FINANCIAL SERVICES FORUM

August 14, 2025

VIA ELECTRONIC SUBMISSION

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations (Docket No. OP-1868)

Dear Ms. Misback:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Federal Reserve Board (the "FRB") on its proposed amendments (the "Proposal") to the Large Financial Institution rating system (the "LFI Framework"), which would revise the component ratings required for a firm to be considered "well managed" under the LFI Framework.[2] The Proposal is of significant importance to each of our member institutions—the eight U.S. global systemically important bank holding companies ("U.S. GSIBs")—each of which is subject to the LFI Framework.

We fully support the Proposal's goal to more accurately align a firm's "well managed" designation with an institution's ability to maintain safe-and-sound operations across the business cycle, and we agree with FRB Vice Chair for Supervision Bowman's observation that under the current LFI Framework there is a "mismatch between [a firm's] ratings and overall firm condition."[3] As it has been applied in practice, ratings under the LFI Framework too often fail to reflect "a complete look at the financial and

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1 The Financial Services Forum is an economic policy and advocacy organization whose members are the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace and a sound financial system.

2 Revisions to the Large Financial Institution Rating System and Framework for the Supervision of Insurance Organizations, 90 Fed. Reg. 31641 (July 15, 2025).

3 FRB, Statement on Large Financial Institution Rating Framework Proposal by Vice Chair for Supervision Michelle W. Bowman (July 10, 2025), available *here*.

managerial health of a firm,"[4] and instead reflect an approach to supervision that has given into "the temptation to overemphasize or become distracted by relatively less important procedural and documentation shortcomings."[5] Accordingly, we recommend that the FRB expeditiously adopt the revisions to the LFI Framework as set out in the Proposal.

That said, while the proposed revisions to the LFI Framework are a useful first step toward reforming the overall federal bank supervisory framework to focus on core, material financial risks, they are not by themselves sufficient. As the Proposal itself observes, while up to eight firms may become "well managed" at the holding company level if the Proposal takes effect, only three of those firms would see practical benefits from this designation, because the other five are not "well managed" at the level of their bank subsidiaries.[6] Revisions to other relevant ratings frameworks, such as CAMELS, are also needed, as are broader reforms to supervisory practices. This will require the sustained efforts of, and coordination among, the FRB and other federal agencies, and we urge the FRB to continue to press ahead with additional reform efforts.

Still, we welcome this first step, and the need for broader reform should not delay the FRB in finalizing a revised LFI Framework based on the Proposal.

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In this letter, we wish to highlight the following key points:

- **We support the proposed revisions to the LFI Framework that would allow a firm to remain "well managed" with a single "Deficient-1" rating**. Shortcomings in the current supervisory framework have caused too many firms to be considered not "well managed" over issues that are not core, material financial risks. Until these underlying supervisory issues are addressed, the proposed changes to the LFI Framework are a practical and pragmatic first step toward mitigating the negative effects that current issues with the federal bank supervisory framework have on the banking sector and the broader American economy.

- **Inflexible timing requirements that do not reflect the specific circumstances of a firm's supervisory issues should not impact the firm's ability to maintain "well managed" status with a single "Deficient-1" rating.**

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[4] *Id*.

[5] Vice Chair for Supervision Michelle W. Bowman, Taking a Fresh Look at Supervision and Regulation, FRB (June 6, 2025) ("Bowman Speech"), available *here*.

[6] 90 Fed. Reg. at 31648.

- **There should be a strong presumption that a firm with satisfactory ratings for the capital and liquidity components of the LFI Framework will not be rated "Deficient-2" for the governance and controls component**.

- **The FRB should undertake a broader range of reforms to the bank supervisory framework**. We have set out a non-comprehensive list of such reforms in Sections II and III of this letter, and we would be pleased to make ourselves available to discuss these and other opportunities for reform.

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I. We Support the Proposed Revisions to the LFI Framework That Would Allow a Firm to Remain "Well Managed" with a Single "Deficient-1" Rating and Remove the Presumption for an Enforcement Action for Firms with a "Deficient-1" Rating

The FRB's proposed revisions to the LFI Framework would be an important first step toward mitigating issues with the current bank supervisory framework, and we recommend the FRB adopt the Proposal expeditiously.

