Regulatory Alert

Regulatory Insights for Financial Services

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FRB Rating Systems: Proposal to Modify the LFI Framework

KPMG Regulatory Insights:

- ***Changes to Management Ratings:*** *More changes expected to the management components of supervisory ratings across different frameworks (e.g., CAMELS, RFI/C(D).*
- ***Modification of "Well-Managed" Status:*** *Intends to directly tie "well-managed" to financial risk.*
- ***"Targeted Proposal":*** *Expect additional targeted proposals focused on a particular area or group as part of regulatory reforms and tailoring.*

The Federal Reserve Board (FRB) proposes revisions to its Large Financial Institution (LFI) rating system (referred to as the LFI Framework) as well as its rating system for supervised insurance organizations (the Insurance Supervisory Framework). The FRB:

- Proposes to modify the definition of "well managed"
- Suggests potential additional changes to the ratings systems

1. Modification to the Definition of "Well Managed"

For both the LFI Framework and the Insurance Supervisory Framework, the FRB proposes to:

- Consider a firm with no more than one Deficient-1 component rating and at least two Broadly Meets Expectations or Conditionally Meets Expectations component ratings to be "well managed."
- Remove the presumption that the FRB will bring an informal or formal enforcement action against firms with one or more Deficient-1 ratings but allow that such firms may be subject to a formal or informal enforcement action depending on the particular facts and circumstances.
- Retain the current standard for evaluating the individual components.

Comparison Table: Current vs. Proposed Frameworks

Aspect	Current Framework	Proposed Framework
Definition of "Well Managed"	A firm must receive a rating of Broadly Meets Expectations or Conditionally Meets Expectations in all three components (Capital, Liquidity, Governance & Controls) to be considered "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.
Deficient-1 Rating Impact	Any single Deficient-1 rating disqualifies a firm from being "well managed."	A single Deficient-1 rating would not disqualify a firm from being "well managed."
Deficient-2 Rating Impact	A Deficient-2 rating disqualifies a firm from being considered "well managed."	No change — a Deficient-2 rating would continue to disqualify a firm from being considered "well managed."
Enforcement Action Presumption	Firms with one or more Deficient-1 ratings are presumed to be subject to informal or formal enforcement actions.	The presumption would be removed; however, enforcement actions may still occur but would be based on facts and circumstances.
Impact on Firms	As of Q4 2024, 23 of 36 firms were classified as not "well managed" under the LFI Framework alone.	FRB estimates that under the proposal, 15 of 36 firms would be classified as not "well managed" (based on LFI ratings alone).

2. Potential Additional Changes to the Ratings Systems

The FRB indicates that it will continue to evaluate whether additional changes to the ratings systems may be warranted, including potentially adding a composite rating for the LFI Framework and revisiting the weighting of the management and risk management components respectively under the CAMELS and RFI frameworks in determining a holding company's or bank's composite rating.

Background

LFI Framework: The FRB's LFI Framework applies to bank holding companies and non-insurance, 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.

For more information, please contact Amy Matsuo or Peter Torrente.

Contact the author:

Amy Matsuo
Principal and National Leader
Regulatory Insights
amatsuo@kpmg.com