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Comptroller of the Currency
Administrator of National Banks

Large Bank Supervision

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Introduction

Background

This booklet explains the philosophy and methods the Office of the Comptroller of the Currency (OCC) uses in supervising the largest and most complex national banks that are assigned to deputy comptrollers for Large Bank Supervision in Washington, D.C. and complex, mid-sized national banks that are assigned to district assistant deputy comptrollers.¹ This guidance also pertains to foreign-owned U.S branches and agencies, and international operations of both mid-sized and large banks.² When reviewing the international operations of national banks, examiners should also be guided by the “Basle Core Principles for Effective Supervision.”³

Many national banks serve as the “anchors” of diversified financial organizations. Therefore, the OCC’s large bank program also assesses the risks to the bank posed by related entities, to the extent necessary to reach conclusions about the consolidated organization. This overall approach is consistent with the cross-guaranty provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the capital maintenance provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), and the Gramm-Leach-Bliley Act of 1999 (GLBA).

Because of the vast — and in some cases global — operating scope of large banks, the OCC assigns examiners to work full-time at the largest institutions. This enables the OCC to maintain an ongoing program of risk assessment, monitoring, and communications with bank management and directors.

¹ The “Community Bank Supervision” booklet of the *Comptroller’s Handbook* guides supervision of less complex domestic mid-sized banks.

² More detailed guidance on the supervision process for OCC-licensed offices of foreign banks can be found in the “Federal Agencies and Branches Supervision” booklet of the *Comptroller’s Handbook*.

³ The Basle Committee on Banking Supervision is a committee of banking supervisory authorities established by the central bank governors of the Group of Ten countries in 1975. The committee issued the “Basle Core Principles for Effective Banking Supervision” in September 1997. The 25 principles establish minimum requirements and were designed to promote more consistent and effective bank supervision in all countries.

Personnel selected for these assignments are rotated periodically to ensure that an objective and fresh supervisory perspective is maintained.

The OCC's large bank supervision objectives are designed to:

- Determine the condition of the bank and the risks associated with current and planned activities, including relevant risks originating in subsidiaries and affiliates.
- Evaluate the overall integrity and effectiveness of risk management systems, using periodic validation through transaction testing.
- Determine compliance with laws and regulations.
- Communicate findings, recommendations, and requirements to bank management and directors in a clear and timely manner, and obtain informal or formal commitments to correct significant deficiencies.
- Verify the effectiveness of corrective actions, or, if actions have not been undertaken or accomplished, pursue timely resolution through more aggressive supervision or enforcement actions.

In addition to performing their own analyses, the OCC's large bank examiners leverage the work of other OCC experts, other regulatory agencies, and outside auditors and analysts to supervise the bank. As the size and complexity of a bank's operations increase, so too does the need for close coordination among all relevant regulators. For banks with international operations, this includes coordination with foreign supervisors, as appropriate.

The foundation of large bank supervision is a risk assessment framework designed to determine that banks effectively assess risks throughout their entire enterprise, regardless of size, diversity of operations, or the existence of subsidiaries and affiliates. The risk assessment program for large banks consists of the following three components:

- **Core Knowledge** — the OCC's database of information that defines the bank's culture, risk tolerance, and other internal and external factors. This database enables examiners to communicate critical data to each other with greater consistency and efficiency.

- **Core Assessment** — standards and procedures that guide examiners in reaching conclusions regarding both risk and ratings under the Uniform Financial Institutions Rating System (UFIRS, more commonly referred to as “CAMELS”). Core assessment standards define the minimum conclusions that examiners must reach during the 12-month supervisory cycle to meet the requirements of a full-scope examination. The core assessment guidance in this booklet applies to all large banks, regardless of size or complexity. The guidance permits examiners the flexibility and discretion to develop supervisory strategies that respond to existing and emerging risks.
- **Expanded Procedures** — detailed guidance that explains how to examine specific activities or products that warrant extra attention beyond the core assessment. Examiners may determine what expanded procedures to use during pre-examination planning, or through preliminary conclusions reached during the core assessment.

Supervision by Risk

The OCC recognizes that banking is a business of taking risks in order to earn profits. While banking risks historically have been concentrated in traditional banking activities, the financial services industry has evolved in response to market-driven, technological, and legislative changes. These changes have allowed banks to expand product offerings, geographic diversity, and delivery systems. They have also increased the complexity of the bank’s consolidated risk exposure. Because of this complexity, banks must evaluate, control, and manage risk according to its significance. The bank’s evaluation of risk must take into account how nonbank activities within a banking organization affect the bank. Consolidated risk assessments should be a fundamental part of managing the bank.

Large banks assume varied and complex risks that warrant a risk-oriented supervisory approach. Under this approach, examiners do not attempt to restrict risk-taking but rather determine whether banks identify, understand, and control the risks they assume. As an organization grows more diverse and complex, the bank’s risk management processes must keep pace. When risk is not properly managed, the OCC directs bank management to take corrective action. In all cases, the OCC’s primary concern is that the bank

operates in a safe and sound manner and maintains capital commensurate with its risk.

Supervision by risk allocates greater resources to areas with higher risks. The OCC accomplishes this by:

- Identifying risks using common definitions. The categories of risk, as they are defined, are the foundation for supervisory activities.
- Measuring risks using common methods of evaluation. Risk cannot always be quantified in dollars. For example, numerous internal control deficiencies may indicate excessive transaction risk.
- Evaluating risk management to determine whether bank systems and processes permit management to manage and control existing and prospective levels of risk.

Examiners should discuss preliminary conclusions regarding risks with bank management. Following these discussions, they should adjust conclusions when appropriate. Once the risks have been clearly identified and communicated, the OCC can then focus supervisory efforts on the areas of greater risk within the bank, the consolidated banking company, and the banking system.

To fully implement supervision by risk, examiners must consider the risk profiles and assign CAMELS ratings to the lead bank and all affiliated national banks. Examiners may determine that risks in individual institutions are increased, reduced, or mitigated in light of the consolidated risk profile of the company as a whole. To perform a consolidated analysis, an examiner should obtain pertinent information from banks and affiliates (within the confines of GLBA), verify transactions flowing between banks and affiliates, and obtain information from other regulatory agencies, as necessary.

Risk Definition

For purposes of the discussion of risk, the OCC evaluates banking risk relative to its impact on capital and earnings. From a supervisory perspective, risk is the potential that events, expected or unanticipated, may have an adverse impact on the bank's capital or earnings.

The existence of risk is not necessarily reason for concern. Likewise, the existence of high risk in any area is not necessarily a concern, so long as management exhibits the ability to effectively manage that level of risk. To put risks in perspective, examiners should decide whether the risks a bank undertakes are warranted. Generally, a risk is warranted when it is identified, understood, measured, monitored, and controlled. It should be within the bank's capacity to readily withstand the financial distress that such risk could cause. When risks are unwarranted (i.e., not understood, measured, controlled, or backed by adequate capital to support the activity), examiners must communicate to management and the directorate the need to mitigate or eliminate the excessive risks. Appropriate bank actions may include reducing exposures, increasing capital, or strengthening risk management processes.

The OCC has defined nine categories of risk for bank supervision purposes. These risks are: *credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation*.⁴ These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. In addition, they can be interdependent. Increased risk in one category can increase risk in other categories. Examiners should be aware of this interaction and should assess the impact in a consistent and inclusive manner.

Risk Management

Because market conditions and company structures vary, there is no single risk management system that works for all companies. Each institution should tailor its risk management program to its needs and circumstances.

Sound risk management systems, however, have several things in common; for example, they are independent of risk-taking activities. Regardless of the risk management program's design, each program should:

- *Identify risk*: To properly identify risks, a bank must recognize and understand existing risks or risks that may arise from new business initiatives, including risks that originate in nonbank subsidiaries and affiliates. Risk identification should be a continuing process, and should

⁴ The risk definitions are found in the "Risk Assessment System" beginning on page 72.

occur at both the transaction and portfolio level. Proper risk identification is critical for banks undergoing mergers and consolidations to ensure that risks are appropriately addressed. Risk identification in merging companies begins with the establishment of uniform definitions of risk; a common language helps to ensure the merger's success.

- *Measure risk:* Accurate and timely measurement of risk is essential to effective risk management systems. A bank that does not have a risk measurement system has limited ability to control or monitor risk levels. Further, the more complex the risk, the more sophisticated should be the tools that measure it. A bank should periodically test to make sure that the measurement tools it uses are accurate. Good risk measurement systems assess the risks of both individual transactions and portfolios. During the transition process in bank mergers and consolidations, the effectiveness of risk measurement tools is often impaired because of the technological incompatibility of the merging systems or other problems of integration. Therefore, the resulting company must make a strong effort to ensure that risks are appropriately measured across the consolidated entity. Larger, more complex companies must assess the impact of increased transaction volume across all risk categories.
- *Monitor risk:* Banks should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed. For large, complex companies, monitoring is essential to ensure that management's decisions are implemented for all geographies, products, and legal entities.
- *Control risk:* The bank should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. These control limits should be valid tools that management should be able to adjust when conditions or risk tolerances change. The bank should have a process to authorize exceptions or changes to risk limits when warranted. In banks merging or consolidating, the transition should be tightly controlled; business plans, lines of authority, and accountability should be clear. Large, diversified companies should have strong risk controls covering all geographies, products, and legal entities.

The board must establish the company's strategic direction and risk tolerances. In carrying out these responsibilities, the board should approve policies that set operational standards and risk limits. Well-designed monitoring systems will allow the board to hold management accountable for operating within established tolerances.

Capable management and appropriate staffing are also essential to effective risk management. Bank management is responsible for the implementation, integrity, and maintenance of risk management systems. Management also must keep the directors adequately informed. Management must:

- Implement the company's strategy.
- Develop policies that define the institution's risk tolerance and ensure that they are compatible with strategic goals.
- Ensure that strategic direction and risk tolerances are effectively communicated and adhered to throughout the organization.
- Oversee the development and maintenance of management information systems to ensure that information is timely, accurate, and pertinent.

When examiners assess risk management systems, they consider the bank's policies, processes, personnel, and control systems. If any one of these areas is deficient, so is the bank's risk management.

Policies are statements of the bank's commitment to pursue certain results. Policies often set standards (on risk tolerances, for example) and recommend courses of action. Policies should express a bank's underlying mission, values, and principles. A policy review should always be triggered when a bank's activities or risk tolerances change.

Processes are the procedures, programs, and practices that impose order on the bank's pursuit of its objectives. Processes define how daily activities are carried out. Effective processes are consistent with the underlying policies, are efficient, and are governed by checks and balances.

Personnel are the staff and managers that execute or oversee processes. Good staff and managers are qualified, competent, and perform as expected.

They understand the bank's mission, values, policies, and processes. Compensation programs should be designed to attract, develop, and retain qualified personnel. In addition, compensation should be structured to reward contributions to effective risk management. Mergers and consolidation present complicated personnel challenges. Any bank merger plans should lay out strategies for retaining the staff members essential to risk management.

Control systems include the tools and information systems (e.g., internal/external audit programs) that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes. Feedback should be timely, accurate, and pertinent.

Measuring and Assessing Risk

Using the OCC's core assessment standards⁵ as a guide, an examiner obtains both a current and prospective view of a bank's risk profile. When appropriate, this profile incorporates the potential material risks to the bank from functionally regulated activities conducted by the bank and from functionally regulated entities (FREs). This risk assessment drives supervisory strategies and activities. It also facilitates discussions with bank management and directors and helps to ensure more efficient examinations.

The core assessment complements the OCC's risk assessment system (RAS). Examiners document their conclusions regarding the quantity of risk, the quality of risk management, the level of supervisory concern (measured as aggregate risk), and the direction of risk using the RAS. Together, the core assessment and RAS give the OCC the means to assess existing and emerging risks in large banks, regardless of size or complexity.

Core Assessment

Examiners must complete the core assessment for each consolidated company and each significant national bank every 12 months. The examiner-in-charge (EIC) or supervisory office can draw the conclusions in the core assessment more often, if deemed appropriate. The core assessment factors are the minimum standards for each risk category. They also supply the criteria for

⁵ The core assessment standards are detailed beginning on page 27.

CAMELS conclusions as outlined in the “Bank Supervision Policy” booklet of the *Comptroller’s Handbook*.

The core assessment standards establish a consistent set of minimum criteria to evaluate risks while allowing for examiner judgment and discretion. The standards are sufficiently flexible to be applied to all companies; examiners can assess risks for all product lines and legal entities. The consistent structure of the core assessment also facilitates the analysis of risk in merging companies because examiners use a common language and the same standards to assess risks at both companies.

When using the core assessment standards, examiners should use judgment in deciding how to carry through on their assessments and how much independent testing is needed. Examiners should be alert to specific activities or risks that may trigger the need for the EIC to broaden the scope of the examination. Examiners can expand the examination procedures to include procedures from other *Comptroller’s Handbook* booklets, such as “Loan Portfolio Management,” “Internet Banking,” and “Internal Control.”

Risk Assessment System

By completing the core assessment and, as necessary, expanded procedures, examiners assess the risk exposure for the nine categories of risk using the RAS framework. For seven of the nine risks — credit, interest rate, liquidity, price, foreign currency translation, transaction, and compliance — the supervisory process identifies:

- **Quantity of risk** — the level or volume of risk that exists, characterized as high, moderate, or low.
- **Quality of risk management** — how well risks are identified, measured, controlled, and monitored, characterized as strong, satisfactory, or weak.
- **Aggregate risk** — the level of supervisory concern, which is a summary judgment incorporating the assessments of the quantity of risk and the quality of risk management (examiners weigh the relative importance of each). Aggregate risk is characterized as high, moderate, or low. In assessing aggregate risk, examiners should perform the activities and use the resources outlined in supervisory strategies.

- **Direction of risk** — the probable change in the bank's risk profile over the next 12 months. Each risk is characterized as decreasing, stable, or increasing. The direction of risk often influences the supervisory strategy, including how much validation is needed. This assessment characterizes risk movement rather than anticipated changes in the aggregate risk rating (e.g., aggregate risk is rated high, however, the institution is at the low end of the rating). If the risk is decreasing, the examiner expects, based on current information, aggregate risk to decline over the next 12 months. If the risk is stable, the examiner expects aggregate risk to remain unchanged. If the risk is increasing, the examiner expects aggregate risk to be higher in 12 months.

Because an examiner expects the aggregate risk profile to increase or decrease does not necessarily mean that he or she expects the movement to be sufficient to change the aggregate risk level within 12 months. An examiner can expect movement **within** the risk level. For example, aggregate risk can be high and decreasing even though the decline is not anticipated to change the level of aggregate risk to moderate. In such circumstances, examiners should explain in narrative comments why a change in the risk level is not expected. Aggregate risk assessments of high and increasing or low and decreasing are possible.

