



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

May 17, 2024

Mr. Gregory Baer
President & Chief Executive Officer
Bank Policy Institute
600 13th Street NW
Suite 400
Washington, D.C. 20005

Dear Mr. Baer:

This is in response to the petition (“Petition”), dated January 10, 2020, submitted on behalf of the Bank Policy Institute (“Petitioner”), requesting that the Board of Governors of the Federal Reserve System (“Board”) and the Federal Deposit Insurance Corporation (“FDIC”) engage in a rulemaking to revise the Uniform Financial Institution Rating System (“UFIRS”).

The Petition was submitted in response to the Board and FDIC’s Request for Information on the Application of the Uniform Financial Institutions Rating System (“UFIRS RFI”), published in the *Federal Register* on October 31, 2019.¹ The Petitioner requests that the Board and FDIC adopt, by rule, changes to the UFIRS ratings framework. The Petitioner also requests that the Board reconsider the consequences that a depository institution’s UFIRS rating has for its parent’s eligibility to be a financial holding company (“FHC”) under section 4 of the Bank Holding Company Act (“BHC Act”) and the Board’s Regulation Y.² In addition, the Petitioner calls for the Board and FDIC to conduct further study of, and engage publicly on, the effectiveness of the UFIRS framework.

The Board has reviewed and considered the Petition. For the reasons described below, the Board declines to grant the Petition.

I. Background on the UFIRS

The UFIRS was developed by the Federal Financial Institutions Examination Council (“FFIEC”) in 1979, pursuant to authority granted under the Federal Financial

¹ 84 Fed. Reg. 58383 (Oct. 31, 2019).

² 12 U.S.C. § 1843; 12 CFR Part 225.

Institutions Examination Council Act of 1978 (“FFIEC Act”) to establish a uniform methodology for supervisors to evaluate the soundness of federally regulated depository institutions. The FFIEC’s purpose is “to promote uniformity in . . . supervision” and “consistency in [Federal] examination” by the Board, FDIC, Office of the Comptroller of the Currency, and National Credit Union Administration (together “FFIEC Agencies”).³ Accordingly, the FFIEC is granted the authority to “establish uniform principles and standards and report forms for the examination of financial institutions which shall be applied by” the FFIEC Agencies.⁴ The FFIEC developed the UFIRS, and has amended the UFIRS, under such authority. As acknowledged in the Petition, the FFIEC is the appropriate body, designated by Congress, for modifying the UFIRS, given its statutory mandate to establish uniform principles and standards for the examination of financial institutions.

Since its establishment, the FFIEC Agencies have applied the UFIRS in connection with the supervision of regulated firms. Following revisions to the framework made after notice-and-comment in 1996, the UFIRS has been commonly referred to as the “CAMELS” rating system—an acronym of the six evaluation components: Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. In addition, the UFIRS includes an overall composite rating.

II. Response to the Petition

The Petition was submitted in response to the UFIRS RFI, which was a joint effort by the Board and FDIC to seek comments and information on the UFIRS, as part of a “commitment to increase transparency, improve efficiency, support innovation, and provide opportunities for public feedback.”⁵ As stated in the UFIRS RFI, it was “not a proposal to modify the CAMELS rating definitions,” as “[s]uch definitions were issued through the FFIEC.”⁶ Nevertheless, the Petitioner requests that the Agencies consider three categories of actions: (A) changes to the UFIRS framework; (B) modifications to the “well managed” definition for purposes of FHC eligibility; and (C) further study of the effectiveness of the UFIRS framework. These three categories of requests are addressed below.

A. Changes Related to the UFIRS Framework

The Petitioner proposes that the Agencies engage in a rulemaking to make the following changes to the UFIRS framework:

- (i) adopt an “explicit purpose” for the CAMELS composite rating, which the Petitioner proposes would be to “gaug[e] the financial condition of the bank, and in particular the likelihood that it will fail at a cost to its creditors or

³ 12 U.S.C. § 3301. The FFIEC is comprised of the Comptroller of the Currency, the Chairman of the Board of Directors of the FDIC, a Governor of the Board designated by the Chair of the Board, the Director of the Consumer Financial Protection Bureau, the Chairman of the National Credit Union Administration Board, and the Chairman of the State Liaison Committee. 12 U.S.C. § 3303.

⁴ 12 U.S.C. § 3305(a) (emphasis added).

⁵ 84 Fed. Reg. at 58385.

⁶ Id.

- insurer, or require significant financial support from its holding company to avoid doing so”;
- (ii) make changes to the considerations for the Capital Adequacy, Asset Quality, Earnings, and Liquidity components to, among other things, reflect certain developments in the financial institutions regulatory framework that the Petitioner identifies;
 - (iii) eliminate the Management component, or significantly modify the Management component rating to presumptively reflect the average of other component ratings; and
 - (iv) change the methodology for determining a firm’s CAMELS composite rating such that the rating is derived by calculating a simple average of the component ratings, rounded to the nearest whole number.

