

1 **7535-01-U**

2 **NATIONAL CREDIT UNION ADMINISTRATION**

3 **12 CFR Parts 700, 701, 703, 704, 713**

4 **RIN: 3133-AF32**

5 **CAMELS Rating System**

6 **AGENCY:** National Credit Union Administration (NCUA).

7 **ACTION:** Final rule.

8 **SUMMARY:** The NCUA Board (the Board) is updating the NCUA’s supervisory rating system
9 from CAMEL to CAMELS by adding the “S” (Sensitivity to Market Risk) component to the
10 existing CAMEL rating system and redefining the “L” (Liquidity Risk) component. The benefits
11 of adding the “S” component are to enhance transparency and allow the NCUA and federally
12 insured natural person and corporate credit unions to better distinguish between liquidity risk
13 (“L”) and sensitivity to market risk (“S”). The addition of “S” also enhances consistency
14 between the supervision of credit unions and financial institutions supervised by the other
15 banking agencies. The effective date of the rule will be April 1, 2022. The Board plans to
16 implement the addition of the “S” rating component and a redefined “L” rating for examinations
17 and contacts started on or after April 1, 2022.

18 **DATES:** The rule becomes effective April 1, 2022.

19 **FOR FURTHER INFORMATION CONTACT:** Thomas Fay, Director of Capital Markets at
20 (703) 518-1179 or Robert Bruneau, Senior Capital Markets Specialist at (703) 945-2491, Office
21 of Examination and Insurance; or Marvin Shaw, Senior Staff Attorney, Office of General
22 Counsel, at (703) 518-6540.

23 **SUPPLEMENTARY INFORMATION:**

24 **I. Legal Authority and Background**

25 The Board is issuing this final rule pursuant to its authority under the Federal Credit
26 Union Act (the Act).¹ Under the Act, the NCUA is the chartering and supervisory authority for
27 federal credit unions (FCUs) and the federal supervisory authority for federally insured credit
28 unions (FICUs).² The Act grants the NCUA a broad mandate to issue regulations governing both
29 FCUs and FICUs. Section 120 of the Act is a general grant of regulatory authority and
30 authorizes the Board to prescribe regulations for the administration of the Act.³ Section 209 of
31 the Act is a plenary grant of regulatory authority to the NCUA to issue regulations necessary or
32 appropriate to carry out its role as share insurer for all FICUs.⁴ The Act also includes an express

¹ 12 U.S.C. 1751 et. seq.

² 12 U.S.C. 1752-1775.

³ 12 U.S.C. 1766(a)

⁴ 12 U.S.C. 1789

33 grant of authority for the Board to subject federally chartered central, or corporate, credit unions
34 to such rules, regulations, and orders as the Board deems appropriate.⁵

35 As part of its supervisory activities, the NCUA adopted the CAMEL rating system in
36 1987.⁶ Through CAMEL ratings, the NCUA sought to account for and reflect all significant
37 financial, operational, and management factors that examiners assess in their evaluation of a
38 credit union's performance and risk profile. Under this system, as specified in the 2007 Letter to
39 Credit Unions (LCU), the NCUA assigns each credit union a composite CAMEL rating and five
40 component ratings based on the agency's evaluation of a credit union's financial condition and
41 operations.⁷ The five components address a credit union's:

- 42 • Capital adequacy;
- 43 • Asset quality;
- 44 • Management;
- 45 • Earnings; and
- 46 • Liquidity and asset liability management.

47 Examiners assign composite and component CAMEL ratings using a scale that ranges
48 from "1" to "5." The highest rating is a "1," indicating the strongest performance and risk
49 management practices, and the least degree of supervisory concern. The lowest rating is a "5,"
50 indicating the weakest performance, inadequate risk management practices, and the highest

⁵ 12 U.S.C. 1766(a)

⁶ NCUA LCU No. 93 (September 25, 1987)

⁷ NCUA LCU 07-CU-12 (December 2007)

51 degree of supervisory concern. Examiners rate these components based upon qualitative and
52 quantitative factors using their professional judgement.

53 In 1997, members of the Federal Financial Institutions Examination Council (FFIEC),
54 with the exception of the NCUA, proposed and subsequently adopted revisions to the Uniform
55 Financial Institutions Rating System (UFIRS).⁸ The FFIEC released a Policy Statement at that
56 time to reaffirm the five CAMEL rating system components and added a sixth component,
57 Sensitivity to Market Risk (“S”), to address price and interest rate risks (IRR).⁹ The NCUA
58 opted not to use the “S” component based on the relative lack of complexity in the consolidated
59 balance sheets of credit unions at the time. Instead, the NCUA retained its existing CAMEL
60 rating system.