Although the two remaining risks, *strategic* and *reputation*, affect the bank's franchise value, they are difficult to measure precisely. Consequently, the OCC modified how the risks are assessed and measured, assessing only **aggregate risk** and **direction of risk**. The characterizations of aggregate risk and direction of risk are the same as for the other seven risks.

Using their assessments of the nine risks, examiners establish an institution's overall risk profile. As the primary regulator of national banks, the OCC has the responsibility for evaluating the consolidated or overall risk profile of such banks. The overall risk profile is developed by combining the assessment of risks at each significant national bank with the assessment of the material risks posed to the bank by the bank's or any FRE's functionally regulated activities, as appropriate. The relative importance of each risk, both for the individual bank and for the holding company, should influence the development of the strategy and the assignment of resources.

Examiners should complete a *consolidated* RAS quarterly. A bank's RAS should be updated more often if the consolidated risk profile warrants it. Examiners record conclusions drawn from the consolidated and individual bank risk assessments in the OCC's electronic information system under the lead company and other affiliates as appropriate.

Examiners should discuss these conclusions with appropriate management and the board. Bank management may provide information that helps the examiner clarify or modify those conclusions. Following the discussions, the OCC and company management should have a common understanding of the bank's risks, the strengths and weaknesses of its risk management, management's commitment and action plans to address any weaknesses, and future OCC supervisory plans.

Audit and Internal Control

An accurate evaluation of audit and internal control is crucial to the proper supervision of a bank. The examiner will determine whether the overall audit and the internal control programs are strong, satisfactory, or weak. Examiners' assessments of a bank's audit and control functions help to leverage OCC resources, help to establish the scope of current and future supervisory activities, and help to assess the quality of risk management.

Audit

The EIC, in consultation with the supervisory office, will tailor the scope of the audit examination to the bank's size, activities, and risk profile. Examiners assigned to review audit will determine how much reliance can be placed on internal and external audit work by periodically validating the audit program throughout the ongoing supervisory process. Validation will take place during each examination cycle.⁶

Validation consists of a combination of examiner discussions with bank/audit management or personnel, internal audit work paper reviews, and process reviews (e.g., policy adherence, risk assessments, follow-up activities). Examiners can take the following three steps, as needed, to validate the audit

⁶ The core assessment minimum audit review standards begin on page 64.

program: work paper review, use of additional procedures, and direct verification.

Work Paper Review — Examiners will review a sample of work papers from internal audit, including those outsourced to external parties. The review should focus on the appropriateness of the audit scope, the support for and completeness of the audit conclusions, and any follow-up actions. The sample should represent a cross-section of bank functions, internal audit ratings, and risks. It should focus on rapidly growing and high-risk areas, franchise businesses, technology support for critical business functions, and any activities new to the bank. If the review of the internal audit function discloses significant issues or if questions are raised regarding the adequacy or independence of the external audit program, examiners should also consider selecting a sample of external audit work papers for the areas reviewed. Examiners should consult with the supervisory deputy comptroller and notify the OCC's chief accountant before beginning any review of external audit work papers.

Use of Additional Procedures — If the work paper review raises questions about audit effectiveness, the examiner should discuss the questions with the appropriate parties. If the examiner continues to believe that the audit might not be effective or if other concerns are raised regarding the audit function, he or she will expand the scope of the audit review and of any affected functional area of the bank. Issues that would require expanded procedures include:

- Issues of competency or independence relating to internal or external auditors.
- Unexplained or unexpected changes in external auditors or significant changes in the audit program.
- Inadequate scope of the overall audit program.
- Audit work papers that are deficient and do not support audit conclusions.
- High-growth or high-risk areas lacking adequate audit or internal control.
- Inappropriate actions by insiders to influence the findings or scope of audits.

The scope of the procedures must be sufficient to determine the extent of problems and their effect on the bank. Examiners should include, when

appropriate, internal control questionnaires (ICQs) in conjunction with the expanded procedures.

Direct Verification — After completion of the expanded procedures, concerns may remain about the adequacy of internal or external audit, internal control, or the integrity of the bank's financial or risk management controls. If so, examiners should further expand the scope of the review by completing verification procedures.

Verification procedures must be used whenever:

- Account records are significantly out of balance.
- Management is uncooperative or poorly manages the bank.
- Access to bank records is restricted.
- Significant accounting, audit, or internal control deficiencies remain uncorrected from previous examinations or from one audit to the next.
- Bank auditors are unaware of, or are unable to sufficiently explain, significant deficiencies.
- Management engages in activities that raise questions about its integrity.
- Repeated violations of law affect audit, internal control, or regulatory reports.
- Other situations exist that examiners believe warrant further investigation.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the supervisory deputy comptroller. The Enforcement and Compliance Division should be notified whenever verification procedures are being performed.

As an alternative to having examiners perform the verifications, the EIC may require the bank to expand its audit program. However, this alternative will be used only if management has demonstrated a capacity and willingness to address regulatory problems, if there are no concerns about management's integrity, and if management has initiated timely corrective action in the past. In other instances, the EIC may consider requiring the bank to contract with a third party to perform the verification procedures. If used, these alternatives must resolve each identified supervisory problem in a timely manner, and supervisory follow-up will include a review of audit work papers in the areas where the bank audit was expanded.

At the conclusion of the audit and internal control review, the EIC or designee will discuss significant weaknesses and any related recommendations with audit and/or risk managers and the board of directors. Examiners will summarize these discussions in the examination working papers. In addition, the report of examination (ROE) will include comments summarizing the assessments (strong, satisfactory, or weak) of the bank's audit program and internal control, as well as any significant concerns or weaknesses.

If examiners identify significant audit or internal control weaknesses, the EIC will determine whether to recommend to the appropriate supervisory office that bank management develop a compliance plan to address noted issues and concerns, consistent with 12 CFR 30 standards. In making this decision the EIC and the supervisory office should consider the significance of the weaknesses, management's ability and commitment to effect corrective action, and the risks posed to the bank.

Internal Control

A system of strong internal control is the backbone of a bank's risk management program. As required in 12 USC 363, bank management is to make an annual assessment of the effectiveness of the bank's internal control and the external auditors must attest to management's assertions. Examiners should obtain an understanding of how the auditors reached their conclusions for their attestation of management's assertions.

The core assessment is designed to assess a bank's control environment during each examination cycle. The assessment is consistent with broadly accepted criteria⁷ for establishing and evaluating the effectiveness of sound internal control. Examiners should refer to the "Internal Control" booklet or other appropriate *Comptroller's Handbook* booklets and the *FFIEC Information Systems (IS) Examination Handbook* for more information on types of internal control commonly used in a specific banking function or if expanded procedures are appropriate.

⁷ The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 report "Internal Control - Integrated Framework" discusses control system structures and components. COSO is a voluntary private-sector organization, formed in 1985, dedicated to improving the quality of financial reporting through business ethics, effective internal control, and corporate governance. COSO was jointly sponsored by the American Accounting Association, the American Institute of Certified Public Accountants, the Financial Executives Institute, the Institute of Internal Auditors, and the National Association of Accountants.

The Supervision Process

The OCC uses a continuous supervisory process for all national banks. For banks that have resident OCC staff, supervision is an ongoing cycle of planning and examining. Communication of the results of examinations and supervisory planning is an essential part of an OCC examiner's job. Such communication facilitates open and useful discussion between bankers and examiners.

Planning

Examination planning is essential to effective supervision by helping examiners develop detailed strategies to effectively and efficiently supervise each company. Planning begins with an examiner's assessment of a bank's current and anticipated risks from existing and planned banking activities and products. In assessing a bank's planned activities, examiners should give special attention to new activities. "New" activities include not only activities new to the financial services industry but also traditional activities that are new to the bank and existing activities that are slated for expansion. Examiners should also consider the company's merger and acquisition plans.

Effective planning for all large companies, especially complex, diversified firms, requires adequate and timely communication among supervisory agencies, including functional regulators. Effective functional supervision is attained through close cooperation and coordination among the various regulators. EICs should maintain open channels of communication with other regulators and work directly with them on institution-specific items. By doing so, EICs reduce the burden of overlapping jurisdiction on the regulated entities. Interagency guidelines on coordination among U.S. banking regulators are printed in the "Examination Planning and Control" booklet of the *Comptroller's Handbook*. Examiners should comply with all other formalized agreements among regulators to ensure that intracompany supervision is consistent.

Examiners planning supervisory activities of international operations should also coordinate with foreign regulators as appropriate. The guidance for this communication is in PPM 5500-1, "Communications with Foreign Supervisors."

Planning also requires effective and periodic communication with bank management. Supervisory strategies are dynamic documents reviewed and updated frequently based on company, industry, economic, legislative, and regulatory developments. Examiners should discuss supervisory strategies with bank management as the plans are made and when any of the plans are modified.

EICs develop consolidated supervisory strategies for each company. The appropriate supervisory deputy comptroller reviews and approves them. If necessary, consolidated strategies can be supplemented by plans specific to one or more affiliates. Examiners document strategies for each company in the OCC's electronic information system.

Examination activities are based on supervisory strategies. The strategies should focus examiners' efforts on monitoring the effectiveness of the bank's risk management processes and seeking bank management's commitment to correct previously identified deficiencies. When possible, supervisory activities should rely on the bank's internal systems, including its internal and external audit activities and risk management systems, to assess the condition and the extent of risks. These systems must be periodically tested and validated for integrity and reliability during the course of routine supervisory activities.

Each supervisory strategy is based on:

- The **core knowledge** of the bank, including its:
 - Management.
 - Risk profile.
 - Control environment.
 - Strengths and weaknesses.
 - Supervisory history.
 - Market(s).
 - Products and activities.
 - Applicable economic conditions.
 - Technology support and services.

- OCC supervisory guidelines including:

- Core assessment standards.
 - Other examination guidelines (i.e., expanded procedures in the *Comptroller's Handbook* and *FFIEC IS Examination Handbook*).
 - Supervisory priorities of the agency that may arise from time to time.
- Statutory examination requirements.

The frequency of on-site safety and soundness examinations is set by statute. Every national bank must receive a full-scope, on-site examination no less than once every 12 months. This time period may be extended to 18 months for smaller affiliated national banks that hold assets of less than \$250 million and that meet certain performance requirements.⁸

Elements of a Supervisory Strategy

An effective supervisory strategy for large banks includes the following elements:

- An identification of the ongoing bank supervisory activities and the targeted examinations recommended for each quarter of the year. This information is often consolidated by each RAS element included on the OCC's quarterly risk assessment and then modified to address the bank's specific risk profile, including areas of potential or actual risk, emerging risks, and regulatory mandated examination areas.
- An indication of the workdays and associated staff needed to perform the bank supervisory objectives recommended for the year.
- A preliminary budget projection of the work to be completed.
- A strategy that addresses both internal and external communications for the year. This communications strategy addresses the type of information examiners will provide to bank management, boards of directors, and business line managers and describes how this information will be provided (i.e., meetings, reports). The communications strategy will also

⁸ Further information on the statutory requirements for examinations can be found in the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

describe what information about the bank will be produced and shared internally with OCC management and staff.

- An overview of the profiles of the significant lines of business (optional).

The strategies are prepared by the EIC and resident staff of each institution and approved by the large bank deputy comptrollers. These strategies are updated throughout the year based on changing risks to national banks and the banking system, conflicting resource demands, system conversions, and changes in supervisory priorities.

Examining

The examination process is designed to determine the condition of a bank, identify areas in need of corrective action, and monitor ongoing bank activities. In assessing the bank's condition, examiners must consider not only risks in the bank's own activities but also risks of activities engaged in by the nonbanking subsidiaries and affiliates. Examiners must perform sufficient work to determine the overall CAMELS, the overall risk assessment, the condition of information technology (IT), and the quality of fiduciary and asset management. Every three years, examiners must also update the bank's consumer rating by reviewing its compliance with consumer protection laws and regulations and the Bank Secrecy Act. Community Reinvestment Act (CRA) examinations are conducted every three to five years depending upon the bank's size and prior CRA rating.⁹

In large banks, most examination-related work is conducted throughout the 12-month supervisory cycle through various ongoing supervisory activities or targeted examinations. Targeted examinations are often conducted as integrated risk reviews by business or product line. Since a product may have implications for several risk categories, the targeted reviews evaluate risk controls and processes for each applicable risk category. For example, a targeted review of credit card lending activities evaluates credit risk; transaction risk from credit card fraud, processing errors, or service interruptions; interest rate risk from low introductory rates; compliance risk from disclosure problems; and reputation risk from predatory lending practices or inadequate controls to ensure the confidentiality and privacy of

⁹ Further information regarding the scope of consumer compliance examinations can be found in the "Compliance Overview" booklet of the *Comptroller's Handbook*.

consumer information. Findings from these targeted, integrated examinations provide input for the annual and quarterly RAS conclusions.

Most smaller national bank affiliates have one on-site examination during the 12-month or 18-month period.

Discovery

Through discovery, examiners gain a fundamental understanding of the condition of the bank, the quality of management, and the effectiveness of the bank's risk management systems. This understanding helps examiners focus their supervision on the areas of greatest concern.

A primary objective of discovery is to verify the integrity of internal risk management systems. During the verification process, examiners should test independently in proportion to the risk they find. Examiners must periodically validate all key control functions within a bank, even those designated as low risk. Examiners should generally validate high-risk areas annually and low-risk areas every three years. Exceptions to the standard are permissible when appropriately detailed in the supervisory strategy.

In discovery, examiners:

- Evaluate the bank's condition.
- Perform sufficient testing to verify the integrity of internal risk management systems.
- Identify significant risks.
- Quantify the risk.
- Evaluate management's and the board's awareness and understanding of the significant risks facing the institution.
- Assess the quality of risk management systems.
- Identify unacceptable levels of risk, deficiencies in risk management systems, and the underlying causes of the deficiencies.

The examiner's initial judgments and evaluations form the foundation for future supervisory activities. Many of these judgments are captured in the core knowledge database. Bank supervision is a continuous process that enables examiners to periodically confirm and update their assessments to

reflect current or emerging risks. This revalidation is fundamental to effective supervision.

Correction

In correction, examiners address identified deficiencies in risk management systems or unacceptable risk levels. Their objective in identifying deficiencies is to seek bank management's commitment to correct significant deficiencies and to verify that the bank's corrective actions have been successful and timely.

In this process, examiners:

- Review bank-prepared action plans to resolve each significant deficiency, including the appropriateness of the time frames for correction.
- Verify that the bank is executing the plans.
- Evaluate whether actions the bank has taken or plans to take adequately address deficiencies.
- Resolve open supervisory issues through informal or formal actions.

Examiners should ensure that bank management's efforts to correct deficiencies address *root causes* rather than symptoms. To do so, examiners may require management to develop new systems or improve the design and implementation of existing systems or processes.

Action plans detail steps or methods management has determined will correct the root causes of deficiencies. Bank management is responsible for developing and executing action plans. Directors are expected to hold management accountable for executing action plans. The OCC's supervision of the deficient areas focuses on verifying execution of the action plan and validating its success. When determining whether to take further action, examiners consider the responsiveness of the bank in recognizing the problem and formulating an effective solution. When the bank is unresponsive or unable to effect resolution, the OCC may take more formal steps to ensure correction.

