American Bankers Association
Building Success. Together.

Alison Touhey
Vice President &
Senior Regulatory Advisor
202-663-5182
atouhey@aba.com

February 27, 2020

Submitted electronically

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

Robert E. Feldman
Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

RE: Request for Information on Application of the Uniform Financial Institutions Rating System (RIN 3064–ZA08)

Dear Sir and Madam:

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the Request for Information (RFI) put forth by the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) on the consistency of ratings assigned under the Uniform Financial Institutions Rating System (UFIRS), commonly known as CAMELS. In addition to seeking comment on the consistency of ratings, the Federal Reserve and FDIC are also seeking feedback on the current use of CAMELS ratings by the agencies in their bank application and enforcement action processes.

Overall, ABA and its members are supportive of the Federal Reserve's and the FDIC's initiative to evaluate the CAMELS framework, which has been in place since 1979 with minimal modification. The Federal Financial Institutions Examination Council (FFIEC) first adopted the UFIRS system, which assigns a rating based on six components of a bank's financial condition and management, as a way to enhance supervisory consistency. The components assess the quality of Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to market risk. A bank is assessed for each category, then given a composite rating of 1-5, with a "1" rating being the highest. Each component rating is based on a "qualitative analysis of the factors comprising the component and its interrelationship with the other components."[2]

Today, CAMELS ratings are a critical supervisory metric and the basis for determining things such as a bank's deposit insurance premiums, fitness for mergers and acquisitions, certain activities, and

[1] The American Bankers Association is the voice of the nation's $18 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard over $14 trillion in deposits, and extend more than $10 trillion in loans.
[2] FDIC Statement of Policy: Uniform Financial Institutions Rating System

supervisory acceptance of a bank's products and business strategy. It is imperative, then, that the factors on which banks are assessed be objective, transparent, and reflective of modern regulations, risk management, and business practices. To this end, ABA encourages the Federal Reserve and FDIC, together with the OCC, to review the CAMELS system to ensure that it accommodates modern banking, regulations, and a diverse range of business models. We also encourage the agencies to establish a more formal regulatory approach through a formal rulemaking. To this end, ABA hereby joins in the formal petition for rulemaking under section 553(e) of the Administrative Procedure Act made by the Bank Policy Institute in its comment letter dated January 10, 2020 for the federal banking agencies (via coordination through the FFIEC) to engage in a rulemaking to revise the CAMELS framework. Additionally, ABA supports the recommendations of other commenters to study and analyze for public evaluation the effectiveness of CAMELS as a gauge of safety and soundness.

In order to inform our response, ABA undertook numerous discussions with banks of all sizes and business models. While many members noted the positive approach to communications between bank management and their examiner-in-charge and field examiners pre-exam and during the course of the exam, the primary and overarching concern our members have with the current CAMELS ratings system is its opaqueness, particularly with respect to the management component. Additionally, banks noted that the ratings are extremely subjective, which causes inconsistency between exams, as well as among agencies for institutions that have multiple regulators (e.g. the FDIC and state regulators). Many banks also noted that examiners tend to be quick to downgrade and slow to upgrade a bank's ratings. Other institutions cited inconsistent views among field examiners, regional offices, and headquarters. While we understand and support the need for flexibility and examiner judgment, the current rating system and its application can be arbitrary and *ad hoc*, with little recourse for banks. Given that the CAMELS rating system is a cornerstone of bank supervision and regulation, its parameters and considerations should be as clear, well-defined, and impartial as possible. The following are key points and recommendations that surfaced from our conversations:

- **The CAMELS ratings should be updated to reflect quantitative standards and other regulatory requirements implemented since the CAMELS ratings system was first conceived.** Since the FFIEC introduced the CAMELS system over 40 years ago, there has been a dramatic transformation of the regulatory framework that governs banking, the markets in which banks operate, and the structure of the banking industry itself. For example, capital and liquidity standards were added to the regulatory framework, while new accounting changes, most notably fair value accounting and CECL, have changed (or will change) the way banks manage capital and assess asset quality and earnings. These quantitative standards are complex and granular, aiming to evaluate a bank's risk, yet it is not clear how or if these quantitative standards are incorporated into a bank's CAMELS rating. Going forward, we encourage the agencies to accept compliance with these standards as evidence of operating within the highest ratings tier.

- **The expectations behind the CAMELS ratings should be communicated in advance.** ABA understands that supervisory focus is by nature dynamic and needs to adapt to a particular bank's position and overall economic and business conditions. Therefore, the ratings framework needs to allow room and flexibility for examiner judgment. However, changes in expectations should be reasoned, clear, and communicated well in advance. For example, it is currently unclear how, or if, the underlying expectations change as banks cross a certain asset threshold, engage in new business, or prioritize different lines of business.

Moreover, recently there was renewed supervisory emphasis on liquidity risk, with one agency holding banks to arbitrary funding concentration limits and incorrectly imposing interest restrictions on well-capitalized institutions.[3] Communication is a vital component of the examination and supervisory process. The agencies should take steps to ensure that banks are neither penalized by *ad hoc* supervisory concepts nor surprised by changes in supervisory expectations.

- **The management component should be more transparent and based on an assessment of governance and risk management.** Regarding specific components, the 'M" component was the basis of widespread and significant concern, as it is viewed by banks of all sizes as an arbitrary, highly subjective, catch-all category. As a general matter, to ensure objectivity, we recommend that the agencies establish clear metrics for achieving the highest "M" rating. Moreover, many of our members noted that examiners tend to factor compliance with securities, consumer, and other laws into the "M" component. Instead, we suggest that the focus of this component be on assessing the effectiveness with which the bank leadership and its Board have identified and managed the bank's risk profile (business model, marketplace, internal resources, financial condition, etc.). This approach would provide significant flexibility with respect to different business models and risk appetites. Additionally, given the significant legal and technological changes that have taken place since 1979, we urge the agencies to consider the need to break out certain components of this rating, for example IT and cyber risk assessment.

We appreciate the FDIC and Federal Reserve issuing the RFI as an important step toward ensuring that the CAMELS rating system is aligned with modern risks and banking practices. Given the broadness of the application of the CAMELS rating system, and the diversity of bank business models, we encourage the agencies to first issue an Advanced Notice of Proposed Rulemaking to receive feedback on any initial framework. Moreover, as the agencies note in the RFI, given the confidential nature of the CAMELS ratings and exam process, it is difficult to offer specific details regarding the accuracy of a rating or the consistency and soundness of an examiner's judgment. As the Federal Reserve and FDIC continue with this initiative, we encourage the use of a voluntary anonymous survey(s) to ensure that the information the agencies are receiving is robust and granular enough to identify problems and inform solutions.

ABA and its members stand ready to continue this important dialog with the FDIC and Federal Reserve. If you have any questions about these comments, please contact the undersigned at (202) 663-5182 or email: atouhey@aba.com.

Sincerely,

Alison Touhey

[3] https://www.aba.com/advocacy/policy-analysis/aba-fdic-chair-mcwilliams-application-of-national-rate-cap-healthy-institutions.