To: Federal Financial Institutions Examination Council (FFIEC)

Thru: FFIEC Task Force on Supervision

From: Interagency CAMEL Working Group

Date: June 28, 1996

Subject: Revised Uniform Financial Institutions Rating System

Recommendation
The Interagency CAMEL Working Group, under the auspices of the FFIEC Task Force on Supervision, recommends that the Council:

• Adopt the recommended revisions to the November 13, 1979 FFIEC Uniform Financial Institutions Rating System (UFIRS); and

• Publish the proposed revisions in the Federal Register and request comment on the recommended revisions to UFIRS.

Discussion of Revised UFIRS Policy Statement
The Task Force on Supervision, through its Interagency CAMEL Working Group, reviewed the existing rating system in light of the current supervisory and financial industry environment. The Task Force has concluded that the current UFIRS framework provides an effective vehicle for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special supervisory concern or attention. As a result, the Task Force recommends retaining the basic rating framework, but proposes certain changes. The proposed text of the revised UFIRS is included in the attached draft Federal Register notice. Following is a summary of the proposed changes:

1. Structure and Format
   The component rating descriptions have been reformatted into three distinct sections:
   a) an introductory paragraph discussing in general terms the areas to be considered when rating each component;
   b) a bullet-style listing of the specific evaluation factors to be considered when assigning the component rating; and,
   c) a brief qualitative description of the five rating grades that can be assigned to a particular component.

2. Component for Sensitivity to Market Risks
   A sixth rating component addressing sensitivity to market risks has been adopted. This component would include an evaluation of interest rate risk, to which every institution
is subject, price risk, and foreign exchange risk. The current UFIRS considers these market risks within a number of components. The revised UFIRS would continue to consider market risks within other components, as appropriate. However, overall conclusions on an institution's sensitivity to interest rate, price, and foreign exchange risks would be summarized under this new component.

3. Risk Management
The revised rating system reflects and reinforces the importance of sound risk management processes. The Federal supervisory agencies currently consider the quality of risk management processes in applying the UFIRS, particularly in the management component. The revised rating system emphasizes the consideration of processes to identify, measure, monitor, and control risks in each of the components, and particularly in the management component.

4. Composite Rating Definitions
The composite rating definitions parallel proposed changes for component descriptions and ratings. The revised composite rating definitions contain an explicit reference to the quality of overall risk management practices. The basic context of the existing composite rating definitions is being retained. The composite ratings would continue to be based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance.

5. Identification of Risk Types
The types of risk associated with each of the rating components is explicitly identified in each component and rating description. For example, the proposed rating description for asset quality notes that a primary consideration in assigning the component rating is an assessment of credit risk associated with loans, investments, other real estate owned, and certain off-balance sheet transactions. However, all other risks affecting the quality of assets, including, but not limited to, operational, market, reputation, strategic, and compliance risks, also would be considered.

Discussion on Federal Register Notice & Request for Comment
As indicated above, the Task Force is recommending that the FFIEC issue, via the Federal Register, a notice and request for comments on the proposed revisions to the rating system. Each agency would simultaneously distribute a copy of the Federal Register notice and request for comments under cover of their particular issuance forms. This would ensure that all the institutions receive a notice and are afforded the opportunity to comment, if they so desire.

Preliminary findings expressed in a draft LAG opinion indicated that the proposed revised UFIRS is not a legislative rule nor a statement of general policy or an interpretation of general applicability subject to APA rulemaking publication requirements. However, Counsels of each agency, and the CAMEL Working Group, believe that some form of public notice would be beneficial. The conservative approach is to use a notice and request for comments in the
Federal Register. Based upon responses received from interested parties, appropriate changes would be made to the proposed revised rating system and then presented to the Council for final approval and distribution.

Field Testing of Revised Rating System
Each agency intends to field test the revised rating system during the third quarter of 1996. Testing will be done in an appropriate cross-section of financial institutions. Results of the test will be reviewed and evaluated in conjunction with the review and evaluation of comments received via the Federal Register notice and request for comment.
Uniform Financial Institutions Rating System

AGENCY: Federal Financial Institutions Examination Council.

ACTION: Notice and request for comment.

SUMMARY: The Federal Financial Institutions Examination Council (FFIEC) is requesting comment on proposed changes to the Uniform Financial Institutions Rating System (UFIRS), commonly referred to as the CAMEL rating system. The term “financial institutions” refers to those insured depository institutions whose primary Federal supervisory agency is represented on the FFIEC. The agencies comprising the FFIEC are the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

The proposed revisions update the rating system to reflect changes that have occurred in the financial services industry and in supervisory policies and procedures since the rating system was first adopted in 1979. The proposed changes include: the reformatting and clarification of the existing component rating descriptions; the addition of a sixth rating component addressing sensitivity to market risks; an increase in emphasis on the quality of risk management processes in each of the rating components, particularly in the management component; the addition of language in composite rating definitions to parallel the proposed changes in component rating descriptions; and, the explicit identification of the risk types that
are to be considered in assigning component ratings. After reviewing public comments, the FFIEC intends to make appropriate additional changes to the revised UFIRS and adopt a final rating system.

The FFIEC notes that some agency regulations currently use an institution's UFIRS or CAMEL rating in determining an institution's status under those regulations. The agencies may consider amending those regulations to incorporate any changes made to the UFIRS system.

DATES: Comments must be received by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Comments should be sent to Joe M. Cleaver, Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue NW, Suite 200, Washington, DC 20037, or by facsimile transmission to (202) 634-6556.

FOR FURTHER INFORMATION CONTACT:

