

Appendix B: CAMELS Scorecard

Bank regulators use the six criteria in the CAMELS scorecard to evaluate financial strength and quality of management. Directors could consider these measures for evaluating their companies.

Capital adequacy—Although this measure of strength applies to banks, directors at any company with financial products and investments will want an understanding of the degree of financial leverage and how it could impact earnings.

Asset quality—Directors should understand the quality of assets—on and off the balance sheet. Could any be a drag on earnings? What are the disposition plans, if any?

Management—Understand the incentives embedded in executive pay packages. Also understand management succession plans, as well as the bench strength of the current management team and the level and quality of management oversight of operations and risk management systems.

Earnings—Bank regulators get nervous when investments are riskier and earnings become volatile. The takeaway for all directors is to understand the quality and source of earnings at your company. How much of the earnings are generated by noncore operations? What proportion is generated by new products, for which the full risks might not be recognized? Understand trends in your company's expenses and how effective the budgeting and forecasting systems or models have been.

Liquidity—Many companies were surprised at how quickly their sources of cash dried up in the midst of the credit crisis. Understand the availability of funding—long and short term—and how diversified the sources of it are. Also understand the role and effect of off-balance sheet structures in creating or requiring liquidity.

Sensitivity to market risks—Understand management's ability to identify, measure, monitor, and control exposure to market risks, including interest rates, foreign exchange rates, and commodity and equity pricing. Although this appears very banking focused, many companies face tangible risks in dealing with volatile exchange rates and commodity prices.