Action plans should:

- Address the underlying root causes of significant deficiencies.

- Specify actions to correct deficiencies.
- Set realistic time frames for completion.
- Establish benchmarks to measure progress toward completion.
- Identify the person(s) in the bank who will be responsible for correction.
- Detail how the board and management will monitor and ensure effective execution of the plan.

Monitoring

Ongoing monitoring allows the OCC to respond to risks facing individual banks, or the industry as a whole, in a timely manner. The dynamic nature of large banks makes this an important part of effective supervision.

In monitoring a bank, examiners:

- Identify current and prospective issues that affect the bank's risk profile or overall condition.
- Decide how to focus future supervisory strategies.
- Measure the bank's progress toward correcting identified deficiencies.
- Communicate often with management regarding areas of concern.

Monitoring activities are focused on assessing the bank's risks including any potential material risks posed by functionally regulated activities conducted by the bank or FREs. Activities are adjusted to include the risks facing each significant affiliate national bank. The more complex an institution, the greater the need for frequent and comprehensive oversight. In addition to assessing progress in executing plans and correcting deficiencies as needed, examiners are required to meet certain minimum requirements for monitoring activities for large banks.

Within 45 days following the end of each quarter, examiners must:

- Review and evaluate the company-prepared consolidated analysis of financial condition, including its significant operating units.
- Identify any significant issues that may result in changes to the CAMELS, IT, fiduciary, and consumer ratings for the lead bank and any significant affiliate national banks. If an issue is identified that affects the rating, the

examiner must update the appropriate rating, assess the impact of the change on the risk profile, and adjust the supervisory strategy to reflect the change in condition. Note: A CRA examination must be performed to change a CRA rating.

- Evaluate the *consolidated* risk of the company using the RAS. In addition, examiners must, at a minimum, update the risk profiles of the lead national bank and significant affiliate national banks using the RAS when the 12-month supervisory cycle is complete. The examiner should update the RAS for each national bank more frequently if the risk profile or CAMELS condition changes significantly.
- Review and update the supervisory strategy for the company and data in the OCC's electronic information system to ensure they are current and accurate. The EIC should change the strategies for individual banks if warranted. Examiners should discuss any significant changes with bank management and their appropriate supervisory deputy comptroller.

Communication

Communication is essential to high-quality bank supervision. The OCC is committed to continual, effective communication with the banks that it supervises. Communication includes formal and informal conversations and meetings, examination reports, and other written materials. All OCC communications must be professional, objective, clear, reflective of a consistent opinion of the bank's condition, and informative.

Open communication should continue throughout the supervision process. Examiners must include detailed plans for communication in the supervisory strategy for the company.

Communication must be tailored to a bank's structure and dynamics. The timing of the communication depends on the situation being addressed. Examiners should communicate with management and the board as often as the bank's condition and examiners' findings require.

Examiners must clearly and concisely communicate significant weaknesses or unwarranted risks to bank management, allowing management an opportunity to resolve differences, commit to corrective action, or correct the

weakness. Examiners should describe the issues, as well as the board's or management's commitment to corrective action, in the "Matters Requiring Attention" (MRA) section of the ROE or in other periodic written communications.

By meeting with management often and directors as needed, examiners can ensure that all current issues are discussed. These discussions, which establish and maintain lines of communication, are an important source of monitoring information. Examiners should document their discussions in the OCC's electronic information system.

Entrance or Planning Meetings with Management

Before a supervisory activity begins, the EIC will meet with the appropriate members of the company's or bank's management. At this meeting the EIC will discuss the purpose and scope of the review. Open discussions between the OCC and the company's management will facilitate a more efficient and less burdensome supervisory process.

Exit Meetings with Management

At a meeting with management that should follow the completion of each significant supervisory activity, the EIC prioritizes the issues identified and discusses the areas of greatest risk to the bank. Examiners should also discuss plans for future supervisory activities. Examiners should encourage bankers to respond to OCC concerns, provide clarification, discuss the OCC's future supervisory plans, and ask questions. At the exit meeting for the supervisory activity, the examiners will ask for management's commitment to correct weaknesses noted during the supervisory activity.

Before conducting an exit meeting, the EIC should discuss significant findings with the appropriate deputy comptroller. This discussion helps ensure that OCC policy is consistently applied and that OCC management supports the conclusions and corrective action.

Examiners must ensure that any significant decisions they reached during the exit meeting are adequately conveyed in the meeting with the board **and** in the written correspondence. Examiners should discuss all issues with management before discussing them with the board, unless, in the

supervisory office's view, the subject is best approached confidentially with the board. Subsequent communications should be consistent in tone and content with exit meeting discussions.

Written Communication

Examiners should periodically provide written communication to the board highlighting significant issues that arise during the supervisory process. These written materials should focus the board's attention on the OCC's major conclusions. They should record the examiner's conclusions and concerns, as well as the actions the bank has committed to take. If the OCC recommends any specific actions, the correspondence should explain concisely what actions the board should take and why. This record, along with other related correspondence, helps establish and support the OCC's supervisory strategy.

Written communication must:

- Be consistent with the tone, findings, and conclusions orally communicated to the bank.
- Convey the condition of the bank or, if appropriate, the condition of an operational unit of the bank.
- Be addressed to the appropriate audience based on how the company is structured and managed.
- Discuss any concerns the OCC has about bank risks or significant deficiencies in risk management.
- Summarize the actions and commitments that the OCC will require the bank to take to correct deficiencies.
- Be concise to ensure that the issues are clear.

In addition to written communication throughout a supervisory cycle, the OCC must provide the bank's board of directors an ROE once every cycle (every 12 months or 18 months according to statute). For large banks, the ROE communicates the overall condition of the bank, summarizing examiners' activities during the most recent supervisory cycle and incorporating their findings. The ROE should also note the root causes of any significant deficiencies examiners identified and should assess the effectiveness of the bank's corrective action plans, including how well the plans were executed.

Examiners use the uniform common core report of examination format for national banks with total assets of \$1 billion or more. The OCC permits exceptions when other communications with the bank clearly communicate the institution's composite and component CAMELS condition and review the significant risks. When alternate communications are used and copies provided to the other financial institution regulators or functional regulators, examiners should ensure that the correspondence is sufficiently informative to convey the bank's condition. In addition, other regulators using the correspondence should be able to reach similar conclusions about the company in order to fulfill their regulatory responsibilities. Regardless of the format, communications with subsidiary banks must disclose significant findings, the subsidiary's condition, and the composite and component CAMELS ratings.

Meetings with the Board of Directors

A national bank's board of directors is ultimately responsible for the safety and soundness of the bank, and the OCC is committed to helping them meet their responsibilities. The OCC maintains communication with boards of directors throughout the supervisory cycle to discuss OCC examination results and other matters of mutual interest, including current industry issues, emerging industry risks, and legislative issues. If necessary, the OCC will use board meetings to discuss how the board should respond to supervisory concerns and issues.

The OCC will conduct a meeting with the board of directors or an approved committee of the board *at least once during the 12-month examination cycle for the lead national bank*. More frequent meetings should be conducted when justified by the bank's condition or special supervisory needs. When meetings are routinely conducted with board committees, examiners are also encouraged to periodically meet with the full board to confirm findings and facilitate effective communication. Examiners should conduct board meetings with affiliated national banks that are not lead banks only when significant supervisory concerns exist or when meetings will enhance overall supervision.

The EIC conducting the meeting should be prepared to discuss methods of corrective action, as well as to discuss all findings, conclusions, and

comments. The EIC should encourage board members to ask questions or make comments. Senior management of the appropriate OCC supervisory office should attend and participate in board meetings with large banks.

OCC's Electronic Information System

In the OCC's electronic information system, examiners record the current condition, supervisory strategy, and supervisory concerns for each bank. They also document follow-up actions, board meeting discussions, commitments to corrective action, progress in correcting identified problems, and subsequent events. Using these electronic records, OCC senior management and other federal bank regulators can review the condition of individual banks and groups of banks.

The EIC is responsible for ensuring that the electronic files for large banks are accurate and up-to-date. Examiners should record information in these files as follows:

- Comments pertaining to or affecting the entire company should be recorded in the electronic file under the holding company charter number. The company's affiliated national bank files should refer the reader to the holding company charter number for comments about the company as a whole.
- Comments particular to a bank should be recorded in the electronic file under the bank's charter number.

Core Assessment

Examiners must periodically validate all key control functions within a bank, even those designated as low risk. Examiners should generally validate high-risk areas annually and low-risk areas every three years. Exceptions to the standard are permissible when appropriately detailed in the supervisory strategy.

Credit Risk

Quantity of Credit Risk

Examiners should consider the following assessment factors when making judgments about the quantity of credit risk. These factors are the minimum **standards** that all examiners will consider when completing the risk assessment. Examiners should apply the standards consistent with the guidelines in the "Loan Portfolio Management" booklet of the *Comptroller's Handbook*. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of credit risk during the 12-month supervisory cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Underwriting Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- Changes in underwriting standards including credit score, leverage, policies, price, tenor, collateral, guarantor support, covenants, and structure.
- The borrower's ability to service debt based on debt service coverage, debt/income ratios, and credit history.
- The volume and extent of exceptions and overrides.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The impact of strategic factors including the target market, the portfolio and product mix, acquisitions, diversification of repayment sources, new

products and delivery channels, third-party originations, concentrations, and securitizations.

- The maintenance of an appropriate balance between risk and reward.

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The impact of external factors including, but not limited to, economic, industry, competitive, and market conditions; legislative and regulatory changes; and technological advancement.

Credit Quality Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The levels and trends of delinquencies, nonperforming and problem assets, losses, weighted average risk ratings, and reserves.
- Trends in the growth and volume of lending and fee-based credit activities, including off-balance-sheet, investment, payment, settlement, and clearing activities.
- Trends in the financial performance of borrowers and counterparties.
- Trends identified in loan pricing methods, portfolio analytics, loss forecasting, and stress testing methods.
- Trends in summary ratings assigned by the bank's loan review and audit.

Quality of Credit Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of credit risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. Examiners should apply the standards consistent with the guidelines in the "Loan Portfolio Management" booklet of the *Comptroller's Handbook*. These factors are the framework for the ongoing supervisory approach used in large banks. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of credit risk management during every 12-month supervisory cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of the credit policy with the bank's overall strategic direction and tolerance limits.
- The appropriate balance of the credit culture between credit and marketing.
- The structure of the credit operation and whether responsibility and accountability are assigned at every level.
- The reasonableness of definitions that guide policy, underwriting, and documentation exceptions and of guidelines for approving policy exceptions.
- The appropriateness of credit policies that establish risk limits or positions and whether the bank requires periodic reevaluation.
- The approval of the credit policy by the board or an appropriate committee.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of processes that communicate policies and expectations to appropriate personnel.
- The production of timely, accurate, complete and relevant management information.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of internal control including segregation of duties, dual control, authority commensurate with duties, etc.
- The capabilities of the front- and back-office systems to support current and projected credit operations.

Credit Granting

- The appropriateness of the approval process, marketing campaigns, and delivery channels.
- The thoroughness of the underwriting analysis, including a sensitivity analysis of borrower projections.

- The sufficiency and reliability of methods used to analyze the creditworthiness of counterparties and debt issuers to ensure repayment capacity.
- The quality of analytical resources, such as scoring systems and portfolio models, and the adequacy of their periodic revalidation.

Credit Monitoring

- The adequacy of portfolio management, including the ability to identify, measure, and monitor risk relating to credit structure and concentrations.
- The adequacy of portfolio stress testing, rescoring, and behavioral scoring practices.
- The adequacy of credit analysis, including financial assessment and comparison of projections to actual performance.
- The frequency and reliability of verifying compliance with covenants.
- The accuracy and integrity of internal risk rating processes.

- *Collection Efforts*

- The development and execution of action plans and collection strategies to facilitate timely collection.
- The timely involvement of a specialized collection unit.

ALLL & Accounting Controls

- The method of evaluating and maintaining the allowance for loan and lease losses.
- Compliance with regulatory and accounting guidelines.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, or competitive conditions.

- The understanding of and adherence to the bank’s strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, and independence of the risk review, quality assurance, and internal/external audit functions.
- The effectiveness of quality assurance and audit functions in identifying deficiencies in policy, processes, personnel and internal control.
- The independent use and validation of measurement controls.
- The effectiveness of exception monitoring systems that identify, measure, and track incremental risk exposure by how much (in frequency and amount) the exceptions deviate from policy and established limits, and the adequacy of corrective actions.

Interest Rate Risk

Quantity of Interest Rate Risk

Examiners should consider the following assessment factors when making judgments about the quantity of interest rate risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. These factors are the framework for the ongoing supervisory approach used in large banks. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of interest rate risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Repricing Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The repricing mismatch of assets and liabilities over the short-term and long-term.
- The adequacy of repricing distribution assumptions for nonmaturity deposit balances.
- The vulnerability of earnings and capital to large interest rate changes, such as rate shocks and gradual rate shifts, e.g., a change of 200 basis points over 12 months.
- The presence of over-the-counter and exchange-traded derivatives, such as futures and interest rate swaps, used for rebalancing repricing mismatches.

Basis Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The use of different indexes to price assets and liabilities (e.g., prime, CMT,¹⁰ Libor, and 11th District COFI¹¹) that may change at different times or by different amounts.
- Lagged or asymmetric pricing behavior in bank-managed rates such as the rates on consumer deposits.

¹⁰ Constant Maturity Treasury

¹¹ Cost of Funds Index

- The impact of changes in cash flow and repricing *correlations* between hedging instruments and the positions being hedged.

Yield Curve Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The exposure of on- and off-balance-sheet positions to changes in the yield curve's absolute level and shape (e.g., rising level with flattening slope, falling level with steepening slope, curve inverts, and twists).

Options Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The extent of written (sold) options embedded in assets (e.g., loan and mortgage prepayments, interest rate caps and floors embedded in adjustable rate loans, and callable securities).
- The potential impact of written options embedded in liabilities (e.g., early deposit withdrawals, nonmaturity deposit elasticities, and callable liabilities).
- The volume of over-the-counter and exchange-traded options contracts.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The ability of the funding strategy to tolerate adverse interest rate movements.
- The impact of the bank's overall business strategy on interest rate risk (e.g., entering into new business activities, speculating on the direction and volatility of interest rates, investing in supporting technology).

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The ability to withstand changes in interest rates caused by external factors including, but not limited to, economic conditions, industry conditions, legislative and regulatory changes, market demographics, technological changes, competition, and market conditions.

