

Regulatory Alert

Regulatory Insights for Financial Services

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Supervision: Proposed Revisions to the CAMELS Rating System

KPMG Regulatory Insights

- **Material Risk:** Consistent with the shift in supervisory focus to material financial risk, proposed revisions to the Uniform Financial Institutions Rating System would focus CAMELS component and composite ratings on factors that materially affect a financial institution's financial condition and risk profile.
- **Minimization of Management Component:** Narrows the evaluation factors attributable to the Management component to focus on "the most material aspects of risk management" and to reduce the influence of the Management component on the composite rating – a priority of FFIEC Chair Bowman.
- **Clarity and Standardization:** Broad risk management and evaluation factor language would be replaced in some cases with more specific clarifying language, and definitions and terminology would be standardized across CAMELS ratings.
- **Larger Effort:** Follows on from recent efforts to refocus examinations on material financial risk, including the FRB's revisions to the ratings system for large financial institutions, and the federal banking agencies' efforts to remove reputation risk from its frameworks.
- **Potential Benefits:** The FFIEC suggests the proposed changes will provide greater clarity and transparency in supervisory expectations which may allow for streamlined management resource allocation.

The Federal Financial Institutions Examination Council (FFIEC) has [issued](#) a proposal to revise the Uniform Financial Institutions Rating System (UFIRS), commonly referred to as the CAMELS rating system based on the individual components (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk).

The proposed revisions would retain the basic framework of the existing CAMELS rating system while modifying component and composite rating definitions and evaluation factors to focus on factors that "materially affect an institution's financial condition and risk profile" and "improve transparency by more clearly articulating expectations for financial institutions." Notably, proposed changes would narrow the

evaluation factors attributable to the Management component to focus on "the most material aspects of risk management" and to reduce the influence of the Management component on the composite rating.

The proposed revisions will apply to financial institutions supervised, as appropriate, by members of the FFIEC, which consist of the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Consumer Financial Protection Bureau (CFPB), National Credit Union Administration (NCUA), and the State Liaison Committee. Comments must be received by August 17, 2026.

Proposed Changes

Key proposed changes include:

Areas of Change	Detail of Proposed Changes
Management component: “special consideration”	Remove the sentence directing examiners to give “special consideration” to the Management component when assigning composite ratings to limit the potential for “diminishing the relative importance of the non-Management components in the determination of composite ratings.”
Management component: evaluation factors	Revise evaluation factors for the Management component to limit factors to the “most material aspects” of management, removing Management component factors related to: <ul style="list-style-type: none"> — Management depth and succession. — Responsiveness to recommendations from auditors and supervisory authorities. — Demonstrated willingness to serve legitimate banking needs of the community. Also, remove a Management factor related to overall performance and risk profile to “limit redundancy.”
Management component: rating definitions	Establish a material financial risk threshold for assigning Management ratings of 3 or worse based on risk management weaknesses. Institutions would generally receive a Management rating of 3 or worse only when risk management practices create material financial risk to the institution as well as in situations where the institution has: <ul style="list-style-type: none"> — Unreliable financial or regulatory reporting. — Failures to safeguard assets. — Significant noncompliance with laws or regulations.
Specialty review findings	Clarify that specialty review findings (e.g., Consumer Compliance, BSA/AML/CFT, Information Systems) would influence CAMELS component and composite ratings to the extent that the findings: <ul style="list-style-type: none"> — Impact overall financial condition. — Represent material financial risks. — Reflect significant noncompliance with laws and regulations.
Composite rating definitions	Revise composite rating definitions to focus on an institution's financial condition and risk profile, with emphasis on material financial risks. Revisions to composite rating definitions would include: <ul style="list-style-type: none"> — Composite rating 1: institution has “strong” financial performance and minor or moderate risk management weaknesses. — Composite rating 2: institution has “satisfactory” financial performance and minor or moderate risk management weaknesses. — Composite rating 3: institution has “less than satisfactory” financial performance or inadequate risk management practices that result in material financial risk, or the institution exhibits significant noncompliance with laws and regulations. — Composite rating 4: institution exhibits “deficient” financial performance; risk management weaknesses that do not result in observable deterioration of financial condition or material financial risk would not alone support this rating. — Composite rating 5: institution exhibits “critically deficient” financial performance. The changes are intended to help ensure that ratings of 3 or worse are more fully supported by evidence of weaknesses that materially impact the safety and soundness of the institution.
Risk management: clarifying language	Remove broad risk management language in component descriptions, including Capital Adequacy, Asset Quality, Earnings, Liquidity, and Sensitivity to Market Risk (CAELS) in favor of considering the “effectiveness” of risk management practices. Replace some component language with more specific risk management factors, including in areas such as Liquidity, Capital Adequacy and Management.

