

CAMELS RATING SYSTEM

**New England Directors College
2011**

TODAY'S OBJECTIVES

- Present an overview of the CAMELS rating system
- Review what examiners consider when assigning ratings
- Apply concepts with two case studies



OVERVIEW

The CAMELS rating system is used to:

- **Assess the soundness of financial institutions on a uniform basis**
- **Identify those institutions requiring special supervisory attention**
- **Monitor aggregate trends in overall soundness of financial institutions**



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OVERVIEW (CONTINUED)

- **Originally adopted by the FFIEC in 1979**
- **Revised in 1997 to address the changes in the industry and in supervisory procedures**
 - **Increase the emphasis on quality of risk management practices**
 - **Addition of the Sensitivity to Market Risk component**
 - **Decrease peer comparison emphasis**



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STRUCTURE AND FRAMEWORK

- Six Component Ratings of **CAMELS**:
Capital – Asset Quality – Management – Earnings – Liquidity – and Sensitivity to Market Risk
- Component and Composite Ratings
 - 1 – Strong
 - 2 - Satisfactory
 - 3 – Less than Satisfactory
 - 4 – Unacceptable
 - 5 – Critically Deficient



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COMPONENT RATINGS

- Ratings process has always contained elements of subjectivity and examiner judgment
- Reasonably applied based on the examiner's experience, knowledge, and familiarity with the institution
- Each component rating based on a qualitative and quantitative analysis of specified factors and interrelationship with other components



Any Town State Bank

An Asset Quality Case Study



ASSET QUALITY

- Reflects quantity of existing and potential credit risk associated with assets and off-balance sheet items
- Evaluation Factors
 - Adequacy of underwriting standards
 - Credit administration practices
 - Level, severity, trend of problem assets
 - Appropriateness of the level of the ALLL



ASSET QUALITY EVALUATION FACTORS

- Off-balance sheet credit risk
- Diversification and quality of the loan and investment portfolios
- Asset concentrations
- Adequacy of policies
- Ability of management to administer problem assets



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ASSET QUALITY

KEY FINANCIAL RATIOS

- Adversely Classified Items/Tier 1 Capital and ALLL
- Non-current Loans/Leases to Gross Loans and Leases
- Net Losses to Average Total Loans and Leases
- Asset Growth Rate
- ALLL to Total Loans
- Loan Portfolio Mix



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ASSET QUALITY COMPONENT

RATING DEFINITIONS

- 1 – *Strong* asset quality and credit administration practices. *Weaknesses are minor* in nature and *risk exposure is modest* in relation to capital.
- 2 – *Satisfactory* asset quality and credit administration practices. The level and severity of classifications and other weaknesses warrant a *limited level of supervisory attention*.
- 3- Asset quality or credit administration practices are *less than satisfactory*. Trends may be stable or indicate deterioration in asset quality or an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an *elevated level of supervisory concern*. There is generally a need to improve credit administration and risk management practices.



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ASSET QUALITY COMPONENT

RATINGS DEFINITIONS (CONTINUED)

- 4 – *Deficient* asset quality or credit administration practices. The levels of risk and problem assets are *significant*, inadequately controlled, and subject the financial institution to potential losses that, if left unchecked, *may threaten its viability*.
- 5 – *Critically deficient* asset quality or credit administration practices that present an *imminent threat to the institution's viability*.



Beantown Community Bank

An Earnings Case Study



EARNINGS

- Rating reflects quantity and trend of earnings as well as sustainability or quality of earnings.
- Rating should consider levels and trends



EARNINGS EVALUATION FACTORS

- Level, trend, and stability
- Quality and sources of earnings
- Strength of net interest margin
- Level of expenses in relation to operations
- Adequacy of valuation reserves
- Budgeting process
- Earnings exposure to market risk (IRR)



EARNINGS KEY FINANCIAL RATIOS

- **Return on Average Assets (Net Inc/Avg Assets)**
- **Net Interest Margin (Net Interest Income/Avg Earning Assets)**
- **Interest Income/Avg Assets**
- **Interest Expense/Avg Assets**
- **Noninterest Income/Avg Assets**
- **Noninterest Expense/Avg Assets**
- **Provision Expense/Avg Assets**
- **Securities Gains/Avg Assets**
- **ALLL/Total Loans**



EARNINGS COMPONENT

RATING DEFINITIONS

- **1 – Earnings are *strong* and are *more than sufficient* to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings.**
- **2 – Earnings are *satisfactory* and *support* operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, 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 level of earnings is adequate in view of the assessment factors listed above.**



EARNINGS COMPONENT

RATING DEFINITIONS (CONTINUED)

- 3 – Earnings *need to be improved* and *may not fully support* operations and provide for the accretion of capital and allowance levels in relation to the overall condition, growth, and other factors affecting the quality, quantity, and trend of earnings.
- 4 – Earnings are *deficient and insufficient to support* operations and maintain operations and maintain appropriate capital and allowance levels. 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 years.
- 5 – Earnings are *critically deficient and losses represent a distinct threat* to the institution's viability through the erosion of capital.

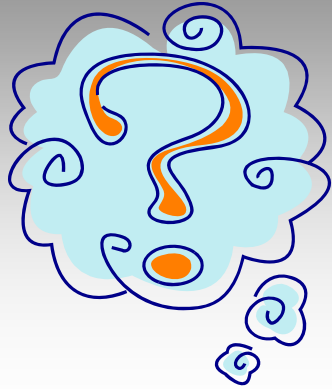


CAMELS SUMMARY

- Backbone of the examination process
- Exam ratings are disclosed to management and the Board of Directors to promote dialogue
- Exam ratings are confidential
- Exam ratings are used to determine what, if any, corrective action should be pursued



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Was this helpful?

We'd be glad to answer your questions!

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