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Bank Supervision and Examination Process

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Introduction

Background

This booklet explains the philosophy and methods of the Office of the Comptroller of the Currency (OCC) for supervising community banks. Community banks are generally defined as banks with less than \$1 billion in total assets and may include limited-purpose chartered institutions (e.g., trust banks, community development banks). As banks grow in size and complexity, the supervisory process transitions to that outlined in the “Large Bank Supervision” booklet of the *Comptroller’s Handbook*. While serving as the primary guide to the OCC’s overall supervision of community banks, this booklet should be used in conjunction with other booklets of the *Comptroller’s Handbook*.

The OCC’s community bank supervision is designed to:

- Determine the condition of the bank, as well as the levels and trends of the risks associated with current and planned activities.
- Evaluate the overall integrity and effectiveness of risk management systems by conducting periodic validation.¹
- Determine compliance with banking 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 resolution through appropriate supervisory or enforcement actions.

The community bank supervision process also gives examiners flexibility when developing supervisory strategies and conducting supervisory activities. It integrates all functional areas of the bank under one supervisory plan,

¹ Validation is accomplished by a combination of observation, inquiry, and testing.

which helps ensure consistency in the assessment of risks and the degree of supervisory attention warranted.

The OCC's supervisory framework for community banks consists of the following three components:

- **Core Knowledge** — the OCC's database that contains core information about the institution, its profile, culture, risk tolerance, operations and environment, and key examination indicators and findings. This database enables examiners to document and communicate critical data with greater consistency and efficiency.
- **Core Assessment** — objectives and procedures that guide examiners in reaching conclusions regarding Regulatory Ratings under the Uniform Financial Institutions Rating System (UFIRS, more commonly referred to as "CAMELS"), the Uniform Rating System for Information Technology (URSIT, more commonly referred to as the "I" rating), the Uniform Interagency Trust Rating System (UITRS, more commonly referred to as the "T" rating), and the Uniform Interagency Consumer Compliance Rating System (more commonly referred to as the "C" rating).²

The core assessment assists examiners in assessing the bank's overall risk profile using risk assessments made under the OCC-developed community bank risk assessment system (RAS). The core assessment also defines the conclusions examiners must reach when conducting supervisory activities every supervisory cycle to meet the requirements of a full-scope, on-site examination.³ Supervisory activities, including periodic monitoring, are tailored specifically to the risk profile of each community bank. When examining low-risk banks or low-risk areas of banks, generally only the first objective, identified as the minimum objective, under each section of the core assessment is completed. For all other community banks or areas of community banks, examiners will tailor the scope of the supervisory activity by selecting objectives and procedures appropriate to the complexity and risk profile of the institution. For details on the flexibility

² For more information on UFIRS, URSIT, and other regulatory ratings systems, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*. The group of regulatory ratings required for banks is sometimes referred to by the OCC by the designation of CAMELS/ITCC, with the "ITCC" referring to the information technology rating, trust, compliance, and community reinvestment activities ratings.

³ The frequency (12 or 18 months) of full-scope, on-site safety and soundness examinations is based on the bank's condition and complexity as prescribed by 12 USC 1820(d), Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) and 12 CFR 4.6.

of timing and scope of supervisory activities, see the “Examining” section of this booklet.

- **Expanded Procedures** — detailed guidance that explains how to examine specialized activities, or specific products that warrant extra attention beyond the core assessment. These procedures are found in the other booklets of the *Comptroller’s Handbook* and the *FFIEC IT Examination Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

The supervisory framework is designed to achieve the following operational and administrative objectives:

- Ensure that supervision by risk is applied consistently throughout the community bank supervision process by tailoring supervisory strategies that integrate all examining areas to the risk profile of each community bank.
- Ensure that the assistant deputy comptroller (ADC) is responsible for the supervision of the bank and is accountable for the development and execution of appropriate integrated risk-based strategies.
- Define minimum conclusions that examiners must reach during the supervisory cycle, while providing the flexibility to vary the amount of supporting detail or volume of work.
- Ensure conformance with statutory requirements for full-scope examinations.
- Provide direction for less-experienced examiners by providing detailed procedural guidance to be used, as needed, to reach key conclusions and objectives.

The OCC also conducts targeted reviews and examinations of functions and areas not covered by the core assessment section of this booklet. An examination of the bank’s Community Reinvestment Act (CRA) performance is conducted every 36 months to 60 months depending on the bank’s asset size, holding company affiliation, and previous composite CRA rating.

Supervision by Risk

The OCC recognizes that banking is a business of managing risks while maximizing profits. While banking risks historically have been concentrated in traditional banking products and services, community banks today offer a wide array of new and complex products and services. Whatever products and services they offer, community banks must have risk management systems that identify, measure, monitor, and control risks. Therefore, risk management systems in community banks will vary based on the complexity and volume of risks assumed by the bank.

OCC supervision of community banks focuses on the bank's ability to properly manage risk.⁴ Using the core assessment, OCC examiners draw conclusions about the adequacy of a bank's risk management system. When risks are high; when activities, products, and services are more complex; or when significant issues or problems are identified, examiners will expand the scope of their supervisory activities to ensure that bank management has appropriately identified, measured, monitored, and controlled risk. However, the extent of the additional supervisory activities will vary, based on the impact those activities, products, services, or significant issues may have on the overall risk profile or condition of the bank.

The community bank supervision process primarily focuses on the individual national bank. Nevertheless, supervision by risk requires examiners to determine whether the risks at an individual bank are mitigated or increased by the activities and condition of the entire holding company. To perform a consolidated risk analysis, examiners may need to obtain information from banks and affiliates (as prescribed in the Gramm-Leach-Bliley Act of 1999 (GLBA)), review transactions flowing between banks and affiliates, and obtain information from other regulatory agencies, as necessary. GLBA is important legislation that addresses a number of significant issues affecting both national banks and the supervision process, and while it reaffirms the OCC's responsibility for evaluating the consolidated risk profile of the individual national bank, it also establishes a functional regulatory framework for certain activities conducted within banks and through functionally regulated affiliates.

