrades. Any supervisory deficiency affecting a rating decision should have a direct relationship to a material concern related to a firm's safety and soundness and/or financial condition.[28] For example, currently examiners may find a "deficiency" concerning the accuracy and/or completeness of financial institution data and information that is publicly disclosed or reported or otherwise provided to the banking agencies, even if

[27] See Federal Reserve Board, Supervision and Regulation Report, *supra* note 7, at 17.

[28] In general, in our experience, this means that where the other LFI component ratings are satisfactory the Governance and Controls component rating would normally be satisfactory as well. Moreover, where a Governance and Controls-related issue has been self-identified and remediated by a bank the issue should not normally be the basis for a ratings downgrade.

it is a minor or isolated discrepancy. While material or pervasive financial data errors can affect a bank's financial condition and rise to the level of a safety and soundness risk, minor, isolated discrepancies do not have such an effect. A materiality standard would prevent downgrades based on such isolated or immaterial issues that do not have a direct effect on safety and soundness.

- Second, the Governance and Controls component should provide objective standards for examiner review. Oftentimes, practices are labeled as deficient based on subjective or idiosyncratic examiner views on the "effectiveness" of policies and procedures or "best practices."[29] The Federal Reserve should propose new Governance and Controls standards with more objective and verifiable considerations that will allow institutions to better understand and, if necessary, challenge examination findings.
- Finally, there should be clear rules for how the individual expectations, which function as subcomponents, of the Governance and Controls component roll up into the component rating, to prevent a single deficiency in one area from affecting the component rating overall.

2. Capital and Liquidity Component Ratings

Like Governance and Controls, the Capital Management and Liquidity Management components also contain entirely subjective subcomponents that can result in a downgrade even when a bank's financial condition is strong. The Capital and Liquidity components should be revised to (1) minimize subjective assessments of governance and planning processes and (2) provide a presumption that a bank that is well capitalized and meets regulatory capital and liquidity requirements, including the stress capital buffer and other regulatory buffers, will normally receive a rating of Broadly Meets Expectations for these components.

Specifically, the capital component includes evaluation of "the effectiveness of a firm's governance and planning processes used to determine the amount of capital necessary to cover risks and exposures..." Similarly, the liquidity component includes evaluation of "the effectiveness of a firm's governance and risk management processes used to determine the amount of liquidity necessary to cover risks and exposures." The emphasis on governance and risk management processes in both components can lead to undue focus on documentation and procedural exercises, even when a bank's substantive capital and liquidity positions and planning are sound. To the greatest extent possible, LFI

[29] See Section II.B above.

ratings for capital and liquidity should be based on objective, quantitative criteria (e.g., capital ratios and liquidity buffers). For example, "best practices" regarding modeling approaches or other preferred practices that examiners have identified through horizontal reviews should not be the basis for rating decisions. "Deficient" ratings of any type in these components should be anchored in identified financial condition and/or safety and soundness risks, not purely process-based issues like documentation or subjective criteria like best practices resulting from horizontal reviews.

3. "Double Counting" the Same Supervisory Findings in Multiple Component Ratings

The practice of counting a single discrete deficiency towards more than one component within the framework could hamper the efficacy of the proposed reforms. The LFI rating framework includes a footnote stating that some supervisory deficiencies can be considered in the assessment of more than one component rating.[30] For example, a weakness in capital planning information delivered to the board of directors could possibly be considered a deficiency in both the Capital Planning and Positions component rating (which includes "[t]he extent to which a firm maintains sound capital planning practices through effective governance and oversight") and in the Governance and Controls component rating (which includes "directing senior management regarding the board's information"). Under the current well managed construct, this makes less of a difference in practice because if a deficiency results in just one component downgrade, then the firm will not be well managed. However, this double-counting could limit the efficacy of the proposed reforms because a single deficiency resulting in one D-1 rating could be carried over to another component to result in a second D-1 rating. This would result in the institution being considered not well managed, despite the proposal's intent to clarify that a discrete deficiency should **not** result in the firm losing its well managed status.

