“CAMELS and the impact on Financial Institutions”

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Regulatory Structure and Ratings

- Uniform Financial Institutions Rating System
  - Adopted by FFIEC in November 1979
    - Capital Adequacy
    - Asset Quality
    - Management
    - Earnings
    - Liquidity
Regulatory Structure and Ratings

- CAMEL Revised in January 1997
  - Added sixth component (S) for Sensitivity to Market Risk.
  - Revised definitions to include Quality of Risk Management and risk elements for individual component and composite ratings.
Regulatory Structure and Ratings

- CAMELS Ratings
  - Components and Composite ratings on numerical scale of 1-5.
  - Composite Rating not arithmetic average of components.
  - Ratings are Confidential!!!!
Regulatory Structure and Ratings

- Capital Adequacy
  - Level of Tier 1 Capital, Risk-based Capital, and trend considered.
  - Impact of Asset Quality
  - Impact of Earnings
  - Strength of Holding Company
Regulatory Structure and Ratings

- **Asset Quality**
  - Level and Trend of Asset Quality as noted by ACQR (Adversely Classified Items Coverage Ratio)
  - Levels of Nonperforming Loans, OREO, and other Nonperforming Assets.
  - Severity of Classified Assets (i.e., Substandard, Doubtful, Loss)
Asset Quality (continued)

- Inherent Portfolio Risk
  (i.e., composition, concentrations, etc.)

- Allowance for Loan and Lease Loss (ALLL) coverage.

- *Credit Administration/Risk Management*
Regulatory Structure and Ratings

- Management
  - Depth and Abilities of Management Team
  - Quality and Effectiveness of the Board
  - Compliance with Laws, Regulations, and Statements of Policy
Regulatory Structure and Ratings

- Management (continued)
  - Strategic Planning
  - Operations and Audits
  - Overall Financial Condition
Regulatory Structure and Ratings

- Earnings
  - Level and Trend.
  - Composition of and Sustainability of Earnings.
  - Impact of AQ, Market Risk, and Liquidity.
  - Adequacy of Budgeting and Forecasting.
Regulatory Structure and Ratings

- Liquidity
  - On Balance Sheet Liquidity
  - Off Balance Sheet Liquidity
  - Funding Mix
  - Quality of Liquidity Monitoring tools
  - Contingency Funding Plans
Regulatory Structure and Ratings

• Sensitivity to Market Risk
  ◦ Level of Market Risk Present and Anticipated.
  ◦ Quality of Interest Rate Risk Monitoring Tools
    • Earnings Simulation Models
    • Economic Value of Equity Models
  ◦ Ability of Capital and Earnings to Absorb the Market Risk Exposure.
What is happening in Indiana?

- Continued deterioration in 2010.
- Ratings downgrades for institutions of all sizes.
- Concentrations in CRE amplifying the problem.
- Some stabilization evident in 2011.
Classified Assets / Capital and ALLL

<table>
<thead>
<tr>
<th>Year</th>
<th>Coverage Ratio</th>
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<tbody>
<tr>
<td>2008</td>
<td>30.16%</td>
</tr>
<tr>
<td>2009</td>
<td>46.27%</td>
</tr>
<tr>
<td>2010</td>
<td>53.31%</td>
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</tbody>
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Indiana Banks by Size

Classifications by Size

- $>200MM
- $200MM to $500MM
- $500MM to $1B
- <$1B

Coverage Ratio

- 2008
- 2009
- 2010
Ratings

- Increase in “3” and “4” rated Asset Quality.
  - Causes
    - Economic Conditions
    - Increased Classification levels
      - “3” ratings range from 37% to 89%
      - “4” ratings range from 68% to 140%
    - Credit Administration Weaknesses
    - Inadequate Earnings and Capital Support
    - Deterioration in investment portfolios (Trup CDO and Private Issue MBS)
Asset Quality Ratings

- 2008:
  - Banks w/AQ 1: 12
  - Banks w/AQ 2: 37
  - Banks w/AQ 3: 15
  - Banks w/AQ 4: 2
  - Banks w/AQ 5: 0

- 2009:
  - Banks w/AQ 1: 10
  - Banks w/AQ 2: 28
  - Banks w/AQ 3: 26
  - Banks w/AQ 4: 9
  - Banks w/AQ 5: 0

- 2010:
  - Banks w/AQ 1: 8
  - Banks w/AQ 2: 27
  - Banks w/AQ 3: 23
  - Banks w/AQ 4: 15
  - Banks w/AQ 5: 1

Legend:
- Banks w/AQ 1
- Banks w/AQ 2
- Banks w/AQ 3
- Banks w/AQ 4
- Banks w/AQ 5
CAMELS Composite Rating

1
2
3
4
5

Typical Enforcement Action

None
Board Resolution (Possible)
Memorandum of Understanding (MOU)
Infrequently Board Resolution
Section 39 (FDIC)
Consent Order (FDIC)
Written Agreement (FRB)
Prompt Corrective Action
Removal Order

Enforcement Actions
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