⁴ For more information on supervision by risk and risk management, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.

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 a problem. Even the existence of high risk in any area is not necessarily a concern, so long as management effectively manages that level of risk. To put risks in perspective, examiners should decide whether the risks a bank assumes are warranted. Generally, a risk is warranted when it is identified, understood, measured, monitored, and controlled as part of a deliberate risk reward strategy. It should be in the bank's capacity to readily withstand the financial distress that such risk could cause. When risks are unwarranted (e.g., 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, and strengthening risk management processes.

The OCC has defined nine major categories of risk for bank supervision purposes. These risks are *credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation*.⁵ These categories are not mutually exclusive; any product or service may expose the bank to multiple risks. In addition, risks can be interdependent, with increased risk in one category increasing the risk in other categories. Examiners should be aware of this interdependence and assess the impact in a consistent and inclusive manner.

Risk Management

Because of the vast diversity in the risks community banks take, there is no single prescribed risk management system that works for all. Each bank should tailor its risk management program to its needs and circumstances.

⁵ The risk definitions are found in the "Risk Assessment System" beginning on page 141.

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. Risk identification should be a continuing process, and risks should be understood at both the transaction and portfolio levels.
- *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. Measurement systems in community banks will vary greatly depending on the type and complexity of their products and services. For more complex products, risk measurement systems should be more sophisticated. All banks should periodically test their measurement tools to make sure they are accurate. Sound risk measurement systems assess the risks individually (transaction level) and in aggregate (portfolio level).
- *Monitor risk:* Banks should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed.
- *Control risk:* Banks should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. These limits should serve as a means to control exposures to the various risks associated with the bank's activities. The limits should be tools that management can adjust when conditions or risk tolerances change. Banks should also have a process to authorize and document exceptions or changes to risk limits when warranted.

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

- Implement the institution'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 (MIS) 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. For small community banks engaged in limited or traditional activities, risk management systems may be less formal in scope and structure. Examiners will assess risk control systems consistent with the risk profile of each community bank.

Policies are statements, either written or verbal, of the bank's commitment to pursue certain results. Policies often set standards (e.g., on risk tolerances) and may recommend courses of action. Policies should express a bank's underlying mission, values, and principles. A policy review should 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 and are governed by appropriate checks and balances. In small community banks, processes may be effective even when less formal than those in banks that offer more complex products and services.

Personnel are the staff and managers that execute or oversee processes. Bank staff and managers should be qualified and competent; perform as expected; and understand the bank's mission, values, policies, and processes.

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 — appropriate to the level and complexity of risk taking.

Risk Assessment System

The community bank risk assessment system (RAS) gives examiners a consistent means of measuring the nine major risks as defined by the OCC and of determining when the core assessment should be expanded. For

seven of the risks — *credit, interest rate, liquidity, price, foreign currency translation, transaction, and compliance* — the examiner assesses **quantity of risk, quality of risk management, aggregate risk, and direction of risk**. To make these assessments, examiners use conclusions from the core assessment or expanded procedures and guidance on the risk assessment system.

The risk assessment system was developed to assist in prospectively identifying the risks in the banking system and to assist examiners in determining what depth and type of supervisory activities are appropriate for each community bank. For effective use of the system, examiners consider the current condition of the bank and other factors that indicate a potential change in risk. It is important that examiners are aware of early warning signs that the level of risk may rise.

Under the RAS, an institution's risk profile has the following four dimensions, any one of which can influence the supervisory strategy, including the extent to which expanded procedures might be used:

- **Quantity of risk** is the level or volume of risk that the bank faces and is characterized as low, moderate, or high.
- **Quality of risk management** is how well risks are identified, measured, controlled, and monitored and is characterized as strong, satisfactory, or weak.
- **Aggregate risk** is a summary judgment about the level of supervisory concern. It incorporates judgments about the quantity of risk and the quality of risk management (examiners weigh the relative importance of each). Examiners characterize such risk as low, moderate, or high.
- **Direction of risk** is the probable change in the aggregate level of risk over the next 12 months and is characterized as decreasing, stable, or increasing. If the risk is decreasing, the examiner expects 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.

The quantity of risk and quality of risk management should be assessed independently. Therefore, when assigning the individual RAS ratings, the assessment of the quantity of risk should not be affected by the quality, no matter how strong or weak, of risk management. Also, strong capital support

or strong financial performance should not mitigate an inadequate risk management system. The examiner should not conclude that “high” risk levels are bad and “low” risk levels are good. The quantity of risk simply reflects the level of risk the bank accepts in the course of doing business. Whether this quantity is good or bad depends on whether the bank’s risk management systems are capable of identifying, measuring, monitoring, and controlling that amount of risk.

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 and direction of risk are the same as for the other seven risks.

The risk assessment system is updated and recorded in Examiner View⁶ whenever the examiner becomes aware of changes in the bank’s risk profile. For example, examiners could identify changes in the bank’s risk profile while performing periodic monitoring activities. Assessments are always formally communicated to the bank at the conclusion of the supervisory cycle by including a page in the report of examination containing a matrix with all of the risk categories and assessments, but may also be included in other communication to the bank if appropriate. Any changes in the aggregate risk assessments during the supervisory cycle are required to be formally communicated to the bank at the time they are identified.

Examiners will discuss RAS conclusions with appropriate management and the board. Bank management may provide information that may help the examiner clarify or modify those conclusions. Following the discussions, the OCC and bank management should have a common understanding of the

⁶ Examiner View is a software application designed by the OCC to assist examiners in preparing for, conducting, and maintaining work papers of supervisory activities completed at community banks.

bank's risks, the strengths and weaknesses of risk management systems, management's commitment and action plans to address any weaknesses, and future OCC supervisory plans.

The Supervisory Process

The supervision of community banks is an ongoing process. Supervisory planning, examining through the use of the core assessment and expanded procedures, and communicating examination findings are integral parts of the supervision process.⁷

The OCC uses an integrated risk-based approach to supervision. The goal of this approach is to maximize the effectiveness of our supervision process by assessing all bank activities under one supervisory plan. With this integrated approach, the supervisory office ADC has responsibility for all supervisory activities including safety and soundness, information technology, asset management, and compliance. Integrating all examining areas under one ADC ensures that the OCC assesses risks in all areas using the same criteria and that the most significant risks to the bank will receive the most supervisory attention.