<p>Evaluation factors: clarifying scope</p>	<p>Remove the “but not limited to” language from all of the CAMELS component descriptions and replace it with a general paragraph, applicable to all components, that would allow for additional evaluation factors to be considered only if warranted by exceptional circumstances or evolving business practices. Further:</p> <ul style="list-style-type: none"> — The factors must be critical to assessing an institution's financial condition or risk profile, with emphasis on material financial risks. — Examiners must document and explain the rationale for including additional evaluation factors. <p>Replace some component language around evaluation factors to clarify the scope of supervisory evaluations. Examples include:</p> <ul style="list-style-type: none"> — Capital Adequacy: Clarifying that risks related to contingent liabilities would be considered. — Earnings: Clarifying that a financial institution's funding costs and earnings exposure to commodity prices would be considered. — Sensitivity to Market Risk: Amending to explicitly include: <ul style="list-style-type: none"> - Evaluation of recent net interest income performance in response to the interest rate environment. - Expectations for net interest income based on the balance sheet position. - Exposure to interest rate volatility.
<p>Ratings definitions: terminology and structure</p>	<p>Use more consistent terminology across components and a streamlined structure for component ratings 1 through 5 and their definitions, including:</p> <ul style="list-style-type: none"> — Consistent terms for financial condition: “strong,” “satisfactory,” “less than satisfactory,” “deficient,” and “critically deficient.” — Consistent terms for risk management practices: “effective,” “adequate,” “inadequate,” and “deficient.” — Removing specific descriptions of risk management practices from components other than the Management component.
<p>Modernizing and conforming framework language</p>	<p>Modernize and conform terminology to reflect current industry standards and practices, including:</p> <ul style="list-style-type: none"> — Replacing references to “allowances for loan and lease losses” (ALLL) with “allowances for credit losses” (ACL) to conform with the Current Expected Credit Losses (CECL) accounting standard adopted in 2023 under U.S. Generally Accepted Accounting Principles (GAAP). — Removing all references to reputation risk, consistent with the policies of the FRB, OCC, FDIC, and NCUA, which recently issued proposals or final rules to remove the consideration of reputation risk from their supervisory frameworks.

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Background

The FFIEC was created by the federal Financial Institutions Regulatory and Interest Rate Control Act of 1978 to “prescribe uniform principles and standards for the federal examination of financial institutions” and “make recommendations to promote uniformity” in the supervision of financial institutions. The FFIEC develops the principles and standards through its members and does not directly regulate financial institutions.

Under the CAMELS rating system, each financial institution is assigned component ratings and a composite rating, which reflect examiners’ evaluation of the institution’s financial condition and operations. The component ratings include (1) Capital Adequacy, (2) Asset Quality, (3) Management, (4) Earnings, (5) Liquidity and (6) Sensitivity to Market Risk. Composite ratings are assigned based on an overall evaluation and the six component ratings.

For each of the components, as well as the composite rating, each financial institution is assigned a rating on a scale of 1 to 5, with 1 being the highest rating. An institution generally must have a CAMELS composite rating of 1 or 2 and a Management rating of at least 2 (satisfactory) to be considered “well managed.” Financial institutions that are not considered “well-managed” may be subject to certain regulatory restrictions, including limitations on expansionary activities.

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