Quality of Interest Rate Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of interest rate risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. These factors are the framework for the ongoing supervisory approach used in large banks. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of interest rate risk management during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of the interest rate risk policy with the bank's overall strategic direction and tolerance limits.
- The structure of the interest rate risk management function and whether responsibility and accountability are assigned at every level.
- The appropriateness of guidelines that establish risk limits or positions, including requirements for that the guidelines be periodically reassessed.
- The reasonableness of the definitions that guide policy exceptions and guidelines for approving policy exceptions.
- The approval of the interest rate risk policy by the board or an appropriate committee.
- The existence of adequate standards, given the bank's price risk, for validating an independent model.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of processes that communicate policies and expectations to appropriate personnel.
- The production of timely, accurate, complete, and relevant management information.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.

- The appropriateness of the approval process for policy exceptions.
- The adequacy of risk measurement systems to capture material positions and the risks inherent in the positions.
- The extent of clearly defined and reasonable measurement assumptions.
- The adequacy of internal control including segregation of duties, dual control, authority commensurate with duties, etc.
- The sufficiency of periodic stress tests that use scenarios reducing or eliminating profits and the tests' capacity to project accurately the effect of certain conditions.
- An understanding of the vulnerability to limitations or weaknesses of measurement tools.
- The adequacy of the risk measurement process to consider both risk to earnings and risk to capital.
- The extent of consideration given to the impact of changing rates on noninterest income and expenses.
- The flexibility to modify positions in adverse rate environments in a timely manner.
- The reasonableness of responses to changes in market conditions.
- The capabilities of the front- and back-office systems to support current and projected interest rate processes.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, competitive conditions.
- The understanding of and adherence to the bank's strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The effectiveness of control systems to identify and prevent internal control deficiencies.
- The existence of an independent and competent audit function that validates the reliability and effectiveness of models and management processes.
- The independence of risk-monitoring and control functions from the risk-taking function(s).
- The independence and validation of models and other measurement tools and the validity of assumptions.

Liquidity Risk

Quantity of Liquidity Risk

Examiners should consider the following assessment factors when making judgments about the quantity of liquidity risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of liquidity risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Wholesale Liabilities

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume, composition, growth trends, and projections.
- The level of credit sensitivity.
- The level of customer loyalty generated through direct relationship management.
- The tenor, rates paid, collateralization requirements, and use of brokered deposits (greater than \$100,000).

Retail Liabilities

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume, composition, growth trends, and projections.
- The deposit mix and tenor.
- The loyalty and stability of the customer base.
- The use of brokered deposits (of \$100,000 or less).

Diversification

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The extent to which liabilities are diversified by individual funds provider, product, tenor, market area, industry, etc.
- The sufficiency of diversity by marketer, i.e., individual broker or through direct placement.

- The appropriateness of investment objectives or economic influences.
- The extent of asset diversification as evidenced by the variety of loans and investments or other assets that the bank could use to raise funds.

On- and Off-balance-sheet Cash Flows

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The capacity to access additional unsecured market funding
 - In the current environment.
 - In a distressed environment.
- The existence of current and projected securitization activities and associated cash flows, either as a source or potential use of funds including:
 - The extent of reliance on cash flows from securitization activities (i.e., is securitization used occasionally to enhance liquidity or is it “pipeline” financing required for ongoing business?).
 - The existence of concentrations by maturity dates or purchasers.
 - Compliance with covenants.
 - The depth and breadth of secondary markets.
 - The potential for early amortization (use of funds).
- The presence of other off-balance-sheet items which could result in cash flows to or from the balance sheet including:
 - Unused loan commitments.
 - Letters of credit or other contingent liabilities.
 - Collateral requirement agreements.
 - Early liability termination arrangements.
 - Calls, options.

Net Funding Gaps

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume of on- and off-balance-sheet net funding gaps.
- The extent of short- and long-term cash flow gaps in the existing structure.
- The projected growth or depletion of assets and liabilities.
- The extent of dependence on credit-sensitive sources.
- The adequacy of current and projected cash flow projections in normal environments (i.e., day-to-day activities), as well as in significantly

deteriorated environments (usually best demonstrated in the contingency funding plan).

- The ability to cover projected funding gaps when needed in a cost-effective manner.

External and Environmental Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- How external sources of liquidity view the bank’s current and projected:
 - Asset quality, earnings, and capital.
 - Reputation risk, or other credit-sensitive factors that could influence customer behavior.
- The impact of the parent company’s and affiliate’s current and projected:
 - Asset quality, earnings, and capital.
 - Liquidity, especially relating to commercial paper coverage.
 - Reputation risk, strategic risk, or other factors that could influence customer behavior.
- The impact of the external market environment including:
 - Bank rating agency ratings and trends.
 - Relative cost of funds (debt spreads over comparable U.S. Treasury securities, compared with those of competitors).
 - Economic conditions, including job growth, migration, industry concentrations, competition, etc.

Liquid Asset-based Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The relationship of volume and trends in liquid assets compared with volume and trends of liabilities.
- The volume and composition of money market assets such as fed funds sold, Eurodollars placed, and certificates of deposit (CDs) purchased.
- The volume and composition of free securities (e.g., securities unencumbered by pledging and repurchase agreements).
- The amount of depreciation in the free securities holdings.
- The appropriateness of the unit size of free securities to provide for effective use.
- The capacity to enhance liquidity through asset sales or securitization.
- The bank’s experience in asset sales or securitization markets.

Quality of Liquidity Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of liquidity management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of liquidity risk management during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of the liquidity policy with the bank's overall strategic direction and tolerance limits.
- The appropriateness of stated limits.
- The appropriateness of guidelines for diversification and concentrations.
- Whether the policy establishes appropriate responsibilities and accountability at every level.
- The reasonableness of definitions that guide policy exceptions and guidelines for approving policy exceptions.
- The appropriateness of liquidity guidelines that establish risk limits or positions and whether periodic revaluation is required.
- The periodic approval of liquidity policy by the board or senior management.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of the financial planning and management strategy.
- The adequacy of processes communicating policies and expectations to appropriate personnel (starting with the asset-liability committee (ALCO) or similar committee).
- The production of timely, accurate, complete, and relevant management information.

- The depth of contingency funding planning.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of internal control including segregation of duties, dual control, authority commensurate with duties, etc.
- The capabilities of the front- and back-office systems to support current and projected operations.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of the performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel, and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, competitive conditions.
- The understanding of and adherence to the bank's strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The effectiveness of control systems to identify and prevent internal control deficiencies.
- The appropriateness of limits governing balance sheet composition (ratios), cash flow (funding gaps), and diversification (concentrations), as well as the appropriateness of limits on the amount provided by any one source of funds.

- The adequacy of assumptions, scenario definitions, communication channels, and crisis management capabilities within the contingency funding plan.
- The existence of an independent and competent audit function that validates the reliability and effectiveness of models and management processes.
- The independence of risk-monitoring and control functions from the risk-taking function(s).
- The independence and validation of models and other measurement tools, and the validity of assumptions.

Price Risk

Quantity of Price Risk

Examiners should consider the following assessment factors when making judgments about the quantity of price risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of price risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Volume of Open Positions

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The level of open positions expressed as earnings and/or capital at risk.
- The size of illiquid positions.

Market Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The price sensitivity to various market factors (e.g., foreign exchange, interest rates, equity, or commodity prices) in portfolios without options (linear portfolios).

Options Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The existence of nonlinear price sensitivity to changes in market factors.
- The existence of discontinuous option exposure (e.g., the exposure arising from path-dependent options).

Basis Risk

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume of potential exposure caused by a change in the correlation between two prices (e.g., when the price of a derivative instrument and the price of its hedged asset do not move in tandem).

Concentration of Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The level and diversification among products or types of products.
- The existence of concentrations in market factors (e.g., option strike prices).

Product Liquidity

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume of readily marketable products that generally can be liquidated or hedged within a reasonable time frame.
- The volume of illiquid products whose prices may decline because managers need a relatively long time to liquidate or effectively hedge them.

Stability of Trading Revenue

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- Revenue derived from customer-initiated trades in proportion to revenue derived from proprietary trading activity.

Quality of Price Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of price risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of price risk management during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of the price risk policy with the bank's overall strategic direction and tolerance limits.

- The structure of the risk-taking operation and whether responsibility and accountability are assigned at every level.
- The reasonableness of the definitions that guide policy exceptions and guidelines for approving policy exceptions.
- The appropriateness of price risk guidelines that establish limits or positions and whether periodic revaluation is required.
- The approval of the price risk policy by the board or an appropriate committee.
- The existence of adequate standards for independent model validation given the bank's price risk.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of risk measurement systems to capture material positions and the risks inherent in the positions.
- The adequacy of processes that communicate policies and expectations to appropriate personnel.
- The production of timely, accurate, complete, and relevant management information.
- The comprehensiveness of the strategic planning process.
- The adequacy of process controls over new product and systems development.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of trading management oversight (i.e., approving and monitoring compliance with limits, communicating policies and expectations to appropriate personnel).
- The adequacy of independent measurement and analysis of risk under a variety of scenarios, including stress tests.
- The adequacy of the models used for testing revenue vulnerability under probable and stress test scenarios.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of the internal control for trading operations (front- and back-office) including segregation of duties, dual control, authority commensurate with duties, etc.
- The capabilities of the front- and back-office systems to support current and projected trading operations.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel, and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, or competitive conditions.
- The understanding of and adherence to the bank's strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The adequacy and independence of validations processes for trading models and methods.
- The frequency and reliability of revaluations of individual position-taking.
- The potential exposure to trading losses as measured under normal and adverse scenarios.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The responsiveness of control systems to prevent and respond to internal control deficiencies.
- The existence of an independent and competent audit function that validates the reliability and effectiveness of models and management processes.
- The independence of risk-monitoring and control functions from the risk-taking function(s).
- The independence and validation of models and other measurement tools, and the validity of assumptions.

Foreign Currency Translation Risk

Quantity of Foreign Currency Translation Risk

Examiners should consider the following assessment factors when making judgments about the quantity of foreign currency translation risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of foreign currency translation risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Is there a material amount of capital at risk from foreign currency translation?

Yes No If no, skip this section and go to quality of foreign currency translation risk management.

Structural Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The level of capital subject to revaluation from currency translation requirements.
- The potential volatility of capital ratios from translating accounts denominated in other currencies to their dollar equivalent, including an analysis of recent trends and projections.
- The extent of exposure to foreign currency translation risk considering:
 - The volume and stability of the portfolio.
 - The level of income items denominated in foreign currencies (e.g., revenues and expenses).
 - The mismatching of assets and liabilities denominated in a foreign currency.
 - The types of products held in foreign currency accounts (e.g., loans, bonds, and derivatives).
 - The volume of sovereign issuances compared with privately backed issues.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The effectiveness of hedging activities to control exposure to translation risk by:
 - Matching of foreign asset and liability cash flows.
 - Hedging projected income.
 - Using financial contracts (futures, options, etc.).
- The volume and tenor of foreign currency/U.S.-dollar mismatches.
- The volume and tenor of cross-currency (not involving dollar-denominated items) mismatches.
- The vulnerability to the true economic value of the hedging instrument.
- The impact of changes in business strategies.
- The volume, nature, and extent of the financial institution's risk exposure in the area of systems development and acquisition.

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The exposure to market volatility or other external factors such as economic conditions, legislative changes, technological changes, and competition.

Quality of Foreign Currency Translation Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of foreign currency translation risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of foreign currency translation risk management during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of policies with the bank's overall strategic direction and tolerance limits.
- The appropriateness of policies to address hedging requirements and standards.
- The adequacy of policies to address the appropriateness and use of monitoring systems.
- The existence of standards that detail the results expected from hedging activities.
- The structure of the foreign currency translation risk operation and whether responsibility and accountability is assigned at all levels.
- The reasonableness of the definitions that guide policy exceptions and guidelines for approving policy exceptions.
- The appropriateness of guidelines that establish risk limits or positions, including periodic reassessment.
- The reasonableness of exposure limits defined within policies.
- The approval of a policy for foreign currency translation activities by the board or an appropriate committee.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of processes that communicate policies and expectations to appropriate personnel.
- The production of timely, accurate, complete, and relevant management information.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of the internal control for hedging operations (front- and back-office), including segregation of duties, dual control, authority commensurate with duties, etc.
- The capabilities of the front- and back-office systems to support current and projected foreign-currency-denominated activities.
- The adequacy of independent measurement and analysis of risk under a variety of scenarios, including stress tests.

- The appropriateness of management's and the board's oversight and responsiveness (i.e., approving and monitoring compliance with limits, communicating policies and expectations to appropriate personnel).

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel, and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, or competitive conditions.
- The understanding of and adherence to the bank's strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The responsiveness of control systems to prevent and respond to internal control deficiencies.
- The existence of an independent and competent audit function that validates the reliability and effectiveness of models and management processes.
- The independence of risk-monitoring and control functions from the risk-taking function(s).
- The independence and validation of models and other measurement tools.
- The existence of systems that test the reasonableness and the validity of assumptions.

Transaction Risk

Quantity of Transaction Risk

Examiners should consider the following assessment factors when making judgments about the quantity of transaction risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of transaction risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Structural Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume, type, and complexity of transactions, products, and services offered through the bank.
- The condition, security, capacity, and recoverability of systems.
- The complexity and volume of conversions, integrations, and system changes.
- The development of new markets, products, services, technology, and delivery systems to maintain competitive position and gain strategic advantage.
- The volume and severity of operational, administrative, and accounting control exceptions and losses from fraud and operating errors.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The impact of strategy, including marketing plans and the development of new markets, products, services, technology, and delivery systems.
- The impact of acquisition and divestiture strategies.
- The maintenance of an appropriate balance between technology innovation and secure operations.

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The impact of external factors including economic, industry, competitive, and market conditions; legislative and regulatory changes; and technological advancement.
- The impact of infrastructure threats on the bank's ability to deliver timely support and service.
- The ability of service providers to provide and maintain performance that meets the requirements of the bank.

Quality of Transaction Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of transaction risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of transaction risk management during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The consistency of policies with the bank's overall strategic direction and throughout the organization.
- The structure of the bank's operations and whether responsibility and accountability are assigned at every level.
- The reasonableness of definitions that guide policy exceptions.
- The periodic review and approval of policies by the board or an appropriate committee.
- The appropriateness of guidelines that establish risk limits or positions and whether periodic revaluation is required.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of processes that communicate policies and expectations to appropriate personnel.
- The production of timely, accurate, complete, and relevant management information.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of internal control including segregation of duties, dual control, authority commensurate with duties, etc.
- Management's responsiveness to regulatory, industry, and technology changes.
- The incorporation of project management into daily operations (e.g., systems development, capacity planning, change control, due diligence, and outsourcing).
- The adequacy of processes defining the systems architecture for transaction processing and for delivering products and services.
- The effectiveness of processes developed to ensure the integrity and security of systems and the independence of operating staff.
- The adequacy of system documentation.
- The adequacy of processes to ensure the reliability and retention of information, (i.e., data creation, processing, storage, and delivery).
- The quality of physical and logical security to protect the confidentiality of consumer and corporate information.
- The capabilities of the front- and back-office systems to support current and projected operations.
- The adequacy of corporate contingency planning and business resumption for relevant data centers, file servers, PCs, networks, service providers and business units.
- The adequacy of contracts and management's ability to monitor relationships with third-party servicers.
- The development of information technology solutions that meet the needs of end users.
- The capacity to deliver timely services and to respond rapidly to normal service interruptions or to attacks and intrusions from external sources.