Under the current LFI Framework, a bank holding company ("BHC") with $100 billion or more in total assets is not considered "well managed" under the Bank Holding Company Act (the "BHCA") if it receives a rating of "Deficient-1" on a single component of the categories comprising the LFI Framework, which include capital planning and positions; liquidity risk management and positions; and governance and controls.[7] Lack of "well managed" status results in a BHC being unable to use certain expedited procedures and limits a BHC's ability to engage in certain expansionary activities. In particular, under sections 4(l) and 4(m) of the BHCA, BHCs that have elected to become financial holding companies ("FHCs") but are no longer considered "well managed" are required to enter into remediation agreements with the FRB and lose their ability to engage in new categories of activities permissible under section 4(k) of the BHCA or acquire shares of financial companies in reliance on section 4(k) without FRB approval.[8]

As the Proposal explains, the restrictions stemming from an FHC's loss of "well managed" status place significant regulatory encumbrances on a firm and can materially impede its growth.[9] Under current supervisory practice, it can take many years for a firm that has been downgraded to be restored to "well managed" status, long after remediation

7 12 U.S.C. § 1843(o)(9); Large Financial Institution Rating System; Regulations K and LL, 83 Fed. Reg. 58724, 58735 (Nov. 21, 2018).

8 *See* 12 CFR § 225.83(d).

9 90 Fed. Reg. at 31650.

of the original issues that caused the downgrade has been completed, as examiners evaluate progress on issues like "sustainability" based on opaque and subjective criteria. It follows that supervisory issues should meet a sufficiently high bar to justify these consequences before causing a firm to lose its "well managed" status. In many cases, however, institutions lose their "well managed" status without this high bar being cleared, with supervisors second-guessing routine management decisions or internal firm processes, instead of focusing on core safety and soundness considerations.

Currently, a firm may lose this status due to, for example, "a limited number of significant deficiencies—or even just one significant deficiency—noted for management of a single material business line . . . even if the firm meets supervisory expectations" for a particular component "in all other respects."[10] A limited number of deficiencies should not impede a firm's ability to grow and serve its customers, especially as "supervisory focus has shifted away from core financial risks . . . to process-related concerns."[11] The overly punitive application of ratings downgrades has resulted in "over half of large financial institutions [being] considered not 'well managed,' despite their resilience under current and stressed conditions."[12] This misguided approach to supervision acts as an invisible brake on large parts of the U.S. banking sector, restraining innovation and competition and preventing many banking organizations from serving their customers and the American economy to their fullest potential.

For these reasons, we support the approach set out in the Proposal providing that a firm with a single "Deficient-1" rating could still maintain "well managed" status if it maintains a rating of "Broadly Meets Expectations" or "Conditionally Meets Expectations" with respect to the other two components of the LFI Framework. While this change would not fully address the underlying issues with the supervisory framework, it could help to mitigate their consequences.

We also support the removal of the FRB's presumption that a firm with a single "Deficient-1" rating would be subject to a formal or informal enforcement action. The decision to take an informal or formal enforcement action should be based on the specific facts and circumstances of a firm's supervisory issues, evaluated in light of objective standards established by the FRB for bringing such an action and the severity of the issues, and not based on a presumption from a broad rating category.

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10 *Id*. at 31653.

11 Bowman Speech.

12 90 Fed. Reg. at 31644.

II. Responses to Specific Questions

This section responds to certain specific questions raised by the Proposal.[13]

> *Question 1: What are the advantages and disadvantages of revising the current LFI Framework such that firms that receive a Broadly Meets Expectations or Conditionally Meets Expectations rating in the capital and liquidity components and a Deficient-2 rating only in the governance and controls component would be considered "well managed"?*

There should be a strong presumption that a BHC that is rated "Broadly Meets Expectations" or "Conditionally Meets Expectations" in the capital and liquidity components cannot be rated "Deficient-2" for governance and controls. If transparent and objective guidelines for ratings are adopted and enforced that focus supervision on core, material financial risks, such that the "Deficient-2" rating is only assigned when deficiencies in governance and controls actually "present a threat to the firm's safety and soundness, or have already put the firm in an unsafe and unsound condition,"[14] it should not be necessary to revise the framework in this manner. Firms that effectively manage their capital and liquidity should be presumed to have governance and controls adequate to manage material financial risks.