61 However, since 1997, credit union balance sheets have grown larger and more complex.
62 For example, the credit union industry significantly increased the percentage of holdings in
63 mortgage related assets to total assets from 19 percent in 1997 to 45 percent in June 2021.
64 Accordingly, the NCUA has made several modifications to the CAMEL rating system since
65 1997. These involved changes to financial ratios, adding and subsequently eliminating a

⁸ At the time, the FFIEC was comprised of the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve (Federal Reserve), and the Office of the Comptroller of the Currency (OCC), the NCUA, and the Office of Thrift Supervision, which merged into OCC as a result of the Dodd Frank Wall Street Reform and Consumer Protection Act. *See* Section 312 of Pub. L. 111-203.

⁹ 62 FR 752, (Jan. 6, 1997).

66 CAMEL matrix, accommodating the adoption of Prompt Corrective Action, and incorporating
67 the NCUA’s risk-focused exam approach.^{10,11}

68 As balance sheets of natural person credit unions have become larger and more complex,
69 the NCUA has consistently provided supervision and guidance regarding IRR to the credit union
70 industry. The NCUA also advised credit unions that IRR was a supervisory priority from 2012
71 through 2019.¹²

72 In 2012, the Board implemented regulations that introduced standards and expectations
73 affecting examiner procedures and the NCUA’s IRR assessment requirements. The NCUA’s
74 IRR rule became effective for credit unions in September 2012. The rule requires insured credit
75 unions that have more than \$50 million in assets to maintain a written IRR policy and an
76 effective IRR management program.¹³

77 In April 2014, the NCUA also finalized its derivatives rule and subsequently amended it
78 in May 2021. The amendments modernize the NCUA’s derivatives rule and make it more

¹⁰ In 1998, Congress enacted the Credit Union Membership Access Act (Pub. L. 105-219, 112 Stat. 913 (1998)), which amended the Act to require the NCUA to adopt, by regulation, a system of prompt corrective action consisting of minimum capital standards and corresponding remedies to improve the net worth of federally insured “natural person” credit unions.

¹¹ NCUA LCU 00-CU-08 (November 2000) – superseded by NCUA LCU 03-CU-04; NCUA LCU 07-CU-12 (December 2007); NCUA LCU 03-CU-04 (March 2003) – superseded by NCUA LCU 07-CU-12; NCUA LCU 19-CU-01 (January 2019)

¹² *See, e.g.*, NCUA LCU 19-CU-01 (January 2019)

¹³ 77 FR 5155 (Feb. 2, 2012). *See* 12 CFR 741.3, 12 CFR 741, app. A.

79 principles-based, while retaining key safety and soundness components. The changes provide
80 more flexibility for qualified FCUs to manage IRR through the use of derivatives.¹⁴

81 In January 2017, the NCUA also implemented its revised IRR supervision program
82 incorporating the regulatory requirements from § 741.3(b)(5) (IRR) and subpart B to part 703
83 (derivatives), enhancing examiner guidance, improving the consistency of IRR ratings, and
84 identifying outlier credit unions with excessive IRR levels.¹⁵

85 **II. Proposed Rule**

86 On January 14, 2021, the Board approved issuing a notice proposing to amend the
87 existing CAMEL rating system by adding an “S” component to assess sensitivity to market risk
88 and modify the “L” component to include only liquidity evaluation content and rating criteria.¹⁶
89 The Board explained that these changes would provide greater clarity and transparency regarding
90 credit unions’ sensitivity to market and liquidity risk exposures. The Board further explained
91 that the proposed changes would make the NCUA’s rating system more consistent with the other
92 banking agencies’ rating systems at the federal and state levels.¹⁷

¹⁴ 86 FR 28241 (May 26, 2021)

¹⁵ NCUA LCU 16-CU-08 (October 2016)

¹⁶ 86 FR 13494.

¹⁷ The banking regulators (Federal Reserve Board, FDIC, and OCC) each include the “S” component to evaluate sensitivity to marketplace risk. In addition, as of January 2021, 24 SSAs have adopted the “S” component.

93 In support of the proposal, the Board explained that changes in the size and complexity of
94 FICUs warranted the changes and that increased complexity typically requires greater focus on
95 interest rate and liquidity risk profiles.

96 The Board noted that separating the “S” and “L” component ratings will allow NCUA to
97 better:

- 98 • Monitor sensitivity to market and liquidity risks in the credit union system;
- 99 • Communicate specific concerns to individual credit unions; and
- 100 • Allocate resources.

101 **III. Final Rule and Public Comments on the Proposed Rule**

102 The Board solicited public comments over a 60-day comment period and received 16
103 comments. Commenters included credit union trade associations, state credit union leagues, an
104 organization of state credit union supervisors, credit unions, and individuals. Most commenters
105 supported the proposal. Several expressed concern about the proposal’s implementation,
106 particularly about the associated compliance costs and the need for consistent application across
107 the NCUA regions and examiners.