- The appropriateness of risk measurement systems for the nature and complexity of activities, and how these systems are incorporated into the decision-making process.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to identified deficiencies in policies, processes, personnel, and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The ability of managers to implement new products, services, and systems in response to changing business, economic, or competitive conditions.
- The understanding of and adherence to the strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The effectiveness of exception monitoring systems that identify, measure, and track incremental risk exposure by how much (in frequency and amount) the exceptions deviate from policy and established limits, and the adequacy of corrective actions.
- The independent testing of processes to ensure ongoing reliability and integrity (e.g., Internet penetration testing).
- The adequacy of systems to monitor capacity and performance.
- The adequacy of controls over new product and systems development.

Compliance Risk

Quantity of Compliance Risk

Examiners should consider the following assessment factors when making judgments about the quantity of compliance risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quantity of compliance risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Business Activity

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The nature and extent of business activities, including new products and services.

Noncompliance

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume and significance of noncompliance and nonconformance with policies and procedures, laws, regulations, prescribed practices, and ethical standards.

Litigation

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The amount and significance of litigation and customer complaints.

Quality of Compliance Risk Management

Examiners should consider the following assessment factors when making judgments about the quality of compliance risk management. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor the quality of compliance risk management during every 12-month cycle to ensure quality supervision.

Examiners are required to judge, based on the review of the core assessment factors, whether the risk management is strong, satisfactory, or weak.

Policies

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The appropriateness of established policies and risk limits.
- The consistency of policies with the banks’ overall strategic direction.
- The structure of the compliance operation and whether responsibility and accountability are assigned at every level.
- The reasonableness of definitions that determine policy exceptions and guidelines for approving policy exceptions.
- The periodic approval of compliance policies by the board or an appropriate committee.

Processes

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The adequacy of processes communicating policies and expectations and changes to such policies and expectations to appropriate personnel.
- The production of timely, accurate, complete, and relevant management information, including information on consumer complaints.
- The adequacy of processes and systems to approve, monitor, and report on compliance with policy.
- The appropriateness of the approval process for policy exceptions.
- The adequacy of internal control including segregation of duties, dual control, authority commensurate with duties, etc.
- The capabilities of the front- and back-office systems to support current and projected operations.
- The adequacy of processes assimilating legislative and regulatory changes into all aspects of the company.
- The adequacy of the budget to ensure that appropriate resources are allocated to training and compliance.
- The extent to which violations, noncompliance or weaknesses in the compliance management system are identified internally and corrected.
- The adequacy of integrating compliance considerations into all phases of corporate planning, including the development of new products and services.

Personnel

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The depth of technical and managerial expertise.
- The appropriateness of performance management and compensation programs.
- The appropriateness of management's response to deficiencies identified in policies, processes, personnel, and control systems.
- The level of turnover of critical staff.
- The adequacy of training.
- The adequacy of employee screening processes.
- The understanding of and adherence to the bank's strategic direction and risk tolerance as defined by senior management and the board.

Control Systems

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The timeliness, accuracy, completeness, and relevance of management information systems, reports, monitoring, and control functions.
- The scope, frequency, effectiveness, and independence of the risk review, quality assurance, and internal/external audit functions.
- The independent use and validation of measurement tools.
- The effectiveness of exception monitoring systems that identify, measure, and track incremental risk exposure by how much (in frequency and amount) the exceptions deviate from policy and established limits, and the adequacy of corrective actions.

Strategic Risk

Examiners should consider the following assessment factors when making judgments about the aggregate strategic risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor a bank's strategic risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The magnitude of change in established corporate mission, goals, culture, values, or risk tolerance.
- The financial objectives as they relate to the short- and long-term goals of the bank.
- The market situation, including product, customer demographics, and geographic position.
- Diversification by product, geography, and customer demographics.
- Past performance in offering new products and services.
- Risk of implementing innovative or unproven products, services, or technologies.
- Merger and acquisition plans and opportunities.
- Potential or planned entrance into new businesses, product lines, or delivery channels, or implementation of new systems.

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The impact of economic, industry, and market conditions; legislative and regulatory change; technological advances; and competition.

Management, Processes, and Systems

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The expertise of senior management and the effectiveness of the board of directors.

- The priority and compatibility of personnel, technology, and capital resources allocation with strategic initiatives.
- Past performance in offering new products or services and evaluating potential and consummated acquisitions.
- Performance in implementing new technology or systems.
- The effectiveness of management's methods of communicating, implementing, and modifying strategic plans, and consistency with stated risk tolerance and policies.
- The adequacy and independence of controls to monitor business decisions.
- The responsiveness to identified deficiencies in internal control.
- The quality, integrity, timeliness, and relevance of reports to the board of directors necessary to oversee strategic decisions.
- The ability to manage fair lending, community reinvestment, and compliance issues in conjunction with strategic initiatives.

Reputation Risk

Examiners should consider the following assessment factors when making judgments about the aggregate reputation risk. These factors are the minimum **standards** that all examiners will consider when completing a risk assessment. At a minimum, using the standards as a guide, examiners should review, analyze, and monitor a bank's reputation risk during every 12-month cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the risk is low, moderate, or high.

Strategic Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The volume and types of assets and number of accounts under management or administration.
- Merger and acquisition plans and opportunities.
- Potential or planned entrance into new businesses, product lines, or technologies (including new delivery channels), particularly those that may test legal boundaries.

External Factors

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- The market's or public's perception of the corporate mission, culture, and risk tolerance of the bank.
- The market's or public's perception of the bank's financial stability.
- The market's or public's perception of the quality of products and services offered by the bank.
- The impact of economic, industry, and market conditions; legislative and regulatory change; technological advances; and competition.

Management, Processes, and Systems

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- Past performance in offering new products or services and in conducting due diligence prior to startup.
- Past performance in developing or implementing new technologies and systems.

- The nature and amount of litigation and customer complaints.
- The expertise of senior management and the effectiveness of the board of directors in maintaining an ethical, self-policing culture.
- Management's willingness and ability to adjust strategies based on regulatory changes, market disruptions, market or public perception, and legal losses.
- The quality and integrity of management information systems and the development of expanded or newly integrated systems.
- The adequacy and independence of controls used to monitor business decisions.
- The responsiveness to deficiencies in internal control.
- The ability to minimize exposure from litigation and customer complaints.
- The ability to communicate effectively with the market, public, and media.
- Policies, practices, and systems protecting information consumers might consider private or confidential from deliberate or accidental disclosure.
- Management's responsiveness to internal, external, and regulatory review findings.

Internal Control

Examiners should consider the following assessment factors when making judgments about internal control. These factors are the minimum **standards** that all examiners will consider during every 12-month supervisory cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether internal control is strong, satisfactory, or weak.

Control Environment

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- The integrity, ethical values, and competence of personnel.
- The organizational structure of the bank.
- Management’s philosophy and operating style (i.e., strategic philosophy).
- External influences affecting operations and practices (e.g., independent audits, regulatory environment, and competitive and business markets).
- Methods of assigning authority and responsibility and of organizing and developing people.
- The attention and direction provided by the board of directors and its committees, especially the audit and risk management committees.

Risk Assessment

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- Assessment of external and internal factors that could affect whether strategic objectives are achieved.
- Identification and analysis of risks.
- The systems used to manage and monitor the risks.
- Processes that react and respond to changing risk conditions.
- The competency, knowledge, and skills of personnel responsible for risk assessment.

Control Activities

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- Policies and procedures established to ensure control processes are carried out.

- Reviews of operating activities.
- Approvals and authorization for transactions and activities.
- Segregation of duties.
- Vacation requirements or periodic rotation of duties for personnel in sensitive positions.
- Safeguarding access to, and use of, sensitive assets, records, and systems.
- Independent checks or verifications on function performance and reconciliation of balances.
- Accountability.

Accounting, Information, and Communication

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- Management information systems that identify and capture relevant internal and external information in a timely manner.
- Accounting systems that ensure accountability for related assets and liabilities.
- Information systems that ensure effective communication of positions and activities.
- Contingency planning for information systems.

Self-assessment and Monitoring

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- Periodic evaluation of internal control whether by self-assessment or independent audit.
- Systems to ensure timely and accurate reporting of deficiencies.
- Processes to ensure timely modification of policies and procedures, as needed.

After considering the above factors, the overall system of internal control is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

Audit

Objective: To determine the adequacy of internal and external audit programs for the purpose of determining an overall audit program rating.

Note: These procedures are minimums that examiners should perform during each bank's supervisory cycle. Examiners should use expanded procedures,¹² including verification procedures where significant control concerns are evident, in areas of greater complexity and/or higher risk profiles. Internal audit may be a department of the bank or holding company, or an outsourced function.

1. Evaluate the effectiveness of the audit committee and overall audit processes relative to the company's size and risk profile. Consider all of the following:
 - The corporate culture and commitment to the audit function supporting an effective control environment.
 - Internal audit's integration of risk assessments into the development and execution of an audit plan approved by the audit committee.
 - Independence of internal audit and the overall adequacy of the internal audit staff.
 - The audit committee's understanding of and compliance with its statutory duties and responsibilities pertaining to external audit's processes/procedures, conclusions/findings, and reporting regarding the company's financial reporting control systems.
2. Review the composition and qualifications of the company's audit committee to ensure compliance with regulatory requirements.
3. Evaluate the effectiveness of internal audit reporting to the audit committee:

¹² Expanded procedures should be drawn from "Internal and External Audits" and other booklets of the *Comptroller's Handbook*. Internal control questionnaires and verification procedures for all examination areas can be found on the "Examiner's Library" and "e files" CDs.

- Determine whether sufficient information is provided from the internal audit program to the audit committee so that the committee understands issues and can ensure that management takes necessary actions.
 - Review the effectiveness of the internal audit program's exception/correction-tracking system used to monitor and report significant control findings from all sources and to report on the status/adequacy of corrective actions to the audit committee.
 - Review exception/correction-tracking system for systemic issues or trends that could affect the OCC's supervisory plans.
4. During functional reviews of significant, high-risk, or new lines of business, examiners should evaluate the internal audit program's scope, frequency, and findings in the related area. They should:
- Review a sufficient variety of the internal audit program's supporting work paper documentation to confirm that audit coverage and scope is adequate to assess the internal control environment in the audited unit.
 - Determine that internal audit conclusions are consistent with the supporting documentation and analysis.
5. Consider OCC's evaluation of the internal audit program's reliability in developing the supervisory strategy for the company.
6. Review and evaluate the company's external audit program for regulatory significance and board and audit committee oversight by doing the following:
- Determine whether the company appropriately oversees its external audit program, addresses external audit program findings in an adequate and timely manner, and considers the effect of external audit program findings on its overall current and future audit plans.

- Obtain from the audit committee the external auditor's required annual disclosures to the audit committee.¹³ Determine what relationships, including non-audit services the external auditor provides in addition to statutory financial statement audit and attestation requirements, are disclosed and whether the external auditor confirms that it is independent of the company.
- Discuss with the external auditor how it ensures that its employees who are responsible for auditing the bank do not have relationships that compromise their independence. Discuss the external auditor's communication with the audit committee on independence issues.
- Discuss any preliminary concerns about the external auditor's independence with the appropriate level of bank management and the external auditor. If warranted, contact the Chief Accountant's office before discussing any adverse conclusions or recommendations about independence concerns with the audit committee or external auditor.
- Discuss with the external auditor its approach to assessing risk and substantive testing of transactions and financial reporting controls.
- Review reports issued to management and/or the audit committee by the external auditor, including the audit opinion on the financial statements and attestation on internal controls over financial reporting, for significance and possible impact on OCC strategies, bank ratings, and risk assessments.
- Establish regular communication channels with bank management and the external auditor to maintain an understanding of the company's plans for use of external audit services and the external auditor's on-going audit plans and findings.

¹³ Independence Standards Board Standard No.1, "Independence Discussions with Audit Committees," requires at least annually, such an external auditor to a) disclose to the audit committee of the company (or the board of directors if there is no audit committee), in writing, all relationships between the auditor and its related entities and the company and its related entities that in the auditor's professional judgement may reasonably be thought to bear on independence; b) confirm in the letter that, in its professional judgement, it is independent of the company within the meaning of the acts; and c) discuss the auditor's independence with the audit committee.

7. Incorporate the OCC's overall findings/conclusions regarding audit as a part of the M rating in CAMELS and the company's risk assessment profile. Include comments about audit findings/conclusions in the annual report of examination and other written communications to the bank.

CAMELS

Examiners should consider the assessment factors listed below when making judgments about CAMELS. These factors are the minimum **standards** that all examiners will consider during the course of a 12-month supervisory cycle to ensure quality supervision. Examiners are required to judge, based on the review of the core assessment factors, whether the component is rated 1, 2, 3, 4, or 5.¹⁴

| | 1 | 2 | 3 | 4 | 5 |
|----------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Capital | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- The level and quality of capital and the overall financial condition of the institution.
- The ability of management to address emerging needs for additional capital.
- The nature, trend, and volume of problem assets and the adequacy of allowances for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.
- Risk exposure represented by off-balance-sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.
- Access to capital markets and other sources of capital, including support provided by a parent holding company.

| | 1 | 2 | 3 | 4 | 5 |
|----------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Asset Quality | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- The adequacy of underwriting standards, soundness of credit administration practices, and appropriateness of risk identification practices.

¹⁴ The factors are extracted from the "Bank Supervision Process" booklet of the *Comptroller's Handbook* and reflect guidance in the Uniform Financial Institutions Rating System.

- The level, distribution, severity, and trend of problem, classified, nonaccrual, restructured, delinquent, and nonperforming assets for both on- and off-balance-sheet transactions.
- The adequacy of the allowance for loan and lease losses and other asset valuation reserves.
- The credit risk arising from or reduced by off-balance-sheet transactions, such as unfunded commitments, credit derivatives, commercial and standby letters of credit, and lines of credit.
- The diversification and quality of the loan and investment portfolios.
- The extent of securities underwriting activities and exposure to counterparties in trading activities.
- The existence of asset concentrations.
- The adequacy of loan and investment policies, procedures, and practices.
- The ability of management to properly administer its assets, including the timely identification and collection of problem assets.
- The adequacy of internal control and management information systems.
- The volume and nature of credit documentation exceptions.

| | | | | | |
|-------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | 1 | 2 | 3 | 4 | 5 |
| Management | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- Conclusions from all examination areas.
- The level and quality of oversight and support of all institution activities by the board of directors and management.
- The ability of the board of directors and management, in their respective roles, to plan for and respond to risks that may arise from changing business conditions or the initiation of new activities or products.
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities.
- The accuracy, timeliness, and effectiveness of management information and risk-monitoring systems appropriate for the institution's size, complexity, and risk profile.
- The adequacy of audits and internal control to promote effective operations and reliable financial and regulatory reporting, to safeguard assets, and to ensure compliance with laws, regulations, and internal policies.
- Compliance with laws and regulations.
- Responsiveness to recommendations from auditors and supervisory authorities.