A significant benefit of integration is that the coordination of supervisory activities minimizes duplication of effort and leverages resources in the supervisory process. For example, audit and internal control may be reviewed once for all bank areas, rather than at different times for separate safety and soundness, information technology, asset management, and compliance examinations.

Planning

Supervisory strategies are dynamic documents that outline all supervisory activities and help ensure that sufficient resources are available to address bank risks and fulfill statutory requirements. The strategy focuses examiners' efforts on monitoring the condition of the bank and seeking commitments from the bank's board of directors and management to correct previously identified deficiencies. All community bank strategies are maintained in Examiner View.

⁷ Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more detailed information.

The portfolio manager assigned by the OCC is responsible for developing a supervisory strategy that integrates all examining areas and is specifically tailored to the bank's complexity and risk. As needed, the portfolio manager consults with specialty examiners to ensure that significant issues have been appropriately addressed in the supervisory activities planned for the cycle. The portfolio manager also schedules centralized reviews of matters that affect more than one examination area (e.g., audit and internal controls) within the bank, and is also responsible for communicating the results to all examiners completing supervisory activities on the bank to minimize duplication in the supervisory process.

At a minimum, the strategy for community banks will include completing the core assessment during the supervisory cycle. For areas of low risk, the scope of the planned supervisory activities will generally consist of the minimum objectives. For areas of higher risk or supervisory concern, the strategy may direct examiners to complete other objectives beyond the minimum and may even expand the examination beyond the core assessment. When determining the appropriate depth of supervisory activities for a specific examination area, the portfolio manager takes into account both the level of risk of the area to be reviewed and the potential impact that area would have on the bank as a whole.

The strategy includes an estimate of resources, including the level of expertise, and the number of days, based on the bank's risk profile that the OCC will need to effectively supervise the bank. The strategy also includes a narrative supporting the specific strategy that has been developed for the supervisory cycle. The volume of the supporting narrative should vary based on the risk profile and the complexity of the planned supervisory activities.

Each supervisory strategy is based on:

- **Core knowledge** of the bank including, but not limited to, its:
 - Management.
 - Control environment.
 - Audit functions.
 - Market(s).
 - Information technology support and services.
 - Products and activities.
 - Ratings.
 - Risk profile.

- OCC supervisory guidance and other factors including:
 - Core assessment.
 - Supervisory history.
 - Applicable economic conditions.
 - Other examination guidelines (e.g., expanded procedures in the *Comptroller’s Handbook* and *FFIEC IT Examination Handbook*).
 - Supervisory priorities of the agency that may arise from time to time.
- Statutory examination requirements.

The portfolio manager is also responsible for discussing with bank management the scope of the supervisory strategy, including the specific types of supervisory activities planned for the cycle. Prior to scheduling activities that extend throughout a supervisory cycle, the portfolio manager should discuss the proposed timing with bank management.

The planning process for a specific activity continues until that activity is initiated. A request for bank information that examiners must review is sent to bank management shortly before an activity is scheduled to begin. The portfolio manager then reviews all information that has been submitted to determine whether to adjust any supervisory strategy for that activity. For example, the most recent loan review report submitted by the bank may prompt the portfolio manager to reduce the scope of the asset quality review. This final step in the planning process allows the portfolio manager to effectively allocate supervisory resources based on the most current information available.

Examining

Examining is a continual process consisting of a set of integrated and tailored supervisory activities. Supervisory activities are designed to determine the condition and risk profile of a bank, identify areas in need of corrective action, and monitor ongoing bank activities. Because the risk profiles of community banks are diverse, the OCC recognizes that effective and efficient supervision cannot be accomplished using a rigid set of examination procedures. Examiners use the core assessment and expanded procedures (when necessary) to tailor supervisory activities to ensure that risks within each community bank are appropriately identified and managed.

The OCC's approach to community bank supervision also stresses the importance of determining and validating the bank's condition during the supervisory cycle. However, the process itself is flexible and activities can be completed through different means. While on-site activities are essential to supervision, parts of the core assessment may be effectively performed away from the bank.

The OCC supervisory approach for community banks is also flexible about when on-site activities are completed. Supervisory activities can be completed at one time or at various times throughout the supervisory cycle. The scheduling of supervisory activities should maximize the efficiency and effectiveness of the supervisory process and should be appropriate for the bank's size, risk profile, and condition. For example, if an accounting firm or vendor does internal audit work for a number of banks in an area, it may be more efficient to review the firm's work papers as part of a targeted supervisory activity rather than to review each bank's audit work papers during its on-site examination. Examiners may also want to coordinate such reviews with other field offices whose banks employ the same vendor or firm for the same purpose. Targeted reviews in other examination areas also provide scheduling flexibility when a specific area of examination expertise is needed.

Examiners identify supervisory concerns and monitor their correction throughout the supervisory cycle. Generally, during on-site activities, examiners focus on identifying the root cause of deficiencies and ensuring that management is taking appropriate and timely steps to address and correct all deficiencies.

Periodic monitoring, which is a key element of the OCC's supervisory process, is designed to identify changes in the bank's condition and risk profile and to review the bank's corrective action on issues identified during previous supervisory activities. The depth and scope of monitoring activities also varies based on the bank's size, risk profile, and condition, but in all cases examiners complete some level of activities quarterly. By monitoring community banks, examiners can modify supervisory strategies in response to changes in a bank's risk profile, and respond knowledgeably to bank management's questions. Periodic monitoring makes supervision more effective and on-site activities more focused.

