C.A.M.E.L.S. RATINGS

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Background

- First developed in 1979
- Adopted by the NCUA in 1987
- Examines the five critical elements of a credit union’s operations

**Capital Adequacy**

**Asset Quality**

**Management**

**Earnings**

**Liquidity**
The “S” component, Sensitivity to Market Risk, was developed in 1995.

DFI adopted the component soon after, but has only been issuing ratings for banks.

DFI’s Credit Union Branch will begin assigning an “S” component rating at exams starting July 1, 2021.
Component Ratings

Ratings are based on the quantity of risk and the quality of controls in place to mitigate those risks

- **1 Rating:**
  - “Strong”, “Sound”

- **2 Rating:**
  - “Satisfactory”, “Adequate”

- **3 Rating:**
  - “Less than satisfactory”, “Needs improvement”, “May not be adequate”

- **4 & 5 Ratings:**
  - “Deficient”, “Critically deficient”
Capital Adequacy

Based on the overall risks to the credit union, is capital sufficient for adverse conditions?

What we review:

- Capital level, quality of capital
- Compliance with net worth requirements
- Overall financial condition
- Growth plans and past experience managing growth
- Economic environment
Capital Adequacy Ratings

1 rating:
- Sound capital levels and trends, fully supports the current and prospective risk profile of the CU

2 rating:
- Satisfactory levels, meets the current and prospective risk profile

3 rating:
- Less than satisfactory, does not fully support the risk profile

4 & 5 ratings:
- Deficient to critically deficient
Asset Quality

What is the level of existing and potential credit risk?

What we review:

- Loan and investment portfolios
- Growth plans and concentration trends
- Quality of loan underwriting and policies
- Allowance for Loan and Lease Losses
- Delinquency, Charge-Offs, Troubled Debt Restructurings
Asset Quality Ratings

1 rating:
- Sound AQ and credit administration practices, minor weaknesses

2 rating:
- Satisfactory AQ and credit administration, weaknesses or trends warrant limited level of supervisory concern,

3 rating:
- Less than satisfactory, weaknesses or trends may indicate a deterioration in AQ

4 & 5 ratings:
- Deficient to critically deficient
Management

Are the Board of Directors and management sufficiently identifying, monitoring, and controlling risks to the CU?

- What we review:
  - Corporate Governance
    - Bylaws, strategic and business plans, budget variance reports, board minutes, bonus structures, adequacy of policies and procedures, policy review schedule, succession planning, response to audit/exam recommendations

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Management (cont.)

- Supervisory Committee
  - Annual Audit, Member Account Verification, audit plans, meeting minutes
- Bank Secrecy Act / Anti-Money Laundering
  - Risk assessment, BSA audit reports, CTRs and SARs, wire transfers, monetary instrument logs, etc.
- Information Security Program
  - E-banking, risk assessment, annual report to the Board, independent testing reports, Disaster Recovery Plans, IT committee minutes, etc.

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Management (cont.)

- Internal Controls
  - File maintenance reports, cash and shares, bank reconciliations and recordkeeping, internal audit program, segregation of duties, dual controls

- Other
  - Call Report
  - Bond Coverage
  - CUSOs
Management Ratings

1 rating:
- Sound performance and risk management practices by management and the board, all significant risks are consistently identified, monitored, and controlled

2 rating:
- Satisfactory management and board practices, risks are generally mitigated, weaknesses are minor

3 rating:
- Needs improvement, risk management is inadequate, elevated supervisory concern

4 & 5 ratings:
- Deficient to critically deficient
Earnings

Are earnings sufficient to support the risk profile and strategic plans of the CU?

- What we review:
  - Quality and sources of income and expenses
    - Note: Provision expenses, unrealized gains/losses, nonrecurring events
  - Adequacy of budgeting, forecasting, and business planning
  - Overall financial condition and economic environment
Earnings Ratings

1 rating:
- Earnings are sound, more than sufficient to support current and future operations, consistent and favorable trends

2 rating:
- Earnings are adequate, sufficient to support current operations, consistency and trends elevate supervisory concern

3 rating:
- Earnings need improvement, may not be sufficient to support operations, consistently weak or negative earnings

4 & 5 ratings:
- Deficient to critically deficient
Liquidity

Is the CU’s liquidity position sufficient for current and prospective funding needs?

What we review:

- Balance sheet structure
- Liquidity management policies and procedures
- Contingency Funding Plans
- Contingent liabilities, borrowings, lines of credit
- Business plans, budgets, and projections
Liquidity Ratings

1 rating:
- Liquidity position and funds management practices are sound, sufficient sources of funds on favorable terms to meet current and future needs

2 rating:
- Liquidity position is adequate, funds management practices have minor weaknesses, sufficient sources of funds with acceptable terms

3 rating:
- Needs improvement, may lack ready access to funds on reasonable terms

4 & 5 ratings:
- Deficient to critically deficient
What is the level of market risk exposure taken by the CU?

What we review:

- ALCO minutes
- IRR limits and monitoring reports
- ALM Model
- Independent reviews: program audits, model / assumption validations, backtesting, etc.
- Economic environment
Sensitivity to Market Risk Ratings

1 rating:
- Market rate sensitivity is well-controlled, strong risk management practices, minimal potential impact on capital and earnings

2 rating:
- Sensitivity is adequately controlled, satisfactory risk management, moderate potential impact on capital and earnings

3 rating:
- Needs improvement, significant potential impact on capital and earnings

4 & 5 ratings:
- Deficient to critically deficient
Composite Ratings

Not a calculation of the component ratings

► 1 rating:
  ▶ Overall sound financial performance and risk management, minor weaknesses, no cause for supervisory concern

► 2 rating:
  ▶ Overall satisfactory risk management, stable financial trends, only moderate weaknesses, no material supervisory concern

► 3 rating:
  ▶ Moderate to severe weaknesses that management may not be able or willing to address, elevated supervisory concern but failure unlikely

► 4 & 5 ratings:
  ▶ Failure is plausible or imminent
Summary

DFI’s Mandate:

- DFI must perform a full examination of every state-chartered CU at least every 14-22 months
- For CUs with over $1 billion in assets, DFI must examine at least annually
- **1 & 2 ratings:**
  - Little to no supervisory concern
  - Eligible for the 14-22 month review cycle
Summary (cont.)

- **3 ratings:**
  - Moderate supervisory concern
  - Annual exam cycle
  - DFI may perform on/offsite visit(s) between examinations to monitor identified weaknesses

- **4 & 5 ratings:**
  - Moderate to major supervisory concern
  - Annual exam cycle
  - DFI may perform visits or consistent follow-up on weaknesses until the issues are resolved