- Management depth and succession.
- The extent to which the board of directors and management is affected by, or susceptible to, a dominant influence or a concentration of authority.
- Reasonableness of compensation policies and avoidance of self-dealing.
- Demonstrated willingness to serve the legitimate banking needs of the community.
- The overall performance of the institution and its risk profile.

| | | | | | |
|-----------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | 1 | 2 | 3 | 4 | 5 |
| Earnings | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- The level of earnings, including trends and stability.
- The ability to provide for adequate capital through retained earnings.
- The quality and sources of earnings.
- The level of expenses in relation to operations.
- The adequacy of the budgeting systems, forecasting processes, and management information systems in general.
- The adequacy of provisions to maintain the allowance for loan and lease losses and other valuation allowance accounts.
- The earnings exposure to market risk such as interest rate, foreign currency translation, and price risks.

| | | | | | |
|------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | 1 | 2 | 3 | 4 | 5 |
| Liquidity | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- The adequacy of liquidity sources compared with present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition.
- The availability of assets readily convertible to cash without undue loss.
- Access to money markets and other sources of funding.
- The level of diversification of funding sources, both on- and off-balance-sheet.
- The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer term assets.
- The trend and stability of deposits.
- The ability to securitize and sell certain pools of assets.
- The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, including the effectiveness of

funds management strategies, liquidity policies, management information systems, and contingency funding plans.

| | 1 | 2 | 3 | 4 | 5 |
|-----------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Sensitivity to Market Risk | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, commodity prices, or equity prices.
- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.
- The nature and complexity of interest rate risk exposure arising from nontrading positions.
- When appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

| | 1 | 2 | 3 | 4 | 5 |
|-------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Composite Rating | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Risk Assessment System

Credit Risk

Credit risk is the current and prospective risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with the bank or otherwise to perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of credit risk, the quality of credit risk management, the aggregate credit risk, and the direction of change. Although examiners normally will not need to complete in full the core assessment quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of credit risk and the quality of credit risk management to derive the following conclusions.

Aggregate credit risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
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Quantity of Credit Risk

Examiners should use the following definitions to determine the quantity of credit risk. It is not necessary to exhibit every characteristic to be accorded a specific rating.

The quantity of credit risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — Current or prospective exposure to loss of earnings or capital is minimal. Credit exposures reflect conservative structure or marketing initiatives. The volume of substantive exceptions or overrides to sound underwriting standards poses minimal risk. Exposures represent a well-diversified distribution by investment grade (or equivalently strong nonrated borrowers) and borrower leverage. Borrowers operate in stable markets and industries. Risk of loss from concentrations is minimal. Limited sensitivity exists due to deteriorating economic, industry, competitive, regulatory, and technological factors. The bank’s compensation is adequate to justify the risk being assumed. Portfolio growth presents no concerns. The volume of troubled credits is low relative to capital and can be resolved in the normal course of business. Credit-related losses do not meaningfully impact current reserves and result in modest provisions relative to earnings.
- **Moderate** — Current or prospective exposure to loss of earnings or capital does not materially impact financial condition. Credit exposures reflect acceptable underwriting or marketing initiatives. Substantive exceptions or overrides to sound underwriting standards may exist, but do not pose advanced risk. Exposures may include noninvestment grade (or equivalently strong nonrated borrowers) or leveraged borrowers, but borrowers typically operate in less volatile markets and industries. Exposure does not reflect significant concentrations. Vulnerability may exist due to deteriorating economic, industry, competitive, regulatory, and technological factors. The bank’s compensation is adequate to justify the risk being assumed. While advanced portfolio growth may exist within specific products or sectors, it is in accordance with a reasonable plan. The volume of troubled credits does not pose undue risk relative to capital and can be resolved within realistic time frames. Credit-related losses do

not seriously deplete current reserves or necessitate large provisions relative to earnings.

- **High** — Current or prospective exposure to loss of earnings or capital is material. Credit exposures reflect aggressive underwriting or marketing initiatives. A large volume of substantive exceptions or overrides to sound underwriting standards exists. Exposures are skewed toward noninvestment grade (or equivalently strong nonrated borrowers) or highly leveraged borrowers, or borrowers operating in volatile markets and industries. Exposure reflects significant concentrations. Significant vulnerability exists due to deteriorating economic, industry, competitive, regulatory, and technological factors. The bank’s compensation is inadequate to justify the risk being assumed. Portfolio growth, including products or sectors within the portfolio, is aggressive. The volume of troubled credits may be large relative to capital and may require an extended time to resolve. Credit-related losses may seriously deplete current reserves or necessitate large provisions relative to earnings.

Quality of Credit Risk Management

Examiners should use the following definitions to determine the quality of credit risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of credit risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — The credit policy function comprehensively defines risk tolerance, responsibilities, and accountabilities. All aspects of credit policies are effectively communicated. The credit culture, including compensation, strikes an appropriate balance between marketing and credit considerations. The credit granting process is extensively defined, well understood and adhered to consistently. Credit analysis is thorough and timely. Risk measurement and monitoring systems are comprehensive and allow management to proactively implement appropriate actions in response to changes in asset quality and market conditions. Information processes (manual and/or automated) are fully appropriate for the volume and complexity of activity. Any weaknesses are minor, with potential for

nominal impact to earnings or capital. MIS produced by these information processes are accurate, timely, and complete, providing relevant information necessary for sound management decisions. Credit administration is effective. Management identifies and actively manages portfolio risk, including the risk relating to credit structure and concentrations. The ALLL method is well-defined, objective and clearly supports adequacy of current reserve levels. Personnel possess extensive technical and managerial expertise. Internal control is comprehensive and effective. The stature, quality, and independence of internal loan review and audit support highly effective control systems.

- **Satisfactory** — The credit policy function satisfactorily defines risk tolerance, responsibilities, and accountabilities. Key aspects of credit policies are effectively communicated. The credit culture, including compensation, appropriately balances marketing and credit considerations. The credit granting process is well-defined and understood. Credit analysis is adequate. Risk measurement and monitoring systems permit management to capably respond to changes in asset quality or market conditions. Information processes (manual and/or automated) are adequate for the volume and complexity of activity. MIS produced by these processes contain weaknesses in accuracy, timeliness, completeness, or relevance. Weaknesses in information processes (including resulting MIS) are not so significant that they lead management to decisions that materially impact earnings or capital. Internal grading and reporting accurately stratifies portfolio quality. Credit administration is adequate. Management identifies and monitors portfolio risk, including the risk relating to credit structure. Management's attention to credit risk diversification is adequate. The ALLL method is satisfactory and results in sufficient coverage of inherent credit losses. Personnel possess requisite technical and managerial expertise. Key internal control is in place and effective. The stature, quality, and independence of internal loan review and audit are appropriate.
- **Weak** — The credit policy function may not effectively define risk tolerance, responsibilities, and accountabilities. Credit policies are not effectively communicated. The credit culture, including compensation, overemphasizes marketing relative to credit considerations. The credit granting process is not well-defined or not well understood. Credit analysis is insufficient relative to the risk. Risk measurement and

monitoring systems may not permit management to implement timely and appropriate actions in response to changes in asset quality or market conditions. Information processes (manual and/or automated) are inappropriate for the volume and complexity of activity. MIS produced by these processes are inaccurate, untimely, incomplete, or insufficient to make sound management decisions. Weaknesses in information processes (including resulting MIS) can lead management to decisions that materially impact earnings or capital. Internal grading and reporting of credit exposure does not accurately stratify the portfolio's quality. Credit administration is ineffective. Management is unable to identify and monitor portfolio risk, including the risk relating to credit structure. Management's attention to credit risk diversification is inadequate. The ALLL method is flawed and may result in insufficient coverage of inherent credit losses. Personnel lack requisite technical and managerial expertise. Key internal control may be absent or ineffective. The stature, quality, or independence of internal loan review and/or audit is lacking.

Interest Rate Risk

Interest rate risk is the current and prospective risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among different yield curves affecting bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-related options embedded in bank products (options risk).

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of interest rate risk, the quality of interest rate risk management, the aggregate interest rate risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of interest rate risk and the quality of interest rate risk management to derive the following conclusions.

Aggregate interest rate risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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|---|
| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
|---|

Quantity of Interest Rate Risk

Examiners should use the following definitions to determine the quantity of interest rate risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of interest rate risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — Exposure reflects minimal repricing, basis, yield curve, and options risk. Positions used to manage interest rate risk exposure are well correlated to underlying risks. No significant mismatches on longer-term positions exist. The current or future volatility of earnings and capital is relatively insensitive to changes in interest rates or the exercise of options. Interest rate movements will have minimal adverse impact on the earnings and capital of the bank.
- **Moderate** — Exposure reflects manageable repricing, basis, yield curve, and options risk. Positions used to manage interest rate risk exposure are somewhat correlated. Mismatches on longer-term positions are managed. The volatility in earnings or capital is not significantly effected by changes in interest rates or the exercise of options. Interest rate movements will not have a significant adverse impact on the earnings and capital of the bank.
- **High** — Exposure reflects significant repricing, basis, yield curve, or options risk. Positions used to manage interest rate risk exposure are poorly correlated. Significant mismatches on longer-term positions exist. Current or future volatility in earnings or capital due to changes in interest rates or the exercise of options is substantial. Interest rate movements could have a significant adverse impact on the earnings and capital of the bank.

Quality of Interest Rate Risk Management

Examiners should use the following definitions to determine the quality of interest rate risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of interest rate risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — Management fully understands all aspects of interest rate risk management from the earnings and economic perspectives, as appropriate. Discretionary risk positions are effectively measured and controlled. Management anticipates and quickly responds to changes in market conditions. Interest rate risk is well-understood at all appropriate levels of the organization. The interest rate risk management process is effective and proactive. Information processes (manual and/or automated) are fully appropriate for the volume and complexity of activity. Any weaknesses are minor, with potential for nominal impact to earnings or capital. MIS produced by these information processes are accurate, timely, and complete, with relevant information necessary for sound management decisions. Limit structures provide clear parameters for risk to earnings and capital under normal and adverse scenarios. The design and supporting technology of risk measurement tools, including models, are fully appropriate for the size and complexity of activity. Assumptions, software logic, and data input are documented, and independently validated and tested to ensure the measurement tools can accurately measure risks. Staff responsible for measuring exposures and monitoring risk limits are independent from staff executing risk-taking decisions.
- **Satisfactory** — Management reasonably understands the key aspects of interest rate risk management from the earnings and economic perspectives, as appropriate. Discretionary risk positions are properly measured and controlled. Management adequately responds to changes in market conditions. Knowledge of interest rate risk exists at appropriate levels throughout the organization. The interest rate risk management process is adequate. Information processes (manual and/or automated) are adequate for the volume and complexity of activity. MIS produced by these processes may contain weaknesses in accuracy, timeliness, completeness, or relevance. Weaknesses in information processes (including resulting MIS) are not so significant that they lead management to decisions that materially impact earnings or capital. Limit structures are reasonable and sufficient to control the risk to earnings and capital under normal and adverse interest rate scenarios. The design and supporting

technology of risk measurement tools, including models, are adequate for the size and complexity of activity. Assumptions, software logic and data input are documented, and independently validated and tested, but the measurement tools provide only a reasonable approximation of risks. Weaknesses are not so significant that they lead management to decisions that materially impact earnings or capital. Staff responsible for measuring exposures and monitoring risk are independent from staff executing risk-taking decisions.

- **Weak** — Management may not satisfactorily understand interest rate risk management from the earnings or economic perspective. Discretionary risk positions are not adequately measured or controlled. Management does not take timely or appropriate actions in response to changes in market conditions. Knowledge of interest rate risk may be lacking at appropriate management levels throughout the organization. The interest rate risk management process is deficient, given the relative size and complexity of the bank's on- and off-balance-sheet exposures. Information processes (manual and/or automated) are inappropriate for the volume and complexity of activity. MIS produced by these processes are inaccurate, untimely, incomplete, or insufficient to make sound management decisions. Weaknesses in information processes (including resulting MIS) can lead management to decisions that materially impact earnings or capital. Limit structures are not reasonable, or do not reflect an understanding of the risks to earnings and capital under normal and adverse scenarios. The design and supporting technology of risk measurement tools, including models, are inappropriate for the size and complexity of activity. Risk measurement validation or testing is either not performed or seriously flawed. Risks are inaccurately measured, impairing the ability of management to make sound decisions. The potential impact to earnings or capital can be material. Staff responsible for measuring exposures and monitoring risk are not independent from staff executing risk-taking decisions.

Liquidity Risk

Liquidity risk is the current and prospective risk to earnings or capital arising from a bank's inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of liquidity risk, the quality of liquidity risk management, the aggregate liquidity risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of liquidity risk and the quality of liquidity risk management to derive the following conclusions.

Aggregate liquidity risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

| |
|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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|---|
| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
|---|

Quantity of Liquidity Risk

Examiners should use the following definitions to determine the quantity of liquidity risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of liquidity risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — The bank is not vulnerable to funding difficulties should a material adverse change in market perception occur. Earnings and capital exposure from the liquidity risk profile is negligible. Sources of deposits and borrowings are widely diversified, with no material concentrations. Ample funding sources and structural cash flow symmetry exist in all tenors. Stable deposits and a strong market acceptance of the bank's name offers the bank a competitive liability cost advantage. Management has identified reasonable alternatives to credit-sensitive funding, if relied upon, and can easily implement the alternatives with no disruption in strategic lines of business.
- **Moderate** — The bank is not excessively vulnerable to funding difficulties should a material adverse change in market perception occur. Earnings or capital exposure from the liquidity risk profile is manageable. Sources of funding are reasonably diverse but minor concentrations may exist, and funds providers may be moderately credit sensitive. Some groups of providers may share common investment objectives or be subject to similar economic influences. Sufficient funding sources, and structural balance sheet and cash flow symmetry exist to provide stable, cost-effective liquidity in most environments, without significant disruption in strategic lines of business.
- **High** — The bank's liquidity profile makes it vulnerable to funding difficulties should a material adverse change occur. Significant concentrations of funding may exist, or there may be a significant volume of providers that are highly credit-sensitive. Large funds providers may share common investment objectives or be subject to similar economic influences. The bank may currently, or potentially, experience market resistance, which could impact its ability to access needed funds at a

reasonable cost. There may be an increasing demand for liquidity with declining medium- and long-term alternatives. Funding sources and balance sheet structures may currently result in, or suggest, potential difficulty in sustaining long-term liquidity on a cost-effective basis. Potential exposure to loss of earnings or capital due to high liability costs or unplanned asset reduction may be substantial. Liquidity needs may trigger the necessity for funding alternatives under a contingency funding plan, including the sale of, or disruption in, a strategic line of business.