Completing the Core Assessment

To assist examiners in developing risk-based supervisory strategies for each community bank, the supervisory office assistant deputy comptroller (ADC), with input from the portfolio manager, will characterize the overall risk profile of each community bank as either “low-risk,” “moderate-risk,” or “high-risk.”⁸ In addition to the overall risk profile, specific areas of the bank are also characterized as low-, moderate-, or high-risk. For example, while a bank’s overall risk profile is moderate, specific areas or activities could be either low- or even high-risk. The OCC’s portfolio manager develops a supervisory strategy using this overall risk classification, his or her knowledge of the specific risks in the areas of the bank, the effectiveness of the bank’s audit function, and the strength of the bank’s system of internal control. In general, minimum objectives are used in low-risk areas, with other objectives from the core assessment or expanded procedures used in areas of higher risk. However, ultimately the portfolio manager has the flexibility to select which combination of objectives and procedures should be used to effectively and efficiently supervise and meet statutory examination requirements for the bank(s) in his or her portfolio.

Minimum Objectives

The minimum objectives, which are the foundation for review in low-risk areas, determine whether any significant changes have occurred in business activities, the risk profile, management, or the condition of a low-risk area from the prior supervisory cycle. Experienced examiners who are knowledgeable about the bank should complete the minimum objectives. The OCC has determined that these objectives are sufficient to effectively complete the required supervisory activities in low-risk areas and assign the appropriate CAMELS/ITC ratings. If no significant changes in the bank’s risk profile are identified after completion of the minimum objectives, no further work is done. However, if findings identify supervisory concerns, the examiner-in-charge (EIC) of the activity, with approval from his/her ADC, has the flexibility to expand the scope of the supervisory activities by completing other objectives from the core assessment and/or expanded procedures.

Even when an area is consistently identified as low-risk, examiners should periodically expand supervisory activities beyond the minimum objective to determine whether any supervisory concerns or issues are present at a deeper

⁸ High-risk banks typically include community banks with composite ratings of 3, 4, or 5.

level and to ensure that all control systems continue to be effective. The ADC is responsible for ensuring when and to what extent periodic expansion is done for each low-risk area. In addition, expanded reviews and procedures may be appropriate in larger community banks, banks engaged in more complex operations, when conducting training assignments or when assignments are being completed by pre-commissioned examiners and in other situations, as determined by the EIC and ADC, that would benefit from increased testing and validation.

Other Objectives

For areas not identified as low-risk, examiners will complete other selected objectives from the core assessment or expanded procedures consistent with the bank's complexity and level of supervisory concern. While the other objectives in the core assessment contain detailed procedures or clarifying steps, examiners typically will not need to carry out every procedure listed. Instead, experienced examiners can simply summarize their conclusions under the objective, consistent with the bank's condition and risk profile. For less experienced examiners, the clarifying steps provide additional guidance to help them achieve the objective.

Expanded Procedures

When specific products or risks are present that warrant a detailed review, examiners should widen the scope of the supervisory activities by completing expanded procedures found in other booklets of the *Comptroller's Handbook* or *FFIEC IT Examination Handbook*. For example, if a bank has a higher-than-normal risk profile, the OCC will expect the bank to have more sophisticated and formalized policies and procedures to identify, measure, monitor, and control risk. In these cases, the EIC, with approval from the ADC, will typically expand the supervisory activities by using procedures from the appropriate booklet of the *Comptroller's Handbook* to more fully assess risk management processes. If significant issues or areas of increasing risk are identified during the completion of the core assessment, the EIC, with approval from the ADC, may also expand the supervisory activities to review areas of concern in more depth. Expanded procedures may include additional transaction testing or a more thorough assessment of the risk management process.

For example, an experienced EIC may decide to complete the minimum objectives for all areas in a low-risk community bank except asset quality if

the bank has been experiencing growth in the credit card portfolio. After completing other objectives from the core assessment for asset quality and finding that supervisory concerns remain, and, with approval from the ADC, the EIC may then decide to use selected expanded procedures from the “Credit Card Lending” booklet of the *Comptroller’s Handbook*. By selecting all types of procedures available to tailor the scope of the examination, the EIC effectively focuses on the areas of highest risk.

Examiners must use judgment in deciding how much supporting detail or work is necessary to complete the steps or objectives under the core assessment. The policy for work paper documentation requirements, outlined in PPM 5400-8 (rev), “Supervision Work Papers,” states that examiners should retain only those files and documents, preferably in a digital format, necessary to support the scope of the supervisory activity, significant conclusions, ratings changes, or changes in a risk profile. In addition, the work papers should clearly document which procedures were performed either fully or partially.

Summary

The core assessment directly links the risk evaluation process to the risk assessment system and the assignment of regulatory ratings.

When using the core assessment, examiners should:

- Use reasoned judgment in determining when to expand the core assessment or to increase the level of detail needed to support the core assessment conclusions.
- Practice good communication and analytical skills when investigating and judging what processes are appropriate, given a bank’s size, complexity, and risk profile.
- Consider the results of all supervisory activities conducted during the supervisory cycle.

The community bank core assessment does not address compliance with all applicable laws, rules, regulations, and policies. Nonetheless, examiners must understand the laws, rules, regulations, and policies that relate to the

area under examination and must remain alert for any noncompliance.⁹ Examiners should note noncompliance and discuss appropriate corrective action with management. Detailed procedures that address compliance with legal and regulatory requirements can be found in the other booklets of the *Comptroller's Handbook* series. In addition, examiners should ensure that supervisory follow-up includes a review of corrective action for any violations noted.

Audit and Internal Control

The core assessment requires examiners to evaluate and validate the two fundamental components of any bank's risk management system — 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 program and internal control system are strong, satisfactory, or weak. Based on these assessments, the examiner will be able to determine the amount of reliance that areas of the examination can place on the audit program and internal control system. Effective audit functions and internal controls help to:

- Leverage OCC resources, and
- Establish the scope of current and planned supervisory activities.

Internal Control

A system of strong internal control is the backbone of a bank's risk management program. The community bank core assessment includes objectives for assessing a bank's control environment during each supervisory cycle. The objectives are consistent with industry-accepted criteria¹⁰ for establishing and evaluating the effectiveness of sound internal controls. When examiners use expanded procedures, they should refer to the appropriate booklets of the *Comptroller's Handbook* or to the *FFIEC*

⁹ The "References" section lists some laws, regulations, and other guidance commonly used in community bank examinations. More extensive lists of reference materials are included in the other booklets of the *Comptroller's Handbook* and *FFIEC IT Examination Handbook*.