> *Question 2: What are the advantages and disadvantages of revising the LFI Framework to implement a timing requirement where a firm with a single Deficient-1 component rating would be considered not "well managed" if it has not remediated the deficiency within a certain time period?*

The LFI Framework should not include a timing requirement after which a firm with a single "Deficient-1" rating would not be considered "well managed." Different types of remediation may require different timelines depending on the specific circumstances of the firm and the issues identified. For example, solutions to firmwide information systems issues that do not have a material impact on a firm's performance may take longer to implement as compared to more targeted remediation efforts related to capital and liquidity modeling. A timing requirement in this case would not appropriately reflect the materiality of the underlying supervisory issues.

Further, as the current LFI Framework appropriately recognizes, "[a] firm previously rated 'Deficient-1' may be upgraded," and therefore be eligible to be considered "well managed," "if the firm's remediation and mitigation activities are sufficiently advanced . . . <u>even if the firm has outstanding supervisory issues or is subject to an active</u>

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13 The questions are paraphrased from the Proposal to replace references to the "Frameworks" with "LFI Framework" and contain certain other immaterial modifications for ease of reading.

14 90 Fed. Reg. at 31657 (definition of "Deficient-2" for the governance and controls component).

enforcement action."[15] As such, a firm's condition may improve even as its remediation activities are ongoing and firms should not be penalized for undertaking necessary remediations that, because of their operational complexity, may take a significant period of time.

More broadly, the FRB should adopt guidance that directs examiners to establish and communicate clear criteria for closing supervisory findings. The criteria should be objective, focus on material issues that relate to the substance of a finding, and lay out clear expectations for the closure timeline, but firms should be given flexibility in deciding how best to satisfy the criteria. This would be especially important if the FRB did adopt a timing requirement for remediating a "Deficient-1" rating.

> *Question 4: What other changes to the LFI Framework should be considered by the Board, and why?*

The FRB should adopt and publish transparent and objective guidance for evaluating components of the LFI Framework, particularly with respect to the governance and controls component. This guidance should include clear criteria that strictly cabin supervisory discretion in assigning ratings to ensure the objectivity and credibility of such ratings. Examiners should be trained on topics such as the appropriate role of supervisory guidance in informing examiner judgment and the FRB should hold examiners accountable for acting consistent with applicable guidance and applying objective criteria in their ratings and other supervisory findings.

Criteria related to components of the LFI Framework, and related guidelines for examiners, should reflect that a rating of "Deficient-1" requires findings of significant risk and materiality. Isolated or immaterial issues should not lead to downgrades, "double counting" of issues (where a single issue or set of related issues drives downgrades across more than one component) should be discouraged, and examiners should be directed not to abuse their discretion by rating multiple components "Deficient-1" in an effort to preclude a firm from being considered "well managed."

> *Question 5: Should the FRB consider adding a composite rating to the LFI Framework to determine whether a firm is "well managed"? If so, what definitions should be used for the composite rating? For example, should the definitions be aligned with the existing generalized definitions of Broadly Meets Expectations, Conditionally Meets Expectations, Deficient-1, or Deficient-2 for each component? What standard should guide the determination of a composite rating? For example, should the composite rating be based on a comprehensive assessment, or should it involve a presumption based on an average or weighted average of the different component ratings?*

[15] 83 Fed. Reg. at 58736 (emphasis added).

Assuming revisions to the LFI Framework are finalized as proposed, and a single "Deficient-1" rating does not preclude a firm from being considered "well managed," we do not believe the FRB should consider adding a composite rating to the LFI Framework at this time.