Quality of Liquidity Risk Management

Examiners should use the following definitions to determine the quality of liquidity risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of liquidity risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- Strong** — Management proactively incorporates all key aspects of liquidity risk into its overall risk management process, and anticipates and responds promptly to changing market conditions. Management has clearly articulated policies that provide clear insight and guidance on appropriate risk-taking and management. Information processes (manual and/or automated) are fully appropriate for the volume and complexity of activity. Any weaknesses are minor, with potential for nominal impact to earnings or capital. MIS produced by these information processes are accurate, timely, and complete, with relevant information necessary for sound management decisions. Liquidity planning is fully integrated with strategic planning, budgeting, and financial management processes. Management gives appropriate attention to managing balance sheet symmetry, cash flows, cost effectiveness, and evaluating liquidity alternatives. A comprehensive contingency funding plan exists which is fully integrated into overall risk management processes, and which will enable the bank to respond to potential crisis situations in a timely manner and to the fullest capacity of the bank.
- Satisfactory** — Management reasonably incorporates most of the key aspects of liquidity risk into its overall risk management process.

Management adequately responds to changes in market conditions. Liquidity risk management policies and practices are adequate. Liquidity planning is integrated with the strategic planning, budgeting, and financial management processes. Information processes (manual and/or automated) are adequate for the volume and complexity of activity. MIS produced by these processes may contain weaknesses in accuracy, timeliness, completeness, or relevance. Weaknesses in information processes (including resulting MIS) are not so significant that they lead management to decisions that materially impact earnings or capital. Management realistically assesses the funding markets and pays sufficient attention to diversification. Management attention to balance sheet symmetry, cash flow, and cost effectiveness is generally appropriate. Management has a satisfactory contingency funding plan to manage liquidity risk and is generally prepared to manage potential crisis situations.

- **Weak** — Management does not satisfactorily address key aspects of liquidity risk. Management is not anticipating or implementing timely or appropriate actions in response to changes in market conditions. Liquidity planning is not sufficiently integrated in the strategic planning, budgeting, and financial management processes. Information processes (manual and/or automated) are inappropriate for the volume and complexity of activity. MIS produced by these processes are inaccurate, untimely, incomplete, or insufficient to make sound management decisions. Weaknesses in information processes (including resulting MIS) can lead management to decisions that materially impact earnings or capital. Management has not realistically assessed the bank's access to the funding markets, has paid insufficient attention to diversification, or has limited awareness of large funds providers and their sensitivity. Management attention to balance sheet and cash flow symmetry is inadequate. The contingency planning process is deficient, inhibiting management's ability to minimize liquidity problems in a deteriorating scenario or to manage potential crisis situations. Management's evaluation of liquidity alternatives does not adequately consider cost effectiveness or the availability of these alternatives in a variety of market environments.

Price Risk

Price risk is the risk to earnings or capital arising from changes in the value of traded portfolios of financial instruments. This risk arises from market-making, dealing, and position-taking in interest rate, foreign exchange, equity and commodities markets.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of price risk, the quality of price risk management, the aggregate price risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of price risk and the quality of price risk management to derive the following conclusions.

Aggregate price risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

| |
|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
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Quantity of Price Risk

Examiners should use the following definitions to determine the quantity of price risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of price risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — Exposure reflects limited open or illiquid price risk positions. As a result, earnings and capital are not vulnerable to significant loss. Exposure, whether arising from speculative or customer-driven transactions, involves liquid and readily manageable products, markets, and levels of activity.
- **Moderate** — Exposure, whether arising from speculative or customer-driven transactions, reflects moderate open or illiquid price risk positions, limiting the potential for significant loss to earnings and capital. The bank has access to a variety of risk management instruments and markets at reasonable costs, given the size, tenor and complexity of open positions.
- **High** — Exposure reflects significant open or illiquid price risk positions, exposing the bank to a significant loss of earnings and capital. Exposure may arise from transactions or positions that are taken as a result of management or trader views of the market, in conjunction with customer transactions, or from market-making activities. Exposures may be difficult or costly to close out or hedge due to size, complexity, or generally illiquid markets, tenors, or products.

Quality of Price Risk Management

Examiners should use the following definitions to determine the quality of price risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of price risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — Several members of bank management fully understand price risk. Management actively monitors and understands products, market trends, and changes in market conditions. Information processes (manual and/or automated) are fully appropriate for the volume and complexity of activity. Any weaknesses are minor, with potential for nominal impact to earnings or capital. MIS produced by these information processes are accurate, timely, and complete, with relevant information necessary for sound management decisions. Models and methodologies are independently validated, tested, and documented. There is a sound independent valuation process for all significant positions. Management fully researches and documents the risk of new product initiatives prior to implementation. Limit structures are reasonable, clear, and effectively communicated. The limits also reflect a clear understanding of the risk to earnings and capital under normal and adverse scenarios. Staff responsible for measuring and monitoring price risk is well-qualified and independent from risk-taking activities.
- **Satisfactory** — Management understands the key aspects of price risk. Management adequately responds to changes in market conditions. Price risk management processes address major exposures. Information processes (manual and/or automated) are adequate for the volume and complexity of activity. MIS produced by these processes may contain weaknesses in accuracy, timeliness, completeness, or relevance. Weaknesses in information processes (including resulting MIS) are not so significant that they lead management to decisions that materially impact earnings or capital. Risk measurement tools and methods may have minor deficiencies or weaknesses, but are sufficient, given the size and complexity of activities. Models and methodologies are validated and acceptable. Positions are independently valued. Management considers the risk of new product initiatives prior to implementation. Limit structures are reasonable, clear, and effectively communicated. Limits also reflect an understanding of the risk to earnings and capital under normal and adverse scenarios. Staff responsible for measuring and monitoring price risk are qualified and independent from risk-taking activities.

- **Weak** — Management does not satisfactorily address key aspects of price risk. Management is not implementing timely or appropriate actions in response to changes in market conditions. Knowledge of price risk may be lacking at appropriate management levels throughout the organization. The price risk management process is deficient in one or more of the following ways. Risk measurement tools and methods are inadequate given the size and complexity of activities. Processes (manual and/or automated) are inappropriate for the volume and complexity of activity. MIS produced by these processes are inaccurate, untimely, incomplete, or insufficient to make sound management decisions. Weaknesses in information processes (including resulting MIS) can lead management to decisions that materially impact earnings or capital. Position valuations are performed infrequently, exclude major products, or may not be sufficiently independent. Management does not adequately consider the risk of new product initiatives prior to implementation. Limit structures may not be reasonable, clear, or effectively communicated. Limits also may not reflect a complete understanding of the risk to earnings and capital. Staff responsible for measuring and monitoring price risk are not independent of risk-taking activities.

Foreign Currency Translation Risk

Foreign currency translation risk is the current and prospective risk to capital or earnings arising from the conversion of a bank's financial statements from one currency into another. It refers to the variability in accounting values for a bank's equity accounts that result from variations in exchange rates which are used in translating carrying values and income streams in foreign currencies to U.S. dollars. Market-making and position-taking in foreign currencies should be captured under price risk.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of foreign currency translation risk, the quality of foreign currency translation risk management, the aggregate foreign currency translation risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of foreign currency translation risk and the quality of foreign currency translation risk management to derive the following conclusions.

Aggregate foreign currency translation risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

| |
|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
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Quantity of Foreign Currency Translation Risk

Examiners should use the following definitions to determine the quantity of foreign currency translation risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of foreign currency translation risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — Exposures to foreign currencies exist, but translation adjustments will have an immaterial impact on capital.
- **Moderate** — Exposures to foreign currencies exist, but translation adjustments are not expected to have an adverse impact on capital.
- **High** — Exposures to foreign currencies could produce accounting translation adjustments that will have a material adverse impact on capital.

Quality of Foreign Currency Translation Risk Management

Examiners should use the following definitions to determine the quality of foreign currency translation risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of foreign currency translation risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — Management fully understands all aspects of foreign currency translation risk. Management anticipates and responds well to changes in market conditions. Exposures are effectively measured, actively managed and monitored independently. Hedging objectives are comprehensive and well-communicated. Information processes (manual and/or automated) are fully appropriate for the volume and complexity of activity. Any weaknesses are minor, with potential for nominal impact to earnings or capital. MIS produced by these information processes are accurate, timely, and complete, with relevant information necessary for sound management decisions.

- **Satisfactory** — Management understands the key aspects of foreign currency translation risk. Management recognizes and responds to changes in market conditions. Exposures are adequately measured and controlled. Hedging objectives are reasonable and effectively communicated. Information processes (manual and/or automated) are adequate for the volume and complexity of activity. MIS produced by these processes may contain weaknesses in accuracy, timeliness, completeness, or relevance. Weaknesses in information processes (including resulting MIS) are not so significant that they lead management to decisions that materially impact earnings or capital.
- **Weak** — Management does not satisfactorily address key aspects of foreign currency translation risk. Management is not anticipating or implementing timely or appropriate actions in response to changes in market conditions. Exposures are not measured, managed effectively, or monitored independently. Hedging objectives are not reasonable, clear, or effectively communicated. Information processes (manual and/or automated) are inappropriate for the volume and complexity of activity. MIS produced by these processes are inaccurate, untimely, incomplete, or insufficient to make sound management decisions. Weaknesses in information processes (including resulting MIS) can lead management to decisions that materially impact earnings or capital.

Transaction Risk

Transaction risk is the current and prospective risk to earnings and capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information. Risk is inherent in efforts to gain strategic advantage, and in the failure to keep pace with changes in the financial services marketplace. **Transaction risk is evident in each product and service offered.** Transaction risk encompasses product development and delivery, transaction processing, systems development, computing systems, complexity of products and services, and the internal control environment.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of transaction risk, the quality of transaction risk management, the aggregate transaction risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of transaction risk and the quality of transaction risk management to derive the following conclusions.

Aggregate transaction risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
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Quantity of Transaction Risk

Examiners should use the following definitions to determine the quantity of transaction risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of transaction risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — The volume of transaction processing, complexity of operations, and the state of systems development expose the bank to negligible loss of earnings or capital. The volume and complexity of products and services expose the bank to minimal risk from fraud, errors, or processing disruptions. The risk of transaction processing failures from planned conversions, merger integration, or emerging products and technology is minimal.
- **Moderate** — The volume of transaction processing, complexity of operations, and the state of systems development expose the bank to increased loss of earnings or capital. The volume and complexity of products and services increase risks from fraud, errors, or processing disruptions. The risk of transaction processing failures from planned conversions, merger integration, or emerging products and technology is manageable.
- **High** — The volume of transaction processing, complexity of operations, and the state of systems development expose the bank to significant loss of earnings or capital. The volume and complexity of products and services significantly increase risks from fraud, errors, or processing disruptions. The risk of transaction processing failures from planned conversions, merger integration, or emerging products and technology is substantial.

Quality of Transaction Risk Management

Examiners should use the following definitions to determine the quality of transaction risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of transaction risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — Management anticipates and responds to key aspects of risk associated with operational changes, systems development, and emerging technologies. Systems and processes effectively address exposure to transaction risks. Management has implemented sound operating processes, information systems, internal control, and audit coverage. Management identifies weaknesses in transaction processing and takes timely and appropriate action. MIS for transaction processing appropriately provides for monitoring of processing volumes, error reporting, potential fraud, suspicious activity, etc. Management comprehensively provides for continuity and reliability of services, including services furnished by outside providers. Appropriate processes and controls exist to manage data and protect it from unauthorized change or disclosure. Risks from new products and services, planned strategic initiatives, or acquisitions are well-controlled and understood.
- **Satisfactory** — Management satisfactorily responds to risks associated with operational changes, systems development, and emerging technology. Systems and processes adequately address significant transaction risks. Operating processes, information systems, internal control, and audit coverage are satisfactory although deficiencies may exist. Management recognizes weaknesses in transaction processing and generally takes appropriate action. MIS for transaction processing are reliable, although they may be modestly flawed. Management adequately provides for continuity and reliability of significant services furnished by outside providers. Processes and controls to manage data and protect it from unauthorized change or disclosure are adequate. Management has implemented controls that mitigate risks from new products and services, planned strategic initiatives, or acquisitions.
- **Weak** — Management may not take timely and appropriate actions to respond to operational changes, systems development needs, or emerging technologies. Systems and processes ineffectively address significant transaction risks and may need substantial enhancement. Significant weaknesses exist in operating processes, information systems, internal control, or audit coverage related to transaction processing. Management

does not recognize weaknesses in transaction processing or make the necessary corrections. MIS for transaction processing are seriously deficient or may not exist. Management has not provided for continuity and reliability of services furnished by outside providers. Processes and controls to manage data and protect it from unauthorized change or disclosure are seriously deficient or non-existent. Inadequate planning or due diligence expose the bank to significant risk from activities such as the introduction of new products and services, planned strategic initiatives, or acquisitions.

Compliance Risk

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of the bank's clients may be ambiguous or untested. This risk exposes the institution to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential, and an inability to enforce contracts.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the quantity of compliance risk, the quality of compliance risk management, the aggregate compliance risk, and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Examiners should consider both the quantity of compliance risk and the quality of compliance risk management to derive the following conclusions.

Aggregate compliance risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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|---|
| Support all ratings in one narrative comment (i.e., aggregate risk, direction of change expected, quantity of risk, and quality of risk management) in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
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Quantity of Compliance Risk

Examiners should use the following definitions to determine the quantity of compliance risk. It is not necessary to meet every qualifier to be accorded a specific rating.

The quantity of compliance risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

- **Low** — The nature and extent of business activities limit the company's potential exposure to violations or noncompliance. The bank has few violations. Violations will not impact reputation, capital, earnings, or business opportunity. The bank's history of complaints or litigation is good.
- **Moderate** — The nature and extent of business activities may increase the potential for violations or noncompliance. The bank may have violations outstanding which are correctable in the normal course of business without impacting reputation, capital, earnings, or business opportunity. The bank's history of complaints or litigation is not a concern.
- **High** — The nature and extent of business activities significantly increase the potential for serious or frequent violations or noncompliance. The bank may have substantive violations outstanding that could impact reputation, capital, earnings, or business opportunity. The bank may have a history of serious complaints or litigation.

Quality of Compliance Risk Management

Examiners should use the following definitions to determine the quality of compliance risk management. It is not necessary to meet every qualifier to be accorded a specific rating.