This could also lead to disparate results among firms because there are no parameters for when double-counting will or will not apply. A single deficiency with the same level of materiality could lead to downgrades to two component ratings in some cases, where in other cases potentially just one. Therefore, to ensure the proposal has its intended effect and is applied consistently across firms, the framework should be revised to eliminate double-counting and to specify the same practice (i.e., whether relating to capital planning or any other type of practice) cannot be evaluated as part of two separate

[30] 90 Fed. Reg. 31,653, note 59 ("There may be instances where deficiencies or supervisory issues may be relevant to the Federal Reserve's assessment of more than one component area. As such, the LFI rating will reflect these deficiencies or issues within multiple rating components when necessary to provide a comprehensive supervisory assessment.")

components. In other words, any particular supervisory finding should only be considered in the assessment of one of the three component ratings.

4. Proposals to engage in expansionary activities

Under the proposal, two or more D-1 ratings "could" be a barrier to approval of a proposal to engage in new or expansionary activities unless the LFI "can demonstrate that (i) it is making meaningful, sustained progress in resolving identified deficiencies and issues; (ii) the proposed new or expansionary activities would not present a risk of exacerbating current deficiencies or issues or lead to new concerns; and (iii) the proposed activities would not distract the firm from remediating current deficiencies or issues."[31] As a practical matter, we understand banks are almost never able to successfully demonstrate the foregoing and, in fact, are advised that an effort to make such a demonstration is unlikely to prevail absent special circumstances. We urge that this language be revised to add "material" before "risk" in clause (ii) and "materially" before "distract" in clause (iii). More importantly, the Federal Reserve should make clear that this is a general guideline and not an insurmountable barrier.

5. Indexing application threshold for LFI framework

We recommend that the Federal Reserve adjust and index the $100 billion asset threshold (as well as the $50 billion asset threshold for U.S. intermediate holding companies of foreign banking organizations) currently in place for the LFI rating system in connection with a broader review to index other regulatory thresholds. We strongly support indexing regulatory thresholds to account for economic growth and inflation,[32] and believe that such efforts to align regulatory thresholds with the current market realities will support the Federal Reserve's tailoring efforts to match supervision with material financial risks. We agree with Vice Chair for Supervision Michelle Bowman's comments that indexing could be a "simple fix" to "ensure a sound, tailored approach that remains durable over time."[33] Indexing is necessary to align the regulatory framework with economic reality and to ensure rules are appropriately calibrated as the economy grows. Therefore, we

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[31] *Id*.

[32] Francisco Covas and Alexander Kim, Adjusting Regulatory Thresholds for Economic Growth (Sept. 9, 2024), https://bpi.com/adjusting-regulatory-thresholds-for-economic-growth/; BPI, Right-Sizing Bank Regulations Enables Lending and Greater Economic Growth (May 20, 2025), https://bpi.com/right-sizing-bank-regulations-enables-lending-and-greater-economic-growth/.

[33] Vice Chair for Supervision Michelle W. Bowman, Taking a Fresh Look at Supervision and Regulation (June 6, 2025), https://www.federalreserve.gov/newsevents/speech/bowman20250606a.htm.

recommend that, as the Federal Reserve considers indexing of regulatory thresholds generally, it index the $100B threshold for application of the LFI framework.

B. CAMELS reforms

The proposed changes to the LFI framework address the issue of determining a bank's well managed status by reference to a single, subjective component. The CAMELS system urgently requires a similar fix. As the proposal states, due to interaction between the LFI and CAMELS frameworks, "changes solely to the LFI Framework would initially have a limited impact."[34] Therefore, it is essential for the Federal Reserve to undertake a joint rulemaking with the OCC and FDIC to initiate similar reforms to the CAMELS framework.