¹⁰ 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.

Information Technology (IT) Examination Handbook for more information on the types of internal control commonly used in a specific banking function.

Audit

The EIC, with approval from the supervisory office, will tailor the scope of the audit assessment to the bank's size, activities, and risk profile. The examiners assigned to review audit, through coordination and integration with examiners reviewing other functional and specialty areas, will determine how much reliance can be placed on the audit program by validating the adequacy of the audit's scope and effectiveness during each examination cycle.¹¹

Validation, which encompasses observation, inquiry, and testing, generally consists of a combination of examiner discussions with bank/audit management or personnel, review of audit work papers and processes (e.g., policy adherence, risk assessments, follow-up activities). Examiners will use the following three successive steps, as needed, to validate the audit program:

- Review of internal audit work papers.
- Expanded procedures.
- Verification procedures.

The review of internal audit work papers, including those from outsourced internal audit and director's examinations, may not be waived during any supervisory cycle. However, the EIC has flexibility in limiting the scope of the work paper reviews (i.e., the number of internal audit programs or work papers to review) based on his or her familiarity with the bank's audit function and findings from the previous review of internal audit. Examiners typically will not review external audit work papers¹² unless the review of the internal audit function discloses significant issues (e.g., insufficient audit coverage) or unless questions are otherwise raised about matters normally within the scope of an external audit program.¹³

¹¹ National banks that are subject to 12 CFR 363 or that file periodic reports under 12 CFR 11 and 12 CFR 16.20 are also subject to the provisions of the Sarbanes-Oxley Act. For more information refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook*.

¹² Prior to reviewing external auditor work papers, examiners should meet with bank management and the external auditor, consult with the district accountant, and obtain approval from the supervisory office ADC.

¹³ For a comprehensive set of audit procedures, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook*. For internal control procedures refer to the "Internal Control" booklet published in January 2001. Additional guidance and procedures are also found in other booklets of

Examiners may identify significant audit or control discrepancies or weaknesses or may raise questions about the audit function's effectiveness after completing the core assessment. In those situations, examiners should consider expanding the scope of the review by selecting expanded procedures in the "Internal and External Audits" booklet of the *Comptroller's Handbook*.

When reviewing the audit function, significant concerns may remain about the adequacy of an audit or internal controls, or about the integrity of a bank's financial or risk management controls. If so, examiners should consider further expanding the audit review to include verification procedures. Even when the external auditor issues an unqualified opinion, verification procedures should also be considered if discrepancies or weaknesses call into question the accuracy of the opinion. The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

The examiner communicates to the bank his or her overall assessments (strong, satisfactory, or weak) of the audit functions and internal control, along with any significant concerns or weaknesses, in the report of examination. If examiners identify significant audit weaknesses, the EIC will recommend to the appropriate supervisory office what formal or informal action is needed to ensure timely corrective measures. Consideration should be given to whether the bank complies with the laws and regulations¹⁴ that establish minimum requirements for internal and external audit programs. Further, if the bank does not meet the audit safety and soundness operational and managerial standards of 12 CFR 30, appendix A, possible options to consider are having bank management develop a compliance plan, consistent with 12 CFR 30, to address the weaknesses, or making the bank subject to other types of enforcement actions. In making a decision, the supervisory office will consider the significance of the weaknesses, overall audit rating, audit-related

the *Comptroller's Handbook* that address specific banking product lines and activities.

¹⁴ For a more information on the laws, regulations, and policy guidance relating to internal and external audit programs, refer to the "Internal and External Audits" booklet of the *Comptroller's Handbook*.

matters requiring attention (MRA), management's ability and commitment to effect corrective action, and the risks posed to the bank.

Information Technology

Information technology (IT) is an integral part of banking. Without technology, banks would be unable to provide the volume, variety, and complexity of products and services currently offered. Because IT can have a considerable effect on all banking activities, the OCC has integrated the review of technology into the core assessment in two ways. First, examiners consider the effect of technology on each area they review, especially its effect on the accuracy, reliability, and timeliness of automated reports used in the bank's risk management process. Second, examiners assess the potential impact of technology on each of the nine OCC-defined risks.

Technological risk is not a separate RAS category. But because technology impacts all areas of the bank, a single weakness can increase risk in several RAS categories. For example, a weakness in Internet banking controls could lead to increased fraud (i.e., transaction risk). If this fraud becomes public knowledge, reputation risk may also increase. The bank's tarnished reputation can increase the cost of funding or reduce funding availability (e.g., interest rate and liquidity risks). Examiners should consider this type of domino effect in their assessment of a bank's total risk profile.

In conducting IT examinations, examiners focus on the major issues and risks that are common to all IT activities. These common issues are:

- **Management of Technology** — planning for and oversight of technological resources and services and ensuring that they support the bank's strategic goals and objectives.
- **Integrity of Data** — the accuracy and reliability of automated information and associated management information systems (MIS).
- **Confidentiality of Information** — the protection of bank and customer information from inadvertent disclosure to outsiders.
- **Availability of Information** — the effectiveness of business resumption and contingency planning.

The community bank core assessment includes minimum standards for IT supervision in the form of examination conclusions and objectives. The core assessment objectives for IT directly correspond to the four common IT issues. Examiners are required to reach conclusions on each issue and communicate their conclusions in the report of examination.

The OCC has adopted the FFIEC's Uniform Rating System for Information Technology (URSIT). Examiners assign an "I" composite rating to all national banks. Examiners discuss this rating with bank management and disclose it in the report of examination.

Asset Management

Many community banks provide asset management-related services, including traditional fiduciary and retail brokerage services. Traditional fiduciary services include personal trust and estate administration, retirement planning, investment management and advisory, and corporate trust administration. Related services include custody and safekeeping, security-holder, financial planning, cash management, and tax advisory and preparation. The "Asset Management" booklet of the *Comptroller's Handbook* provides a complete overview of asset management services provided by national banks.