The quality of compliance risk management is:

| | | |
|---------------------------------|---------------------------------------|-------------------------------|
| <input type="checkbox"/> Strong | <input type="checkbox"/> Satisfactory | <input type="checkbox"/> Weak |
|---------------------------------|---------------------------------------|-------------------------------|

- **Strong** — Management anticipates and addresses key aspects of compliance risk. Management takes timely and effective actions in response to compliance issues or regulatory changes. Compliance management systems and information processes are sound and the bank has a strong control culture, which has proven effective. Management provides substantial resources and has established accountability and timely enforced it for compliance performance. Compliance considerations are an integral part of product or system developments. Management demonstrates a high concern for privacy of consumer records and has implemented strong controls. Technology is effectively used to identify compliance violations and nonconformance at the point of transaction as well as post transaction.
- **Satisfactory** — Management addresses key aspects of compliance risk. Management takes appropriate actions in response to compliance issues or regulatory changes. Compliance management systems and information processes are adequate to avoid significant or frequent violations or noncompliance. Management provides appropriate resources and has established or enforced accountability for compliance performance. Compliance considerations are incorporated into product or system developments. Management understands and has adequately addressed consumer privacy issues. Technology or internal control is adequate to manage compliance at inception.
- **Weak** — Management does not satisfactorily address key aspects of compliance risk. Management is not anticipating or implementing timely or appropriate actions in response to compliance issues or regulatory changes. Compliance management systems and information processes are deficient. Management has not provided adequate resources or training, and/or has not established or enforced accountability for compliance performance. Errors are often not detected internally, or corrective actions are often ineffective. Compliance considerations are not incorporated into product or system developments. Management has not adequately addressed the privacy of consumer records. Technology or internal

control is not used or ineffectively used to identify violations or nonconformance.

Strategic Risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the composite strategic risk and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Aggregate strategic risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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|--|
| Support ratings in one narrative comment in the OCC's electronic information system. |
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| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
|---|

Examiners should use the following definitions to determine the aggregate strategic risk. It is not necessary to meet every qualifier to be accorded a specific rating.

- **Low** — The impact of strategic decisions or external pressures is expected to nominally affect franchise value. Exposure reflects strategic goals that are sound, and are very compatible with business direction and a changing environment. Initiatives are well-conceived and supported by capital, communication channels, operating systems, delivery networks, staff, and other resources. The depth and technical expertise of staff enables management to effectively set strategic direction and achieve organizational efficiency. Management has a successful record in accomplishing their stated strategic goals. Initiatives are supported by sound due diligence and effective risk management systems. Strategic decisions can be reversed with only negligible cost or difficulty. Strategic goals and the corporate culture are effectively communicated and consistently applied throughout the organization. MIS effectively support strategic direction and initiatives. Management is proactively aware of and effectively incorporates technology into their strategic plans.
- **Moderate** — The impact of strategic decisions or external pressures is not expected to significantly affect franchise value. Exposure reflects strategic goals that, although aggressive, are compatible with the business direction and responsive to changes in the environment. Initiatives are usually well-conceived and supported by capital, communication channels, operating systems, delivery networks, staff, and other resources. Weaknesses in the depth and technical expertise of staff sometime prevent management from effectively setting strategic direction or achieving organizational efficiency. Management has a reasonable record accomplishing their stated strategic goals. Strategic decisions can be reversed without significant cost or difficulty. The quality of due diligence and risk management is consistent with the strategic issues confronting the organization. Strategic goals and the corporate culture are appropriately communicated and consistently applied throughout the organization. MIS reasonably support the company's strategic direction. Management is aware of and usually incorporates technology management into their strategic plans.
- **High** — The impact of strategic decisions or external pressures is expected to adversely affect franchise value. Strategic initiatives may be nonexistent, overly aggressive, incompatible with the business direction, or non-responsive to changes in the environment. Strategic decisions may

be difficult or costly to reverse. Strategic goals may be nonexistent, poorly defined, or fail to consider changes in the business environment. Initiatives may be poorly conceived or inadequately supported by capital, communication channels, operating systems, delivery networks, staff, and other resources. Insufficient depth and technical expertise of staff often prevents management from effectively setting strategic direction and achieving organizational efficiency. Management does not consistently accomplish their stated strategic goal. Less than effective risk management systems or a lack of adequate due diligence has resulted in deficiencies in management decisions and may undermine effective evaluation of resources and commitment to new products and services, or acquisitions. Strategic goals and the corporate culture may not be clearly communicated and consistently applied throughout the organization. MIS may be insufficient to support the company's strategic direction or address a changing environment. Management ineffectively incorporates technology management into their strategic plans.

Reputation Risk

Reputation risk is the current and prospective impact on earnings and capital arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with customers and the community.

Summary Conclusions

Conclusions from the core assessment allow examiners to assess the composite reputation risk and the direction of change. Although examiners normally will not need to complete the core assessment in full quarterly, they must update RAS **quarterly** to reflect the most accurate risk profile of the institution.

Aggregate reputation risk is:

| | | |
|------------------------------|-----------------------------------|-------------------------------|
| <input type="checkbox"/> Low | <input type="checkbox"/> Moderate | <input type="checkbox"/> High |
|------------------------------|-----------------------------------|-------------------------------|

The direction of change is expected to be:

| | | |
|-------------------------------------|---------------------------------|-------------------------------------|
| <input type="checkbox"/> Decreasing | <input type="checkbox"/> Stable | <input type="checkbox"/> Increasing |
|-------------------------------------|---------------------------------|-------------------------------------|

Supporting narrative comment:

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|--|
| Support ratings in one narrative comment in the OCC's electronic information system. |
|--|

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|---|
| Document changes to the supervisory strategy due to changes in risk profile in the OCC's electronic information system. |
|---|

Examiners should use the following definitions to determine the aggregate reputation risk. It is not necessary to meet every qualifier to be accorded a specific rating.

- **Low** — The institution enjoys a favorable market and public perception. The level of litigation, losses, and customer complaints is minimal. The potential exposure to franchise value is nominal relative to the number and type of accounts, the volume of assets under management, and the number of affected transactions. Management anticipates and responds well to changes of a market, technological or regulatory nature that impact its reputation in the marketplace. Management fosters a sound culture and administrative procedures and processes that are well-supported throughout the organization and have proven very successful over time. Management is well-versed in complex risks and has avoided conflicts of interest and other legal or control breaches. MIS, internal control, and audit are very effective. Management has a clear awareness of privacy issues and uses consumer information responsibly.
- **Moderate** — Vulnerability to changes in market and public perception is not material given the level of litigation, losses, and customer complaints. The potential exposure is manageable and commensurate with the volume and type of business conducted. Management adequately responds to changes of a market, technological or regulatory nature that impact the institution's reputation in the marketplace. Management has a good record of self-policing and correcting problems. Any deficiencies in MIS are minor. Administration procedures and processes are satisfactory. The bank has avoided conflicts of interest and other legal or control breaches. Risk management processes, internal control, and audits are generally effective. Management understands privacy issues and uses consumer information responsibly, although some exceptions may be noted.
- **High** — Vulnerability to changes in market and public perception is material in light of significant litigation, large losses, or persistent customer dissatisfaction. The potential exposure may be increased by the number and type of accounts, the volume of assets under management, or the number of affected transactions. Management does not anticipate or take timely or appropriate actions in response to changes of a market, technological or regulatory nature. Weaknesses may be observed in one or more critical operational, administrative, or investment activities. The institution's performance in self-policing risk is suspect. Management has either not initiated, or has a poor record of, corrective action to address

problems. Management information at various levels of the organization may exhibit significant weaknesses. Poor administration, conflicts of interest, and other legal or control breaches may be evident. Risk management processes, internal control, or audit may be less than effective in reducing exposure. Management is not aware of significant privacy issues or sometimes uses consumer information irresponsibly.

Appendix A: Aggregate Risk Matrix

| Quality of Risk Management | Quantity of Risk | | |
|----------------------------|------------------|------------------|------------------|
| | Low | Moderate | High |
| Weak | Low to Moderate | Moderate to High | High |
| Satisfactory | Low | Moderate | Moderate to High |
| Strong | Low | Low to Moderate | Moderate |

Note:

This matrix is a guide to rating aggregate risk. As the matrix indicates, an aggregate rating is a combination of two already assessed ratings — one for quantity of risk and the other for quality of risk management. The ratings at the intersects are guides only; examiners should feel free to consider other factors not depicted on this diagram.

Appendix B: Audit Ratings Guidance

Examiners should consider the following key attributes when assessing the quality of a bank's overall audit program. It is not necessary for the audit program to meet every attribute to be accorded a specific rating of strong, satisfactory, or weak. These key attributes are normally present to distinguish between ratings, but examiners will need to factor in the bank's size, the nature of its activities, and its risk profile to arrive at an overall rating.

Strong

Overall, a **strong** audit program attains the highest level of respect and stature in the organization, which is continually confirmed by management and board attitudes, actions, and support. Audit's role is clearly spelled out and incorporated into overall corporate risk management, new product and service deployment, changes in strategy and tactical plans, and organizational and structural changes.

Audit Committee — The audit committee is proactive in dealing with management and risk management issues in a timely manner. Reports are clear in their discussions of both horizontal and business line issues. Corrective actions, testing, and resolution are reported to the committee. Reporting and discussions also include emerging issues and a profile of enterprise-wide risk in the company. The committee receives presentations on key businesses and risks; maintains frequent dialogue with regulators; and engages in prospective discussions on new business ventures, the potential risks involved, and planned controls. The committee takes an active role in reviewing and approving the annual audit plans and external audit engagement, as well as setting expectations for the roles of both internal and external auditors and evaluating their performance under the plan. The use of external auditors is clearly defined in engagement letters.

Audit Management and Processes — Internal audit management possesses significant industry expertise and knowledge to match the sophistication and complexity of the bank's risk profile and operations. Internal audit is independent by virtue of reporting lines to the board and the board's support in executing the audit plan and audit programs. Audit is very or highly effective in follow-up actions and ensuring change. Follow-up reviews are completed in a timely manner, and testing for management's corrective

actions is thorough. Audit processes and teams have been effective in raising and addressing issues in merger activities. Horizontal risk issues are effectively addressed. Audit plans are completed without any carryover or have appropriately supported amendments based on significant changes in the bank's risk profile.

The internal audit process is fully effective and may include results obtained from traditional and/or continuous audit activities, early warning indicators, management call programs, etc. Any internal audit duties or assignments that have been outsourced or co-sourced are effective and appropriately managed. Internal audit processes include key indicators and well-developed descriptions of key risks and controls in place. Key indicators are being effectively used as an early warning tool for risk management. Management information systems are timely, accurate, complete, and reliable.

Responsibilities between audit and other risk management oversight functions are well delineated. Risk and frequency models are well defined, accurately reflect the risk, and are consistently applied across business lines. Internal audit is effective in assessing risk for silo business lines in addition to addressing risk management processes globally across the corporation. The audit planning horizon is long-term, and it effectively addresses audit needs for low- and moderate-risk areas in a timely fashion. Joint ventures and minority subsidiary activities are appropriately addressed in the internal and external audit program scopes. Audit scopes are flexible to the extent of adding new business lines and merged activities.

Audit Reporting — Audit reports clearly outline the causes of problems and specifically point out management issues when present. There are few differences between bank-assigned internal audit ratings or assessments and examiner assessments of internal controls in the business line audits. Audit ratings or assessments are well defined and are fully effective in identifying areas of increased levels of control weaknesses. Internal audit work paper documentation fully supports the findings presented in the reports and the audit ratings assigned.

Internal Audit Staffing — Audit staffing is appropriate relative to the level of risk undertaken by the bank. Staff turnover is minimal and vacancies are promptly addressed and have little or no effect on audit plans or processes. Recruitment and training processes are active and ongoing. The audit staff

includes subject matter experts, who are active in industry-related organizations. The staffing plan provides for management succession within the internal audit group.

Satisfactory

Overall, a **satisfactory** audit program attains an adequate level of respect and stature in the organization and is generally supported by the actions of management and board. Audit's role in overall corporate risk management and participation in new product and service deployment, changes in strategy and tactical plans, and organizational and structural changes may be limited, but is conducted in accordance with its assigned responsibilities.

Audit Committee — The audit committee is effective in their oversight of the audit program. Reports presented to the committee provide sufficient information and discussion of significant audit issues. The committee holds senior management accountable for issues in their respective business lines. The committee understands the audit plans, external audit engagement, and the respective roles to be performed by both internal and external auditors.

Audit Management and Processes — Internal audit management is independent and generally possesses the knowledge and experience to ensure adequate internal audit operations appropriate to the bank's risk profile. Audits and follow-up are timely, comprehensive, independent, and effective in assessing and monitoring controls. Audit programs, processes, and information systems are generally sound and complement the control and risk management environment. Audit policies are effective, adhered to, and appropriate for the bank's size, complexity, and risk profile. Senior-level audit management adequately manages outsourced or co-sourced internal audit duties or assignments.

Audit Reporting — Audit reports are clear, concise, and reflect an assigned rating properly based on reviews of the area and the root causes of issues. Internally assigned rating or assessment definitions are adequately defined and differences with examination findings may exist in some cases, but do not compromise the overall internal audit program. Internal audit program work papers support findings and conclusions.

Internal Audit Staffing — Audit staff is generally competent and experienced. The internal audit staff, as a whole or in certain groups, experiences some turnover and vacancies, but not to the extent of compromising internal audit plans and processes. Staff training is adequate.

Weak

Overall, a **weak** audit program is one that is not an integral part of the organization. The audit program does not have the full support of or appropriate oversight by the board and management. Audit's role is unclear and not utilized in overall corporate risk management, new product and service deployment, changes in strategy and tactical plans, and organizational and structural changes.

Audit Committee — The audit committee is not effective in their oversight of the audit program. Reports and information submitted to the committee are insufficient or not fully understood. The committee fails to follow up on control and risk weaknesses noted by audit or to hold senior management accountable for issues in their respective business lines. The committee has a passive role in audit planning or selection and/or oversight of the external audit engagement and is not involved in determining the respective roles of the internal and external auditors. Engagement letters describing the work to be performed by external auditors are non-existent, incomplete, or not understood by the board or audit committee.

Audit Management and Processes — Weaknesses exist in internal audit management and processes, such as lack of competence or independence or inadequate scope of review, and are not mitigated by strong internal control. Audit policies exist, but need significant enhancements in light of the bank's size, complexity, and risk profile. Audit programs, processes, reports, and information systems are generally ineffective in addressing significant control or risk issues. Outsourced or co-sourced internal audit duties or assignments are ineffective and have not been appropriately managed by an appropriate level of audit management.

Audit Reporting — Bank-assigned internal audit rating or assessment definitions are loosely defined or nonexistent. Audit reports are unclear and do not reflect accurate ratings or assessments based on reviews of the area or do not fully identify the root causes of issues. Significant rating or assessment

differences exist with examination findings. Internal audit program work papers, in many cases, are insufficient or do not support findings and conclusions.

Internal Audit Staffing — Audit staff is inexperienced or lacks adequate knowledge and suffers from high turnover/vacancies, which significantly affect internal audit plans and processes. Management has failed to maintain the staff levels needed to fully support the internal audit program. Staff training is inadequate.

References

Regulation

12 CFR 28, International Banking Activities

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