Most critically, the Management—or "M"—component of CAMELS should be eliminated or replaced with a more objective component focused on material risks, as described further below. Compared to the other CAMELS components, Management is most subjective and most likely to consider issues that do not directly relate to safety and soundness (and is like the Governance and Controls component of the LFI rating framework in this regard). Whereas a bank could cite objective data in challenging a poor rating for the other components—capital, asset quality, earnings, liquidity and sensitivity to market risk—there is often no path for an objective appeal of a Management rating. Yet, the consequences of the Management rating can be severe because, under the law, a 3 rating for Management automatically results in the bank being considered not well managed, with the attendant restrictions on new activities, applications and investments by the holding company discussed above in Section II.A.2 of this letter.

Given the subjectivity inherent in the Management component as currently applied, the simplest fix would be to eliminate it. Congress specifically recognized this possibility in the Bank Holding Company Act, which confirms that a standalone management rating is not required.[35] Moreover, eliminating a standalone Management component would not mean that management is ignored. Each of the other components includes consideration of management as part of its assessment, as reflected below:

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[34] 90 Fed. Reg. 31,648. The proposed changes to the LFI framework would result in immediate upgrades to "well managed" for LFI purposes for eight banks, but CAMELS ratings (or equivalent ratings for FBOs) at the subsidiary level would counteract these changes for five banks. As a result, only three banks would have a change in their "well managed" status taking CAMELS and equivalent ratings for FBOs into account.

[35] 12 U.S.C. § 1841(o)(9) (providing "well managed" means a company or depository institution that has (i) a CAMEL 1 or 2 composite rating "or an equivalent rating under an equivalent rating system" and (ii) at least a satisfactory rating for management, *if such rating is given*.")

- **C**apital: “The ability of **management** to address emerging needs for additional capital” and “Prospects and plans for growth, as well as past experience in **managing** growth.”

- **A**sset Quality: “The adequacy of loan and investment policies, procedures, and practices” and “The ability of **management** to properly administer its assets”

- **E**arnings: “The adequacy of the budgeting systems, forecasting processes, and **management** information systems in general.”

- **L**iquidity: “The capability of **management** to properly identify, measure, monitor, and control the institution’s liquidity position, including the effectiveness of funds management strategies, liquidity policies, **management** information systems, and contingency funding plans.”

- **S**ensitivity to Market Risk: “The ability of **management** to identify, measure, monitor, and control exposure to market risk given the institution’s size, complexity, and risk profile.”

Recognizing that operational risk (including risks related to cybersecurity and other material compliance issues) can affect bank safety and soundness if the risk is sufficiently pronounced, the current Management component can be replaced with a component focused on material operational risks. A material operational risk component could assess the extent to which the bank’s material operational risks may adversely affect its earnings or capital, giving consideration to management’s ability to identify, measure, monitor, and control material operational risk, the bank’s size and the nature and complexity of its activities, and the adequacy of its capital and earnings in relation to the level of operational risk exposure. A material operational risk component defined in this way should not be treated as a standalone management rating. As demonstrated above, each of the CAMELS components assess an aspect of management, and the framework should not give any single component outsized weight.

At least two additional changes are necessary to the CAMELS framework to improve objectivity and fairness. First, there should be a presumption of a “1” rating for Capital and Liquidity if a bank meets all applicable regulatory requirements, inclusive of the stress capital buffer and other regulatory buffers. This is parallel to our recommendation regarding the Capital and Liquidity components of the LFI framework as described above in Section III.A.2. Second, there should be significantly more transparency in how the CAMELS composite rating is determined. For example, we are concerned that, currently, a 3 rating for Management almost invariably leads to a composite rating of 3, irrespective of the other ratings, and despite the Management component being the most subjective of the CAMELS rating components. As with the LFI system, there should be an objective method for determining a bank's CAMELS composite rating. BPI has long highlighted the opacity of the ratings system and recommended that examination reports contain a complete explanation of how the bank's component ratings affect the composite rating.[36]

Comparable changes should also be made to the Federal Reserve's RFI/C(D) rating system for smaller banks and the ROCA and CUSO rating systems for FBOs. As with the LFI framework, the RFI "risk management" subcomponent is almost entirely subjective and can lead to an overall 3 or "fair" rating. Like the LFI framework, this can lead to a banking organization being considered not well managed and losing authority to engage in financial activities and, in effect, to engage in inorganic expansion. For the same reasons, we endorse the recommendations of the Institute of International Bankers in their comment letter responding to this proposal. Specifically, we agree with the complementary reforms to the ROCA and CUSO rating systems for FBOs described in the IIB letter.