108 As noted previously, commenters generally supported the proposal, stating that it would
109 provide more precise supervision of credit unions. One trade association stated that the change
110 will add clarity and transparency. That commenter also stated that this change recognizes that
111 there is a difference between market sensitivity and liquidity risk, so separating the two
112 components makes sense even if they are interrelated. Additionally, several commenters stated
113 that the proposed change would enhance consistency with other financial institution rating

114 systems, specifically for FDIC-insured financial institutions. These commenters stated the
115 change would enhance consistency with several state credit union regulators who already include
116 the “S” in their rating systems. They also said the change will allow examiners to better
117 communicate specific concerns to credit unions.

118 A few commenters stated that the proposal added burden without any corresponding
119 benefit and thus is unwarranted and unnecessary. One commenter believed that the amendment
120 is not necessary because other components of CAMEL, including Capital, Asset Quality, and
121 Liquidity, already evaluate market risk. This commenter stated that the proposal adds significant
122 burden on both credit unions and examiners and is not necessary or valuable.

123 **A. Comments Regarding Adopting the “S” Component**

124 One commenter requested that the NCUA release details about the agency’s expectations
125 of credit unions meeting any new standards for the “S” component and what this change will
126 mean for the examination process.

127 The NCUA will issue an updated Letter to Credit Unions that explains the criteria and
128 standards for the “S” component and how this change will be incorporated into the examination
129 process. Additionally, the NCUA Examiner’s Guide will integrate the extensive discussion and
130 tables set forth in the proposal that detailed the Board’s expectations.

131 With respect to the “S” component, the proposal noted that sensitivity to market risk
132 reflects the exposure of a credit union’s current and prospective earnings level and economic
133 capital position arising from changes in market prices and interest rates. The Board noted that

134 effective risk management programs include comprehensive IRR policies, appropriate and
135 identifiable risk limits, clearly defined risk mitigation strategies, and a suitable governance
136 framework. The Board further notes that Sensitivity to Market Risk ratings will be based on the
137 proposed “S” component evaluation content and rating criteria.

138 One commenter recommended that the “S” component should be examined by looking at
139 asset liability modeling and engagement levels of the asset and liability management, loans,
140 deposits, and investment committees. This commenter also stated that it would be beneficial to
141 review the change in Net Economic Value of equity.

142 The Board agrees that these factors should be considered in evaluating the “S”
143 component and notes that examiners will continue to review them in their evaluation of IRR.
144 The NCUA’s LCU 16-CU-08, Revised Interest Rate Risk Supervision, and the related guidance
145 that the NCUA implemented in 2017, was designed with the prospect of adding the “S”
146 component and expressly details how the NCUA assesses IRR.

147 One commenter requested that the Board specifically include a definition of “market
148 risk” as it relates to various sensitivity factors. That commenter stated that the term “market
149 risk” is used quite frequently in the descriptions of the proposed factors, but the term “market
150 risk” is not clearly defined in the proposal.

151 After reviewing the NCUA’s Supervisory Guidance, Examiner’s Guide, and regulations,
152 the Board has determined that it is unnecessary to include a definition of “market risk” in the
153 Code of Federal Regulations (CFR). Additionally, no discrete part of the NCUA’s regulations

154 addresses market risk in a dedicated section. Further, the proposal’s sensitivity to market risk
155 evaluation criteria clearly states that market risk represents the exposure of a credit union’s
156 current and prospective earnings and economic capital arising from changes in market prices and
157 of interest rates. Additionally, the description of market risk is highly consistent with how other
158 prudential regulators, such as the FDIC, Federal Reserve Board, and the OCC define market risk
159 in their instructions to examiners.¹⁸ Therefore, the Board has determined the definition of market
160 risk can effectively be addressed in an Letter to Credit Unions that will explain the CAMELS
161 rating system and replace the existing letter.¹⁹

162 A commenter sought clarity to better understand the methodology underlying the direct
163 assessment of IRR. That commenter stated that the thresholds for assessment are a key aspect to
164 maintaining a sound interest rate hedging strategy and managing interest rate sensitivity. The
165 commenter asked if the NCUA will be able to provide context for differentiating a rise in interest
166 rates from an “adverse” rise in interest rates, or from a “materially adverse” IRR exposure.

167 The NCUA has previously provided this type of guidance about the methodology
168 underlying the direct assessment of IRR in its LCU 16-CU-08, Revised Interest Rate Risk
169 Supervision, which details how NCUA examiners assess IRR. Credit unions are encouraged to
170 review this guidance.

¹⁸ <https://www.fdic.gov/regulations/safety/manual/section7-1.pdf> (Section 7.1) (July 2018)

<https://occ.gov/publications-and-resources/publications/comptrollers-handbook/files/bank-supervision-process/pubch-bank-supervision-process.pdf> (June 2018)

¹⁹ NCUA LCU 07-CU-12 (December 2007)

171 The Board has determined that updating the NCUA’s supervisory rating system from
172 CAMEL to CAMELS by adding the “S” (Sensitivity to Market Risk) component to the existing
173 CAMEL rating system as proposed and listed in the following table is appropriate and consistent
174 with the NCUA’s overall mission to ensure the safety and soundness of FICUs.²⁰

175 ***“S” Component for Sensitivity to Market Risk***

176 The sensitivity to market risk reflects the exposure of a credit union’s current and
177 prospective earnings and economic capital arising from changes in market prices and interest
178 rates. Effective risk management programs include comprehensive interest rate risk policies,
179 appropriate and identifiable risk limits, clearly defined risk mitigation strategies, and a suitable
180 governance framework.²¹

181 Sensitivity to Market Risk ratings are based on, but not limited to, the following
182 evaluation factors:

- 183 • Sensitivity of a credit union's current and future earnings and economic value of
184 capital to adverse changes in market prices and interest rates;
- 185 • Management’s ability to identify, measure, monitor, and control exposure to
186 market risk considering a credit union’s size, complexity, and risk profile; and
- 187 • The nature and complexity of interest rate risk exposure.

²⁰ 12 CFR 741.3(b)(5).

²¹ https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/IRR/IRR_Overview.htm%3FTocPath%3DInterest%2520Rate%2520Risk%7C_____0

188 The Board has determined that updating the NCUA’s supervisory rating system from
 189 CAMEL to CAMELS by adding the S” component to the existing CAMEL rating system to
 190 evaluate sensitivity to market risk and adding rating criteria as outlined in the proposed rule,
 191 along with the added evaluation factor examples, is appropriate and consistent with the NCUA’s
 192 overall mission to ensure the safety and soundness of FICUs.²² The Board notes that the updated
 193 rating system is based on, and is consistent with, the UFIRS system utilized by the other
 194 prudential regulators. Nevertheless, the Board made certain minor, non-substantive
 195 modifications to the rating descriptions to clarify and better reflect supervision of credit unions.
 196 Notwithstanding this slight divergence from UFIRs, the Board has determined that the NCUA’s
 197 revised rating system is consistent with the other financial supervisors.

198 Examiners will rate a credit union’s “S” CAMELS rating component on a scale of “1” to
 199 “5”.

“S” Rating	Description
1	<ul style="list-style-type: none"> • Risk management practices and controls for market risk are strong for the size and sophistication of the credit union, and the level of market risk it has accepted. • There is minimal potential for market price or interest rate changes to create a material adverse effect on the credit union’s earnings performance or capital position.

²² 12 CFR 741.12.

“S” Rating	Description
	<ul style="list-style-type: none"> • The credit union has more than sufficient earnings and capital to support the level of market risk taken by the credit union.
2	<ul style="list-style-type: none"> • Risk management practices and controls for market risk are satisfactory for the size and sophistication of the credit union, and the level of market risk it has accepted. • There is only moderate potential for market price or interest rate changes to create a material adverse effect on the credit union’s earnings performance or capital position. • The credit union has sufficient earnings and capital to support the level of market risk taken by the credit union.
3	<ul style="list-style-type: none"> • Risk management practices and controls for market risk are not fully commensurate with the size and sophistication of the credit union, or the level of market risk it has accepted. • There is high potential for market price or interest rate changes to create a material adverse effect on the credit union’s earnings performance or capital position. • The level of market risk taken is high in relation to the credit union’s earnings or capital.

“S” Rating	Description
4	<ul style="list-style-type: none"> • Risk management practices and controls for market risk are significantly deficient given the size and sophistication of the credit union, or the level of market risk it has accepted. • There is high potential for market price or interest rate changes to threaten the viability of the credit union. • The level of market risk taken is excessive in relation to the credit union’s earnings or capital.
5	<ul style="list-style-type: none"> • The level of market risk taken or exposure to market price or interest rate changes is an imminent threat to the credit union’s viability.

200 **B. Comments Regarding Modifying the “L” Component**

201 One commenter stated that liquidity should be evaluated with respect to how a credit
 202 union maintains access to non-member funds and tracking member balances as well as cash flow
 203 projections and stress testing.

204 The NCUA agrees that a liquidity review should include these items. The Board notes
 205 that the proposal’s liquidity evaluation content is comprehensive and addresses liquidity sources
 206 as well as liquidity measurements under various scenarios. However, the Board is adding

207 examples of liquidity evaluation factors to the evaluation content to enhance the clarity of its
208 expectations and consistency with UFIRS.

209 The Board has determined that updating the NCUA’s supervisory rating system from
210 CAMEL to CAMELS by modifying the “L” (Liquidity Risk) component in the existing CAMEL
211 rating system to include only liquidity evaluation content and rating criteria as outlined in the
212 proposed rule, along with the added evaluation factor examples, is appropriate and consistent
213 with the NCUA’s overall mission to ensure the safety and soundness of FICUs.²³ The following
214 discussion and table address the liquidity evaluation content and rating criteria.

215 ***“L” Component for Liquidity Risk***

216 In evaluating the adequacy of a credit union’s liquidity profile, examiners consider the
217 current and prospective sources of liquidity compared to funding needs and the adequacy of
218 liquidity risk management relative to a credit union’s size, complexity, and risk profile. A credit
219 union’s liquidity risk management practices should ensure the credit union maintains sufficient
220 liquidity to timely meet its financial obligations and member share and loan demands. These
221 practices should reflect the credit union’s ability to manage unplanned changes in funding
222 sources, respond to changes in market conditions affecting its ability to quickly liquidate assets
223 with minimal loss, ensure liquidity is maintained at a reasonable cost, and limit reliance on

²³ 12 CFR 741.12.

224 funding sources that may not be available in times of financial stress or adverse changes in
225 market conditions.²⁴

226 A credit union's liquidity risk management practices should also be commensurate with
227 the complexity of the balance sheet and its capital adequacy. This includes evaluating the
228 reporting mechanisms in place to monitor and control risk, management's response when risk
229 exposure approaches or exceeds the credit union's risk limits, and the prescribed corrective
230 action taken when necessary.²⁵

231 Liquidity ratings are based on, but not limited to, the following evaluation factors:

- 232 • The adequacy of liquidity sources compared to present and future needs and the
233 ability of the credit union to meet liquidity needs without adversely affecting its
234 operations or condition;
- 235 • The availability of assets readily convertible to cash without undue loss;
- 236 • Access to sources of funding;
- 237 • The level of diversification of funding sources, both on- and off-balance sheet;
- 238 • The degree of reliance on short-term, volatile sources of funds to fund longer term
239 assets;
- 240 • The trend and stability of deposits; and

²⁴ https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/Liquidity/Liquidity.htm%3FTocPath%3DLiquidity%7C_____0

²⁵ <https://www.ncua.gov/files/letters-credit-unions/LCU2013-10-InteragencyPolicyStatementFunding.pdf>

- 241 • The capability of management to properly identify, measure, monitor, and control
- 242 the credit union’s liquidity position, including the effectiveness of funds
- 243 management strategies, liquidity policies, management information systems, and
- 244 contingency funding plans.

245 The Board has determined that updating the NCUA’s supervisory rating system from
 246 CAMEL to CAMELS by modifying the “L” (Liquidity Risk) component in the existing CAMEL
 247 rating system to include only liquidity evaluation content and rating criteria as outlined in the
 248 proposed rule, along with the added evaluation factor examples, is appropriate and consistent
 249 with the NCUA’s overall mission to ensure the safety and soundness of FICUs.²⁶ The Board
 250 notes that the updated rating system is based on, and is consistent with, the UFIRS system
 251 utilized by the other prudential regulators. Nevertheless, the Board made certain minor, non-
 252 substantive modifications to the rating descriptions to clarify and better reflect supervision of
 253 credit unions. Notwithstanding this slight divergence from UFIRs, the Board has determined
 254 that the NCUA’s revised rating system is consistent with the other financial supervisors.

255 Examiners will rate a credit union’s “L” CAMELS component rating on a scale of “1” to
 256 “5”.

“L” Rating	Description
1	<ul style="list-style-type: none"> • The credit union has strong liquidity levels

²⁶ 12 CFR 741.12.

“L” Rating	Description
	<ul style="list-style-type: none"> • The credit union has well-developed funds management policies and practices. • The credit union has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.
2	<ul style="list-style-type: none"> • The credit union has satisfactory liquidity levels. • The credit union has adequate funds management policies and practices. • The credit union has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs.
3	<ul style="list-style-type: none"> • The credit union has low liquidity levels. • The credit union’s funds management policies and practices are not fully commensurate with its size and complexity, or the liquidity risks it has taken. • The credit union may lack ready access to funds on reasonable terms.
4	<ul style="list-style-type: none"> • The credit union has inadequate liquidity levels. • The credit union’s funds management policies and practices are inadequate given its size and complexity, or the liquidity risks it has taken. • The credit union is likely not able to obtain sufficient funds on reasonable terms to meet liquidity needs.

“L” Rating	Description
5	<ul style="list-style-type: none"> • Liquidity levels are so deficient there is an imminent threat to the credit union’s viability. • The credit union requires extraordinary external financial assistance to meet maturing obligations or other liquidity needs.

257 **C. Comments Regarding Technical Amendments in the Code of Federal**
258 **Regulations**

259 The Board did not receive comments regarding the proposed technical amendments to the
260 CFR. The CAMEL rating system is not in a separate section or part in the NCUA’s regulations,
261 but references to CAMEL appear in several parts in the CFR. NCUA regulations regularly refer
262 to CAMEL composite “1” or “2” rated credit unions, which indicate the ability to safely support
263 additional regulatory flexibility; or CAMEL composite “4” or “5” rated credit unions, which
264 warrant increased regulatory scrutiny. The Board has determined that amending the term
265 CAMEL to CAMELS in the following sections in the CFR as proposed is necessary with the
266 decision to adopt the CAMELS rating system for both natural persons and corporate FICUs.

- 267 • § 700.2 definition of Troubled condition
- 268 • § 701.14 Change in official or senior executive officer in credit unions that are newly
269 chartered or are in troubled condition
- 270 • § 701.23 Purchase, sale, and pledge of eligible obligations
- 271 • § 703.13 Permissible investment activities

- 272 • § 703.14 Permissible investments
- 273 • § 703.108 Eligibility
- 274 • § 704.4 Prompt corrective action [for corporate credit unions]
- 275 • § 713.6 Fidelity Bond and Insurance Coverage for FICUs

276 **D. Other Comments**

277 Several commenters supported the proposal, stating it would enhance uniformity with
278 other regulators. One commenter requested that the NCUA should adopt the UFIRS, which was
279 approved by the FFIEC and used by the OCC, FDIC, the Federal Reserve Board, and many State
280 Supervisory Authorities. The same commenter further suggested that the Board should keep its
281 rating descriptions consistent with the rating descriptions for the “L” and “S” ratings used by
282 other banking agencies by adopting the UFIRS in its entirety, stating the agency would benefit
283 from not having to establish and maintain a separate authoritative framework for its examination
284 rating system. The commenter stated that using the same CAMELS terminology but with
285 different definitions from the UFIRS would create unnecessary confusion, impair a common
286 understanding of the condition of financial institutions, create a disconnect with FFIEC guidance,
287 and impose additional regulatory costs and burdens on credit unions.

288 The NCUA initially modeled its CAMEL rating system framework in 1987 after the
289 FFIEC’s UFIRS, or CAMEL framework. Subsequently, FFIEC updated the CAMEL system to
290 CAMELS in 1996. The NCUA continued to model subsequent amendments to its CAMEL
291 system after the FFIEC’s CAMELS framework. The Board’s decision to add the “S” component
292 and thus adopt the CAMELS rating system further enhances the consistency of the NCUA’s
293 rating system with the UFIRS system. The Board notes that the risk rating criteria for the “S”

294 and “L” components are consistent with UFIRS. In addition, all other composite and component
295 evaluation content and rating criteria are highly consistent with the FFIEC’s CAMELS rating
296 system. Consequently, the Board has determined that it is not necessary or beneficial to adopt
297 UFIRS in its entirety.

298 Another commenter requested that the NCUA address the consistency of the examination
299 process, stating that it has varied over the years from examiner to examiner. The commenter
300 noted that the added criteria, which the commenter referred to as bifurcating components, could
301 create more inconsistencies.

302 The NCUA has a framework in place that supports the uniform application of CAMEL.
303 It includes annual supervisory priorities and examination scope updates, routine updates to the
304 Examiner’s Guide and National Supervisory Policy Manual, a standardized examination
305 platform and training program, regional and national quality assurance and control programs, and
306 periodic training that address the inter-relationships between and among risk categories and the
307 CAMEL rating implications. As with all examination systems across financial regulators, there
308 is the need for examiner judgment to assess a particular situation; however, the Board believes
309 that the agency has established processes that will support uniformity in the application of the
310 CAMELS rating system.

311 Several commenters expressed concern that the proposal would require changes to some
312 credit union processes and procedures. One commenter was especially concerned that recent
313 accounting changes to Current Expected Credit Losses may make the changes related to
314 CAMELS more problematic, given the increased volatility in income statements. Another

315 commenter expressed concern that changing the rating system will disrupt the examination
316 process for credit unions, especially smaller credit unions. The commenter stated that even
317 though this change will not likely be a problem for larger credit unions that already maintain
318 separate policies to address these risks, it may impact smaller credit unions that do not already
319 maintain separate policies. Such credit unions may be required to create new policies and train
320 staff on procedures to monitor them to comply with the proposed rule. The commenter
321 continued that smaller credit unions may not have reached the level of sophistication that is
322 required by this change, thus creating a challenge for them.

323 The Board believes that the changes will not result in an unreasonable burden on credit
324 unions. As the commenters noted, typically larger credit unions already have processes,
325 procedures, and systems in place. With respect to smaller credit unions (for example, those with
326 assets less than \$100 million, or 65 percent of credit unions as of June 2021), the Board believes
327 that the changes will not impose a burden. Examiners of small credit unions will continue using
328 the Estimated NEV Tool (ENT) to evaluate IRR.²⁷ The ENT results inform the IRR category
329 rating which in turn, would inform the “S” component rating. With the exception of the
330 examination report separately disclosing the liquidity risk in the “L” component and sensitivity
331 to market risk in the “S” component, the Board believes that small credit unions will experience
332 minimal, if any, changes in examination procedures. Moreover, the change is an enhancement to
333 the NCUA’s supervision. Credit unions do not need to do anything more than they are already
334 doing to comply with the policy requirements of the IRR Rule (§ 741.3(b)(5)).

²⁷ NCUA LCU 16-CU-08 (October 2016)

335 One commenter stated that it is appropriate to implement the change in the first quarter of
336 2022 to allow credit unions to modify their systems. Several other commenters requested more
337 lead time. One commenter suggested that the NCUA offer a transitional year in 2022,
338 specifically performing examinations with the bifurcation but waiting to officially apply the “S”
339 to the CAMEL rating until 2023. The commenter believed this delay would afford the NCUA
340 time to complete the implementation of its new MERIT system and prepare clear internal
341 guidance for examiners to follow along with clear guidance to the credit unions. Several other
342 commenters recommended that the new rating system not be effective until at least six months
343 after publication in the *Federal Register* noting the additional time would allow credit unions to
344 adjust their reporting systems.

345 Credit unions and other stakeholders are aware that the Board has been working toward
346 the new CAMELS system. Specifically, the NCUA’s Office of Inspector General issued a report
347 recommending this change in 2015 and issued a number of updates between 2016 and 2021
348 regarding the agency’s CAMELS implementation status.²⁸ Accordingly, the Board has
349 determined that its plans to have the CAMELS system take effect on April 1, 2022, as proposed,
350 is appropriate.

351 One commenter stated that the NCUA should give credit unions the opportunity to
352 comment should the NCUA decide to modify the rating descriptions used by the banking
353 agencies.

²⁸ Review of NCUA’s Interest Rate Risk Program, Report #OIG-15-11, NCUA Office of Inspector Gen, (Nov. 13, 2015), available at https://www.ncua.gov/files/oig/NCUA_Semiannual_Report_Congress_March_2016.pdf

354 The Board does not anticipate any modifications of the rating descriptions used by the
355 other financial regulators. Nevertheless, the Board notes that any substantive change to the
356 CAMELS rating system—either through recommendations by the FFIEC or at the Board’s
357 initiative—would generally be made through public notice and comment under the
358 Administrative Procedure Act.

359 One commenter provided a comment, beyond the scope of the proposal, that suggested
360 the NCUA should establish and publish an examination policy stating that if a credit union’s
361 operations have not changed from previous years, yet the same circumstances are leading to a
362 new finding or a downgrade of a credit union’s composite rating under the new system, an
363 automatic review will be triggered. Similarly, another commenter requested that the Board
364 create a process to allow a credit union to appeal a component and composite CAMELS rating.

365 The Board notes these comments are beyond the scope of the proposal and thus it would
366 be inappropriate to make these changes in this rulemaking. The Board believes that it is more
367 appropriate to address these issues in the supervisory process on a case-by-case basis. Further,
368 credit unions currently may appeal composite CAMEL ratings of “3,” “4,” or “5,” and
369 component ratings that have a significant adverse effect on the nature or level of supervisory
370 oversight.²⁹

²⁹ 12 CFR 746.103.

371 **IV. Regulatory Procedures**

372 **A. Regulatory Flexibility Act**

373 The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any
374 significant economic impact a regulation may have on a substantial number of small entities.³⁰
375 For purposes of this analysis, the NCUA considers small credit unions to be those having under
376 \$100 million in assets.³¹ The agency has determined that this rule will not significantly affect
377 credit unions regardless of asset size because it is not adding any substantive requirement.
378 Accordingly, the associated cost is minimal. The NCUA certifies the rule will not have a
379 significant economic impact on a substantial number of small credit unions.

380 **B. Paperwork Reduction Act**

381 The Paperwork Reduction Act of 1995 applies to rulemakings in which an agency by rule
382 creates a new paperwork burden on regulated entities or modifies an existing burden.³² For
383 purposes of the Paperwork Reduction Act of 1995, a paperwork burden may take the form of
384 either a reporting or a recordkeeping requirement, both referred to as information collections.
385 This rule imposes no new paperwork-related requirements. Therefore, this rule will not create
386 new paperwork burdens or modify any existing paperwork burdens.

³⁰ 5 U.S.C. 603(a).

³¹ Interpretive Ruling and Policy Statement 03–2, 68 FR 31949 (May 29, 2003) *as amended by* Interpretive Ruling and Policy Statement 13-1, 78 FR 4032 (Jan. 18, 2013).

³² 44 U.S.C. 3507(d); 5 CFR part 1320.

387 **C. Executive Order 13132**

388 Executive Order 13132 encourages independent regulatory agencies to consider the
389 impact of their actions on state and local interests. In adherence to fundamental federalism
390 principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5),
391 voluntarily complies with the executive order. This rule will not have a substantial direct effect
392 on the states, on the connection between the National Government and the states, or on the
393 distribution of power and responsibilities among the various levels of government. The NCUA
394 has determined this rule does not constitute a policy that has federalism implications for purposes
395 of the executive order.

396 **D. Assessment of Federal Regulations and Policies on Families**

397 The NCUA has determined that this rule will not affect family well-being within the
398 meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999.³³

399 **E. Small Business Regulatory Enforcement Fairness Act**

400 The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) generally
401 provides for congressional review of agency rules.³⁴ A reporting requirement is triggered in
402 instances where the NCUA issues a final rule as defined by § 551 of the Administrative
403 Procedure Act. An agency rule, in addition to being subject to congressional oversight, may also
404 be subject to a delayed effective date if the rule is a “major rule.” The NCUA does not believe

³³ Pub. L. 105–277, 112 Stat. 2681 (1998).

³⁴ 5 U.S.C. 551.

405 this rule is a “major rule” within the meaning of the relevant sections of SBREFA. As required
406 by SBREFA, the NCUA will submit this final rule to OMB for it to determine if the final rule is
407 a “major rule” for purposes of SBREFA. The NCUA also will file appropriate reports with
408 Congress and the Government Accountability Office so this rule may be reviewed.

409 **List of Subjects**

410 **12 CFR part 700**

411 Credit unions.

412 **12 CFR part 701**

413 Credit unions. Insurance. Reporting and recordkeeping requirements.

414 **12 CFR part 703**

415 Credit unions. Investments. Reporting and recordkeeping requirements.

416 **12 CFR part 704**

417 Corporate Credit Unions, Prompt Corrective Action

418 **12 CFR part 713**

419 Bonds. Credit unions. Insurance.

420 By the National Credit Union Administration Board on October XX, 2021

421

422 Melane Conyers-Ausbrooks

423 Secretary of the Board

424 For the reasons discussed in the preamble, the Board amends 12 CFR parts 700, 701, 703,

425 704, and 713 as follows:

426

427 **PART 700 — DEFINITIONS**

428 1. The authority citation for part 700 continues to read as follows:

429 **Authority:** 12 U.S.C. 1752, 1757(6), 1766.

430 **§ 700.2 [Amended]**

431 2. In § 700.2, amend the definition of “troubled condition”, by removing the word,
432 “CAMEL”, and adding, in its place, the word, “CAMELS”, wherever it appears.

433 **PART 701 — ORGANIZATION AND OPERATION OF FEDERAL CREDIT UNIONS**

434 3. The authority citation for part 701 continues to read as follows:

435 **Authority:** 12 U.S.C. 1752(5), 1755, 1756, 1757, 1758, 1759, 1761a, 1761b, 1766,
436 1767, 1782, 1784, 1786, 1787, 1788, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717.
437 Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1981 and 3601-3610.
438 Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

439 **§ 701.14 [Amended]**

440 4. Amend § 701.14(b) by removing the word, “CAMEL”, and adding, in its place, the
441 word, “CAMELS”, wherever it appears.

442 **§ 701.23 [Amended]**

443 5. Amend § 701.23(b)(2) by removing the word, “CAMEL”, and adding, in its place, the
444 word, “CAMELS.”

445 **PART 703 — INVESTMENT AND DEPOSIT ACTIVITIES**

446 6. The authority citation for part 703 continues to read as follows:

447 **Authority:** 12 U.S.C. 1757(7), 1757(8), and 1757(15).

448 **§ 703.13 [Amended]**

449 7. Amend § 703.13(d)(3)(iii) by removing the word, “CAMEL”, and adding, in its place,
450 the word, “CAMELS.”

451 **§ 703.14 [Amended]**

452 8. Amend § 703.14 by removing the word, “CAMEL”, and adding, in its place, the word,
453 “CAMELS”, wherever it appears.

454 **PART 704 — CORPORATE CREDIT UNIONS**

455 9. The authority citation for part 704 continues to read as follows:

456 **Authority:** 12 U.S.C. 1766(a), 1781, 1789.

457 **§ 704.4 [Amended]**

458 10. Amend § 704.4(d)(3)(ii) by removing the word, “CAMEL”, and adding, in its place,
459 the word, “CAMELS.”

460 **PART 713 — FIDELITY BOND AND INSURANCE COVERAGE FOR FEDERALLY**
461 **INSURED CREDIT UNIONS**

462 11. The authority citation for part 713 continues to read as follows:

463 **Authority:** 12 U.S.C. 1761a, 1761b, 1766(a), 1766(h), 1789(a)(11).

464 **§ 713.6 [Amended]**

465 12. Amend § 713.6 by removing the word, “CAMEL”, and adding, in its place, the word,
466 “CAMELS”, wherever it appears.