While asset management is not a defined RAS category, examiners assess the overall risk arising from both the type of activities conducted and the quality of risk management as low, moderate, or high using the risk matrix in appendix A as a guide. The portfolio manager uses this assessment of asset management risk, along with the potential impact that risk has to the bank as a whole, to develop the scope of future asset management supervisory activities.

The asset management section of the core assessment is structured to conduct supervisory activities along the asset management product lines typically found in community banks. The results of these reviews are then used to assess both the composite and component ratings under the Uniform Interagency Trust Rating System (UITRS). Under UITRS, the fiduciary activities of national banks are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components are management; operations, internal controls and auditing; earnings; compliance; and asset management. The ratings are discussed with bank management and disclosed in the report of examination.

Consumer Compliance

In all banks, the board of directors and management are required to monitor compliance with all applicable consumer protection laws and regulations, and Bank Secrecy Act/anti-money laundering/Office of Foreign Asset Control (BSA/AML/OFAC) legislation. Management should create an appropriate compliance program based on an evaluation of the bank's organization and structure, size, resources, diversity and complexity of operations, and delivery channels for its various products and services, including Internet and electronic banking. The compliance program should cover all consumer and BSA/AML/OFAC laws and regulations, and incorporate all areas of the bank to the extent appropriate to the risk that each area represents. Risk management processes should also be included in the compliance program to ensure that necessary systems and controls are in place.

The consumer compliance section of the core assessment is structured to conduct supervisory activities along five specific functional areas of compliance — fair lending, BSA/AML/OFAC regulations, lending regulations (including the Flood Disaster Protection Act), deposit regulations, and other consumer regulations. The review also focuses on the areas of highest compliance risk for community banks — those with the potential to cause customer harm or elicit public scrutiny. The results of these activities are then used to assess the compliance rating using the Uniform Interagency Consumer Compliance Rating System. This rating is discussed with bank management and disclosed in the report of examination.

While the risks arising from the five specific functional areas of compliance are not formally defined RAS categories, examiners do assess the quantity of risk and the quality of risk management for each area. In the RAS section in appendix A, an additional indicator has been added for each functional compliance area for examiners to use as needed to assist in this assessment. These assessments are then considered when determining the overall compliance risk of the bank and used by the portfolio manager, along with the potential impact of those risks on the bank as a whole, to develop the scope of consumer compliance supervisory activities.

Communicating

The OCC is committed to continual, effective communication with the banks that it supervises. All communications, such as formal and informal conversations and meetings, examination reports, as well as other written

materials should be professional, objective, clear, informative, and consistent. When examiners find significant weaknesses or excessive risks, these issues should be thoroughly discussed with bank management and the board of directors. The bank is then given a reasonable opportunity to resolve differences and correct weaknesses.

The OCC must provide the bank's board of directors a report of examination (ROE) once every supervisory cycle. The ROE communicates the overall condition and risk profile of the bank, and it summarizes the examiner's activities and related findings conducted throughout the supervisory cycle. Examiners should detail significant deficiencies and excessive risks, along with the corrective action to which the board or management has committed, in the report of examination's "Matters Requiring Attention" (MRA) page or in other written communications.¹⁵ See appendix C for more detail on the requirements for the ROE.

Examiners may also choose to formally communicate the results of activities conducted throughout the supervisory cycle as they occur. Those results are also then included in the ROE issued at the end of the cycle. However, most importantly, examiners must clearly and concisely communicate significant deficiencies and excessive risks to the bank whenever they are identified throughout the supervisory cycle either by sending a written communication to the board or by meeting with the board or management. Written communication is required if there is any significant change in an aggregate risk assessment or any CAMELS/ITC rating.

Appeals Process

The OCC seeks to ensure that its supervision is consistent and equitable, and that it resolves disputes with bankers fairly and expeditiously in an informal, professional manner. When disagreements cannot be resolved in this manner, a national bank can ask its OCC supervisory office or the OCC ombudsman to review the matter.

The OCC ombudsman operates outside the bank supervision area, and reports directly to the Comptroller of the Currency. With the prior consent of the Comptroller, the ombudsman may stay any appealable agency decision or action (e.g., regulatory ratings) during the resolution of the appealable matter.

¹⁵ For specific guidance on MRAs, refer to the "Bank Supervision Process" booklet of the *Comptrollers Handbook*.

The ombudsman may also report weaknesses in OCC policy to the Comptroller, and may recommend changes in OCC policy.¹⁶

¹⁶ For additional guidance on the appeals process and the definition of an appealable action, refer to OCC Bulletin 2002-9, "National Bank Appeals Process."

Community Bank Core Assessment

Examiners use the core assessment to monitor community banks and to conduct supervisory activities. The core assessment is risk-based and contains the conclusions and objectives that must be reached to meet the full-scope examination requirement and when completing monitoring activities within a bank's 12- or 18-month supervisory cycle. Risk considerations and references to the community bank risk assessment system are noted throughout the core assessment.

Generally, each section has a minimum objective that examiners will meet to complete the core assessment. After considering the bank's risk profile and outstanding supervisory issues, examiners should perform any additional objectives and procedures necessary to ensure that the bank's risk is appropriately managed. For banks or specific areas identified as low-risk, completing the minimum objectives in the core assessment should be sufficient to assess the bank's condition and risks. The examiner has the flexibility to expand the scope of the supervisory activity beyond the minimum objectives if necessary.

The core assessment is made up of the following sections:

- Examination Planning.
- Audit and Internal Control.
- Capital.
- Asset Quality.
- Management.
- Earnings.
- Liquidity.
- Sensitivity to Market Risk.
- Information Technology.
- Asset Management.
- Consumer Compliance.
- Examination Conclusions and Closing.

Examiners must use judgment in deciding how much work or supporting detail is necessary to complete the objectives under the core assessment. The policy for work paper documentation requirements, outlined in PPM 5400-8 (rev), "Supervision Work Papers," states that examiners should retain only

those files and documents, typically in a digital format, necessary to support the scope of the supervisory activity, significant conclusions, ratings changes, or changes in a risk profile. In addition, the work papers should clearly document which procedures were either fully or partially performed.