C. Process and communications reforms to enhance due process and accuracy of ratings.

Additional procedural reforms would improve the supervisory ratings system by enhancing transparency, accuracy and due process. They would also promote better communication between banks and examiners and strengthen the banking system as a whole. These procedural improvements would support supervision by ensuring relevant perspectives, including the bank's, are included as ratings are determined and reviewed as needed. Because of the urgency of the reforms in this proposal, we are not providing a complete description and analysis of these recommendations in this letter; however, we strongly urge the Federal Reserve, with the OCC and the FDIC, to address these topics in additional issuances. We welcome the opportunity to discuss these recommendations further.

- **Opportunity to review draft findings**: The banking agencies should expressly include in the examination/supervisory framework that institutions will have the opportunity to review, discuss, and rebut ratings downgrades before they are finalized and will be provided an opportunity to challenge factual assumptions/misunderstandings. Oftentimes there is little explanation of the rationale for a bank's rating and how they should resolve any issues. The supervisory process would benefit from more thorough,

[36] *See, supra,* note 5. See also the February 2020 Letter (explaining that the Earnings component of CAMELS should include quantitative considerations that are comparable across firms, and that the Liquidity component should include standardized quantitative measures).

transparent explanations of findings so banks can determine whether to appeal and/or understand how to resolve issues.

- **Centralized review process for examination downgrades**. The banking agencies should implement transparent processes for mandatory, centralized review of any downgrade from one examination to the next, to ensure that reports of examination contain adequate support for examination findings.
- **Appeals process for examination ratings.** The exceedingly small number of supervisory appeals that are filed suggests the process is not regarded as meaningful or likely to result in substantive change, and/or that fears of negative consequences outweigh any benefits of pursuing an appeal. A more independent, impartial and transparent supervisory appeals process, in conjunction with the other reforms discussed in this letter, would help to address the flaws of the current framework.
- **Related supervisory actions.** There should be greater responsiveness and alignment between ratings assignments and related supervisory actions. For example, 4(m) agreements should automatically terminate upon a firm being upgraded to well managed. There is no legal justification for a 4(m) agreement remaining in place once a firm has been upgraded to well managed.
- **Timeliness of updated ratings.** The banking agencies should allow for interim upgrades (or downgrades) to ratings based on firm performance, rather than waiting for the next scheduled review cycle. This would ensure ratings reflect current conditions.
- **Deference to functional regulators**. The Federal Reserve should defer to functional regulators of BHC subsidiaries, particularly when the activities are not specific to the holding company and do not implicate holding company safety and soundness. For example, issues like AML or credit risk should be evaluated principally by the regulator with authority over the entity where the relevant activities take place. For a BHC with the great majority of its assets in the bank, that would be the bank's primary supervisor (including the Federal Reserve for state member banks). This approach would streamline and optimize the allocation of agency resources. It would also align the Federal Reserve's examination activities with the authority granted by law

and would ensure the perspective of the primary regulator is appropriately considered.[37]

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We appreciate the Federal Reserve's attention to the supervisory ratings framework and your consideration of our comments on this proposal. If you have any questions or would like to discuss our comments further, please contact us or Tabitha Edgens (Tabitha.Edgens@bpi.com) and Alison Touhey (atouhey@aba.com).

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American Bankers Association

[37] See BPI, Rationalizing Federal Reserve Examination Practices: A Return to Law (July 8, 2025), https://bpi.com/rationalizing-federal-reserve-examination-practices-a-return-to-the-law/.