> *Question 6: What other changes to supervisory ratings systems (such as CAMELS, the RFI/C(D) rating system, ROCA ratings for U.S. branches of foreign banking organizations, and ratings for combined U.S. operations of foreign banking organizations) should be considered by the FRB to reflect recent experiences in the banking system, and why? What changes to other supervisory ratings systems should be considered by the FRB to align it with the proposed revisions to the LFI Framework, and why?*

We reiterate that the Proposal is a useful first step, but by itself it is not sufficient to address the many issues with the current supervisory system. The FRB and other banking agencies should undertake similar revisions to other rating systems, particularly CAMELS, to more broadly reorient supervision and rating systems to focus on core material, financial risks and to maintain competitive equality among firms subject to bank examinations and ratings. As the Proposal notes, "changes solely to the LFI Framework would initially have a limited impact," because, as a result of subsidiary ratings, only three of the eight firms subject to the LFI Framework not currently considered "well managed" would regain that status as a result of the Proposal.[16] This demonstrates that further reforms to supervisory rating systems are necessary.

> *Question 8: What additional benefits or costs could be relevant for assessing the proposal?*

As the FRB recognizes, if adopted the Proposal may help to reduce the compliance costs incurred by firms and the related burdens placed on management to respond to enforcement actions resulting from downgrades. It may also make examinations and remediation more efficient, because it would allow firms to focus resources for examination and remediation on issues that involve material financial issues. These benefits would allow banking organizations to more effectively allocate capital to the American economy through lending and other financial products.[17] Moreover, the ability of FHCs to fully exercise their powers under section 4(k) of the BHCA as a result of being considered "well managed" will promote these firms' ability to expand and innovate on the range of financial services they provide to meet customer needs and support the continued strength of the American economy.

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[16] 90 Fed. Reg. at 31648.

[17] *Id*. at 31649.

III. Considerations for Broader Reforms to the Supervisory Framework

As Vice Chair Bowman has noted, the goal of supervision "should be to prioritize the identification of material financial risks and encourage prompt action to mitigate risks that threaten safety and soundness."[18] Returning to this goal requires broad changes to the supervisory framework. We offer a few considerations below and in our responses to the questions included in the Proposal set out in Section II, above. These considerations are not intended to be comprehensive and should not delay the FRB from finalizing reforms based on the Proposal. We would be pleased to make ourselves available to discuss further steps to reform the federal bank supervisory framework with FRB staff to the extent it would be productive and facilitate this reform agenda.[19]

Improving Transparency and Objectivity of Supervision. As noted in our response to Question 4, the FRB and other banking agencies should adopt and publish transparent and objective guidance for evaluating components of various ratings frameworks that include clear criteria to cabin supervisory discretion and ensure the objectivity and credibility of such ratings. Examiners should be trained on topics such as the appropriate role of supervisory guidance in informing examiner judgment and the agencies should hold examiners accountable for complying with applicable guidance and applying objective criteria in their ratings and other supervisory findings.

Focusing on Material Issues. Consistent with reorienting supervisory focus toward core financial risks, the FRB and other regulators should adopt written guidance directing examiners to identify and focus on matters that can result in a material financial concern, as opposed to issuing supervisory criticism for matters that are immaterial to the health of a firm and the financial system.

Reforming Supervisory Appeals Process. The FRB's current supervisory appeals process does not provide a robust process for a firm to effectively challenge ratings that do not accurately reflect risks faced by the firm or that reflect long-dated issues that have since been remediated. The FRB should consider enhancing its appeals process so that it is a fair forum to resolve disagreements and disputes regarding ratings and, where necessary, remedy supervisory overreach.

Continued Dialogue Between Firms and Supervisors. The supervisory framework should encourage frank dialogue between firms and examiners and promote the timely exchange of feedback. This should include, at a minimum, communicating clear, objective criteria for closing each open supervisory finding in a timely manner. In

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[18] Bowman Speech.

[19] Such meetings would be consistent with the approach taken by FRB staff in promulgating the current LFI Framework. 83 Fed. Reg. at 58725 ("Federal Reserve staff held several meetings on the [initial LFI Framework] proposal with members of the public and obtained supplementary information from certain commenters.").

addition to further engagement between a single firm and its supervisors, the FRB should consider sharing supervisory trends and patterns among peer firms in an appropriate format to give the industry clearer insight into areas of concern across the banking sector.

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Thank you for considering these comments. If you have any questions, please contact Sean Campbell of the Financial Services Forum by phone at (202) 821-2574 or by email at scampbell@fsforum.com.

Respectfully submitted,

Financial Services Forum