The Petitioner’s suggestions to modify portions of the UFIRS framework would result in a version of the ratings system that would diverge sharply from the UFIRS framework used by the other FFIEC Agencies. Such a divergence would result in disparate treatment for depository institutions regulated by the Board, on one hand, and similarly situated depository institutions regulated by other FFIEC Agencies, on the other hand. This would be inconsistent with the emphasis placed by Congress on the FFIEC Agencies adhering to uniform supervisory and examination standards.⁷ Further, the Petition does not provide new material information or data to demonstrate that promulgating rules that diverge from the UFIRS framework, as issued by the FFIEC, would be beneficial or otherwise an appropriate use of agency resources.

Additionally, certain of the proposed changes could reduce the effectiveness of the UFIRS framework by making the ratings more backward-looking. Research has found that supervisory ratings using the current UFIRS framework can have significant predictive power for a bank’s future performance.⁸ Accordingly, the current UFIRS framework helps bank supervisors to maintain a safe and sound banking system by proactively identifying institutions of concern. Making the UFIRS framework more backward-looking, as proposed by the Petitioner, could impede the utility of bank supervision.

Although the FFIEC Agencies may further evaluate some of the proposed changes to the UFIRS in the future, the Board has determined that, for all the foregoing reasons and in light of other priorities, implementing the proposed changes would not be an effective use of the Board’s limited resources at this time.

B. “Well Managed” and FHC Status

The Petitioner also requests that the Board reconsider what constitutes a “well managed” depository institution for purposes of determining eligibility to make an FHC election. The meaning of “well managed” for purposes of FHC election is defined by statute in section 2(o)(9) of the BHC Act.⁹ Although the Petitioner acknowledges that the statutory definition specifically and separately refers to a firm’s composite rating and a “satisfactory rating for management,” the Petitioner asserts that the statutory text implies

⁷ See 12 U.S.C. § 3305(a).

⁸ See, e.g., Lewis Gaul & Jonathan Jones, CAMELS Ratings and Their Information Content, 3 (Jan. 6, 2020), [pub-econ-working-paper-camels-ratings.pdf \(treas.gov\)](https://www.treas.gov/econofinancialaffairs/publications/working-papers/2020/camels-ratings.pdf).

⁹ 12 U.S.C. § 1841(o)(9).

that the Board need not assign a management rating, or, at least, has the authority to design a rating standard different from the UFIRS to assess whether a depository institution is satisfactorily managed for purposes of FHC eligibility.¹⁰ The Petitioner urges the Board to take such steps, offering several possible approaches, including averaging the other component ratings to determine the management rating. If the Board would not elect to design a different approach to determining what constitutes a “satisfactory rating for management,” the Petitioner alternatively urges the Board to either (i) determine that a “3” Management component rating would qualify as a “satisfactory rating” for purposes of FHC eligibility, rather than requiring a “1” or “2”; or (ii) revise expectations for what constitutes a “3” rating to “require demonstrably unsatisfactory management practices that pose actual risk to the bank’s financial condition.”

The Board has determined that designing such a parallel rating system purely to assess FHC eligibility would not be an effective use of limited resources in light of the well-established “Management” rating component currently in use. Designing and implementing a different management evaluation rating system for depository institutions to assess FHC eligibility would require considerable agency resources. The depository institutions of most bank holding companies are primarily supervised by federal regulators other than the Board, so there are considerable benefits to using the Management rating from the depository institution’s primary federal regulator’s assessment under UFIRS, rather than designing a separate system to assess FHC eligibility. Additionally, there is evidence that the UFIRS Management component ratings continue to have significant predictive value for institutions’ future performance and risk.¹¹

Moreover, the Board does not think it is appropriate to change the ratings rubric to consider “3”-rated depository institutions to be well managed for the purpose of their parent bank holding company’s FHC election. Under the UFIRS, a Management component rating of “3” indicates that the institution’s management and board “need improvement,” or that its “risk management practices” are “less than satisfactory given the nature of the institution’s activities.”¹² Institutions with a “3” rating for Management may have inadequate processes for identifying, measuring, and managing significant risks or problems.¹³

C. Further Study of the UFIRS Framework

Finally, the Petitioner calls for further study of, and greater public engagement regarding, the UFIRS and its effectiveness. The Board regularly engages in efforts to consider the effectiveness of its supervisory approach, including the UFIRS framework, consistent with its statutory mandates. The Board also regularly discloses aggregated

¹⁰ Certain of the Petitioner’s proposed options would appear to require the Board to disregard Management component ratings that are given by other federal banking regulators to depository institutions under their supervision, even though the statute requires consideration of ratings for management, “if such rating is given.” 12 U.S.C. § 1841(o)(9).

¹¹ See *supra* n. 8.

¹² 61 Fed. Reg. at 67028.

¹³ *Id.*

information about supervisory ratings in its semiannual Supervision and Regulation Report.¹⁴ To the extent this portion of the Petition was a request for rulemaking, action, or release of information by the Board, such request is denied.

* * *

In light of the foregoing, the Board has determined not to grant the Petition for rulemaking. The Board appreciates the Petitioner's comments and may consider the recommendations raised by the Petitioner in connection with future engagement with the FFIEC and future rulemakings relating to bank supervisory rating systems.

Very truly yours,

(Signed) Ann E. Misback

Ann Misback
Secretary of the Board

¹⁴ As the Petitioner is aware, supervisory ratings are confidential supervisory information. For more information regarding the Board's approach to confidential supervisory information, please see Rules Regarding Availability of Information, 85 Fed. Reg. 57616, 57618-19 (Sept. 15, 2020).