Examination Planning

Planning for supervisory activities is crucial to effective supervision by risk. The following objectives should be completed at least once during the supervisory cycle. However, if significant supervisory activities are conducted separately, some objectives may be completed more than once. The underlying procedures for each objective are optional. The timing of supervisory activities is flexible. The PM or EIC should consider OCC resources, discussions with bank management, and supervisory objectives when scheduling various activities. This section is used to broadly plan the supervisory activities conducted throughout the cycle. The objectives finalizing the scope for each area are included in the other sections of the core assessment.

Objective 1: Review the bank's characteristics and the supervisory activity's preliminary scope and objectives.

1. As appropriate, obtain and review the following:
 - Prior reports of examination.
 - Other applicable regulatory agency reports (e.g., holding company reviews, IT servicer examination reports, shared application software reviews (SASRs)).
 - OCC files:
 - Examination conclusions.
 - Periodic monitoring comments.
 - Risk assessment system ratings.
 - Canary system information.¹⁷
 - Financial and statistical models and databases (e.g., UBPR).
 - OCC correspondence file.
 - Prior examination work papers.
 - Any other internal or external information deemed pertinent to the bank.

¹⁷ For additional guidance in reviewing the Canary system information, refer to PPM 5000-34, "Canary Early Warning System."

2. As appropriate, discuss the bank and associated risks with the portfolio manager and the ADC.
3. Open the supervisory activity in Examiner View.

Objective 2: Develop a plan to conduct the supervisory activity.

1. Assign examining personnel to review the information obtained under Objective 1.
2. Contact bank management to discuss the following, as appropriate:
 - Preference for obtaining the request letter information in digital form.
 - The activity's timing.
 - The activity's general scope and objectives.
 - General information about examiners' schedules, staffing levels, and projected time during which examiners will be at the bank.
 - The availability of key bank personnel during the activity.
 - Actual or planned changes in the bank's financial condition, including any significant injection of capital and the bank's plans to deploy such capital.
 - Actual or planned changes in bank products or services including areas of growth.
 - Actual or planned changes in bank management, key personnel, or operations.
 - Results of audit and internal control reviews, any follow-up required by management, and audit staffing.
 - Any material changes to internal or external audit's schedule or scope.
 - Significant trends or changes in the local economy or business conditions.
 - Broad economic and systemic trends affecting the condition of the national banking system, including those identified by the OCC's national or district risk committees.
 - Purchase, acquisition, or merger considerations.
 - Issues or changes in technology, including operational systems, technology vendors/servicers, critical software, Internet banking, or plans for new products/activities that involve new technology.

- Issues or changes in asset management lines of business.
- Issues or changes regarding consumer compliance, CRA, or BSA/AML/OFAC systems.¹⁸
- Other issues that may affect the risk profile.
- Management concerns about the bank or OCC's supervision, including any areas bank management would like the OCC to consider in the examination scope.

Objective 3: Determine whether changes to the supervisory strategy are needed.

Determine whether the bank has been identified as low-risk or if any specific areas have been identified as low- or high-risk. Review and assess the appropriateness of the current supervisory strategy for the bank. With approval from the supervisory office ADC, modify the strategy as appropriate. Consider:

- Information obtained from bank management.
- Findings from periodic monitoring activities.
- Discussions with supervisory office personnel.
- The supervisory cycle for CRA examinations.

Objective 4: Prepare for the supervisory activity.

1. As appropriate, prepare a scope memorandum.
2. Coordinate the activity with other regulatory agencies, as necessary.
3. If appropriate, arrange with OCC Information Technology Services for the installation of a dedicated analog telephone line at the bank. Make the request at least 20 days prior to the start date of the activity.
4. Designate assignments for examining staff.
5. Send the bank a request letter that provides:
 - The supervisory activity start date.
 - The activity's scope and objectives.
 - Advance information the bank must provide to the examination team, including due dates for submission of requested items.

¹⁸ BSA/AML/OFAC – Bank Secrecy Act, anti-money laundering, and Office of Foreign Assets Control.

- Information the bank must have available for examiners upon their arrival at the bank.
- The name, address, and telephone number of the OCC contact.
- Instructions regarding the delivery of digital files.

Note: Appendix C is a standard request letter for community bank examinations (including IT, fiduciary, and consumer compliance). The letter should be customized to reflect both the supervisory activity's scope and the bank's risk profile. For other expanded examinations of specialized areas, refer to the appropriate booklets of the *Comptroller's Handbook* or the *FFIEC IT Examination Handbook*.

6. Prepare supplies and equipment to take to the bank for the supervisory activity.
7. Generally within one week of the start of the activity, review the items and finalize the scope of the activity.

Objective 5: Conduct on-site planning meetings.

1. At the beginning of the supervisory activity, meet with the CEO and appropriate members of senior management, board members, or board committees to:
 - Explain the scope of the activity, the role of each examiner, and how the team will conduct the activity.
 - Confirm the availability of bank personnel.
 - Identify communication contacts.
 - Answer any questions.
2. At the beginning of the activity, meet with the examination staff to confirm:
 - Scope and objectives.
 - Work days.
 - Assignments and due dates.
 - Administrative duties.
 - Guidelines for contact and communication between the examining team, bank management, and the OCC supervisory office.

Audit and Internal Control

**Conclusions: The quality of audit is (strong, satisfactory, weak).
The system of internal control is (strong, satisfactory, weak).**

Complete this section's objectives to assess the quality of the bank's overall audit and system of internal controls. In completing these assessments, the examiner should consult the EIC and other appropriate personnel. Consider the following factors when assessing the quality of audit and internal controls:

- Board and management oversight.
- Management and processes.
- Reporting.
- Staffing.

CORE ASSESSMENT

Minimum Objective: Determine the quality of audit and internal control systems, and consider the potential impact of these findings on the bank's risk assessment.

