MFA STRATEGIC BRIEFING

Landmark Revisions to the FFIEC CAMELS Framework

McQueen Financial Advisors

On May 19, 2026, the Federal Financial Institutions Examination Council (FFIEC) issued a notice of proposed rulemaking to execute the first major overhaul of the Uniform Financial Institutions Rating System (the CAMELS framework) since 1996. This joint initiative—which applies uniformly across the OCC, FRB, FDIC, NCUA, and state-chartered regulators—represents a structural pivot in bank supervision.

In alignment with the regulatory philosophy of the second Trump Administration, the Proposed Rule explicitly downplays examiner focus on boilerplate policies, procedures, and documentation. Instead, it seeks to strengthen the direct link between CAMELS ratings and an institution's true safety and soundness by focusing components squarely on material financial risks. This shift is designed to provide clearer supervisory expectations, reduce compliance costs, and eliminate unnecessary administrative friction.

THE NEW COMPOSITE RATINGS ARCHITECTURE

The proposed framework completely recalibrates the 1-to-5 composite rating definitions to tie them directly to financial performance and risk profile, placing a strict premium on "material financial risks":

- **Composite 1 & 2:** Indicates strong or satisfactory financial performance, respectively, carrying only minor or moderate risk management weaknesses.
- **Composite 3:** Indicates less than satisfactory financial performance, inadequate risk management practices that create material financial risk, or "significant" noncompliance with laws and regulations.
- **Composite 4:** Indicates "deficient" financial performance. Crucially, under the new rule, a composite 4 cannot be assigned due to risk management weaknesses alone unless those weaknesses result in an "observable deterioration" of financial condition or introduce material financial risk.
- **Composite 5:** Indicates "critically deficient" financial performance.

To ensure consistency, the FFIEC is adopting rigid, uniform terminology across components: "strong," "satisfactory," "less than satisfactory," "deficient," and "critically deficient" to evaluate financial condition; and "effective," "adequate," "inadequate," and "deficient" for risk management practices.

THE MANAGEMENT (“M”) COMPONENT REVOLUTION

Historically, the Management component has been criticized by the banking and credit union industries for being over-weighted. The Agencies acknowledged that their own 25-year review proved the "M" component was the single most influential factor in determining an institution’s composite rating, especially in recent years.

To rectify this outsized influence, the Proposed Rule introduces sweeping changes to the Management component:

- **Elimination of "Special Consideration":** Examiners will no longer be directed to give special consideration to the management rating when deriving the composite score.
- **Removal of Soft/Process Evaluation Factors:** The rule eliminates several non-financial evaluation factors, including "management depth and succession," "responsiveness to recommendations from auditors and supervisory authorities," and "demonstrated willingness to serve the legitimate banking needs of the community".
- **Elimination of Redundancies:** Factors evaluating overall institutional performance and risk profile are removed from the "M" component, as they are already captured by the composite and other components.
- **High Thresholds for Downgrades:** To receive a management rating of 3 or worse based on risk management weaknesses, the weakness must cross a "material financial risk threshold," such as unreliable financial/regulatory reporting, a failure to safeguard assets, or significant noncompliance.

Advisor Insight: The Agencies explicitly note that by reducing the focus on process-related issues, management teams can reallocate internal resources away from check-the-box oversight and back toward managing material risks—a change the regulators anticipate could actually increase lending capacity at certain institutions.

REINING IN SPECIALTY REVIEWS & EXAMINER DISCRETION

A common pain point for community institutions has been "supervisory creep," where specialized compliance or operational audits drag down the entire safety and soundness rating. The Proposed Rule systematically reins this in:

Insulation From Specialty Reviews
Findings from specialty reviews—including consumer compliance, Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT), Community Reinvestment Act (CRA), information systems/IT, trust, and securities dealing—will only influence the composite or individual component ratings if they directly impact the institution's overall financial condition, represent material financial risks, or reflect significant noncompliance. This prevents specialty findings from disproportionately cratering the Management rating.

Narrowing Examiner Discretion
The FFIEC is replacing broad, ambiguous language across all non-management components with highly specific evaluation factors. This is a deliberate effort to eliminate the previous general language that allowed examiners to loosely judge management's broad ability to "identify, measure, monitor, and control" risks.

Furthermore, the rule strips away open-ended language allowing examiners to look beyond the listed factors. Examiners may only introduce outside factors under "exceptional circumstances" or "evolving business practices," and even then, the factors must be "critical" to the institution's financial condition or material financial risks.

STRATEGIC TAKEAWAYS & INSTITUTIONAL ACTION ITEMS

1 Prepare for an Era of "Material Risk" Advocacy

This framework is a clear net win for financial institutions, promising greater uniformity, a clearer rationale behind ratings, and less variation based on your specific supervising agency or region. This change works in tandem with recent regulatory proposals to tighten the definitions of "unsafe or unsound practices" and raise the standards required for issuing Matters Requiring Attention (MRAs). Management should align its internal risk reporting to mirror this focus on quantifiable, material financial impacts rather than just volume of documentation.

2 Leverage State-Federal Alignment

Notably, because a state representative on the FFIEC participated in this rulemaking, state regulators are largely aligned with this shift. This state participation is highly beneficial, as it will significantly reduce the historical friction and disagreements that occur between federal and state regulators regarding whether a specific practice truly warrants an MRA or an "unsafe or unsound" label.

3 Anticipate an Implementation Lag

While this framework is highly favorable, execution on the ground will take time. Examination teams will require extensive retraining, new internal guidance must be disseminated, and agency staff reductions may further slow down the transition. Do not assume your next exam team will immediately self-restrain their historical habits.

4 Be Ready to Challenge Non-Compliant Ratings

The Agencies have tacitly encouraged institutions to pressure-test the underlying support behind supervisory findings. Once this rule is finalized, if an exam team attempts to downgrade a component rating based on minor policy gaps, documentation omissions, or process issues that do not pose a material financial risk, management should aggressively utilize all tools at its disposal. This includes engaging in active discussions with regional leadership and utilizing the formal regulatory appeals process to enforce the boundaries of this new rule.

KEY CAVEATS ACKNOWLEDGED BY REGULATORS

While McQueen views this as a highly positive modernization, management should note that the Agencies themselves recognized a calculated trade-off in this rule. The Agencies explicitly acknowledged that, although "unlikely," completely stripping away these qualitative process measures could potentially diminish the predictive information content of ratings or miscalibrate outcomes, leaving some institutions at risk of future deterioration before balance-sheet metrics fully capture the decline. Furthermore, Comptroller Jonathan Gould issued a concurrent statement highlighting ongoing concerns regarding the exact methodology used to arrive at composite ratings. Expect these specific friction points to be heavily debated during the public comment period.

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