KPMG

Regulatory Alert

Regulatory Insights for Financial Services

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FRB Rating Systems: Final Changes to the LFI Framework

KPMG Regulatory Insights:

— ***Changes to Management Ratings:*** *Further changes to management ratings are possible as the FRB continues its review of supervisory frameworks, including potentially CAMELS.*

— ***Modification of "Well Managed" Status:*** *Final rule directly ties "well managed" to financial risk; changes are expected to increase opportunities for new or expansionary activities for institutions meeting the new definition of "well managed."*

— ***"Targeted Proposal":*** *Expect more targeted proposals as the FRB follows an incremental approach to regulatory reform.*

The Federal Reserve Board (FRB) has finalized revisions to its Large Financial Institution (LFI) rating system (referred to as the LFI Framework) as well as to its rating system for depository institution holding companies significantly engaged in insurance activities (i.e., the Insurance Supervisory Framework). The final revisions are "substantially similar" to those proposed in July 2025 (see KPMG Regulatory Alert, here).

In the final rule, the FRB:

— Modifies the definition of "well managed"

— Adopts changes to the presumption of enforcement action

— Applies the above changes to both the LFI and Insurance Supervisory Frameworks

— Removes a reference to reputational risk within the Insurance Supervisory Framework

Although the FRB had previously suggested it may consider additional changes to the rating system, such as potentially adding a composite rating for the LFI Framework, none of these suggestions were adopted in the final rule.

The rule will become effective 60 days after publication in the Federal Register.

Comparison Table: Proposed vs. Final Frameworks

Aspect	Proposed Framework	Final Framework
Definition of “Well Managed”	A firm would be considered “well managed” if it receives no more than one Deficient-1 rating and the other two components are Broadly Meets or Conditionally Meets Expectations.	Adopted as proposed. A firm is "well managed" with no more than one "Deficient-1" rating and at least two "Conditionally Meets Expectations" or "Broadly Meets Expectations" component ratings.
Deficient-1 Rating Impact	A single Deficient-1 rating would not disqualify a firm from being “well managed.”	Adopted as proposed. A single Deficient-1 rating does not disqualify a firm from being “well managed.”
Deficient-2 Rating Impact	No change — a Deficient-2 rating would continue to disqualify a firm from being considered “well managed.”	No change — a Deficient-2 rating in any component would continue to disqualify a firm from being considered “well managed.”
Enforcement Action Presumption	The presumption would be removed; however, enforcement actions may still occur but would be based on facts and circumstances.	Adopted as proposed. Replaced the presumption with a statement that a formal or informal enforcement action may be considered depending on facts and circumstances.
Application to Insurance Framework of “Well Managed” and Automatic Presumption Changes	The changes to the “well managed” definition and enforcement presumption would apply to both the LFI and Insurance Supervisory Frameworks.	Adopted as proposed. The changes apply to both the LFI and the Insurance Supervisory Frameworks.
Reputational Risk	Not addressed in the proposed rule.	Removed a reference to reputational risk within the Insurance Supervisory Framework. This change aligns with the FRB June 2025 policy announcement that reputational risk would no longer be part of its exam programs.
Impact on Firms	FRB estimates that under the proposal, 15 of 36 firms would be classified as not “well managed” (based on LFI ratings alone), in contrast to an estimated 23 of 36 under the current rule. (Note: FRB estimates that as of Q3 2025, 17 of 36 firms would be not “well managed”)	FRB estimates that 10 out of 36 firms would be classified as not “well managed” (based on LFI ratings alone).

For more information, please contact Laura Byerly or Peter Torrente.

Background

LFI Framework: The FRB's LFI Framework applies to bank holding companies and noninsurance, non-commercial savings and loan holding companies with total consolidated assets of $100 billion or more, and U.S. intermediate holding companies of foreign banking organizations with total consolidated assets of $50 billion or more.

The LFI Framework is intended to evaluate whether a firm possesses sufficient financial and operational strength and resilience to maintain safe-and-sound operations and comply with laws and regulations, including those related to consumer protection, through a range of conditions. It is comprised of three components: (1) Capital Planning and Positions; (2) Liquidity Risk Management and Positions; and (3) Governance and Controls.

Each component is rated based on a four-point non-numeric scale: Broadly Meets Expectations, Conditionally Meets Expectations, Deficient-1, and Deficient-2. Any firm that receives a rating of Deficient-1 or Deficient-2 in any component rating is considered not "well managed." A firm that is not "well managed" faces limitations on certain acquisitions and new activities. In addition, the LFI Framework establishes a presumption that the FRB will impose an informal or formal enforcement action on any firm that is not "well managed."

Insurance Supervisory Framework: Depository institution holding companies significantly engaged in insurance activities are subject to the FRB's Insurance Supervisory Framework, which is modelled after the LFI Framework, including the same three components (Capital, Liquidity, Governance and Controls) and the same four-point non-numeric rating scale.

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