During the supervisory cycle, hold discussions with management covering actual or planned changes in the auditor control systems.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities, including any memorandums issued as part of a centralized outsourced internal audit vendor review.
- Board/audit committee minutes and related internal/external audit packages and information submitted to the board/audit committee.
- A small sample of internal audit work papers. The sample should focus on high-growth or high-risk areas, and any new products or services offered by the bank.

Communicate any significant weaknesses identified by audit to the examiners assigned to review other functional areas for follow-up, as appropriate.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner

should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the audit and internal controls review.

Other Assessment Objectives: NOTE: Examiners should complete only those objectives necessary to assess the bank's condition and risks.

Objective 1: Finalize the scope of the audit review. The examination will include a sample of internal audit work papers, representing a cross-section of the bank's functions, activities, and bank-assigned internal audit ratings. The sample should focus on high-growth, substantive, or high-risk areas, and any new products or services offered by the bank. If a director's examination serves as the bank's only audit program and consists of both internal and external audit work, a sample of the internal audit activity work papers should be reviewed.

1. If not previously provided, obtain and review the following, as applicable:
 - Most recent external audit engagement letter and other written communications between the bank and the external auditor.
 - Internal and external audit reports issued since the last examination, including management letters, attestation reports, and SAS 70 reports on IT servicers, if any.
 - Current year internal and external audit plan/schedule and status reports.
 - Management's responses to internal and external audit reports issued since the last examination.
 - Detailed listing of job duties/responsibilities of internal auditor.
 - Resumes of audit staff including educational and work background, industry certifications, and recent developmental training.
 - Audit committee minutes or excerpts of board minutes applicable to audits since the last examination and audit packages and information submitted to the audit committee or board.
 - Internal audit outsourcing contracts/agreements/reports, etc.
 - Any memorandums issued as part of an OCC centralized outsourced internal audit vendor review.

2. Discuss with the examiners responsible for completing other functional areas of the core assessment any significant audit findings that require follow-up.

3. In consultation with the EIC and examiners assigned major functional and specialized¹⁹ examination areas, identify and select an appropriate sample of internal audit work papers for validation purposes. Consider having examiners who are responsible for other bank activity and specialized areas review the internal audit work papers associated with those activities.

Note: In most situations, a **work paper review** of the procedures and testing performed by the internal auditor should be sufficient in scope to substantiate conclusions about the quality and reliability of the auditing work. **Audit procedures should not be re-performed.**

Objective 2: Determine the quality of board or audit committee oversight of the bank's audit programs.

1. Obtain audit-related information from the examiner assigned to review board minutes. Review and discuss with management, as appropriate, audit committee minutes or summaries and audit information packages to determine whether:
 - Internal and external audit plans, policies, and programs, including any changes/updates and selection/termination of external auditors or outsourced internal audit vendors, are periodically reviewed and approved by the board of directors or its audit committee.
 - The board/audit committee meets regularly with internal and external auditors and receives sufficient information and reports to effectively monitor the audit and ensure that internal and external auditors are independent and objective in their findings.
 - The board/audit committee monitors, tracks, and, when necessary, provides discipline to ensure that management properly addresses control weaknesses noted by internal or external auditors and examiners.
 - Audit findings and management's responses are reported directly to the board or audit committee.
 - The board or audit committee retains auditors who are fully qualified to audit the kinds of activities in which the bank is engaged. They work with internal and external auditors to ensure

¹⁹ Refer to the appropriate booklets of the *Comptroller's Handbook*, if needed, for additional guidance when reviewing internal audit work papers of specialized examination areas.

that the bank has comprehensive audit coverage to meet the risks and demands posed by its current and planned activities.

- The board or audit committee periodically evaluates the operations of the internal audit function, including any outsourced internal audit activities, and has significant input into the performance evaluation of the internal auditor or outsourced internal audit vendor.
 - At least a majority of the audit committee's members are outside directors when practicable (for banks not subject to 12 CFR 363).
 - If the bank has fiduciary powers, a fiduciary audit committee that complies with 12 CFR 9.9, Audit of Fiduciary Activities, directs the fiduciary audit program.
2. If the bank has total assets of \$500 million or more, determine compliance with 12 CFR 363, Annual Independent Audits and Reporting Requirements and auditor independence requirements of the SEC.

Objective 3: Determine the adequacy of the bank's internal audit function.

1. If the bank has no internal audit function, determine management's rationale and any mitigating factors (e.g., strong external audit or director's examination and internal control systems, limited complexity of operations/low risk).
2. Assess the quality of internal audit activities, including any outsourced internal audit activities, by considering:
 - The bank's size, complexity, and risk profile.
 - The quality and effectiveness of internal control assessments, including those for financial reporting.
 - Whether the audit is focused on appropriate areas, given the bank's risk profile.
 - The quality of audit reports and findings.
 - The quality and timeliness of management responses to audit findings and whether audit follows up on significant findings in a timely manner to assess the effectiveness of management's responses.
 - Reporting lines to the board or audit committee.
 - The quality and depth of audit coverage and audit procedures, including regular testing of internal control and MIS.

- Whether audit provides constructive business advice or consulting on evaluating safeguards and controls in the acquisition and implementation of new products, services, and delivery channels, and what its role is in merger, acquisition, and transition activities.
 - Whether audit plans address goals, schedules, staffing, and reporting.
 - Progress made toward completing annual audit plans or schedules.
 - Whether audit scope is adjusted for any significant changes in the bank's environment, structure, activities, risk exposures, systems, or new products or services.
 - The use of audit software and other computer-assisted audit techniques.
3. Determine the competence and independence of the internal audit staff, whether in-house or outsourced. Consider:
- Auditor/staff experience and training.
 - Auditor/staff tenure, turnover, and vacancies.
 - Any incompatible duties performed by the auditor or staff.
 - Lines of reporting, operational duties assigned to the auditor, or other restrictions or relationships.
 - Staff's ability to meet the audit schedule.
4. Review any internal audit outsourcing arrangement contracts or engagement letter and determine whether they adequately address the roles and responsibilities of the bank and the internal audit outsourcing vendor (see OCC Bulletin 2003-12, "Interagency Policy Statement on Internal Audit and Internal Audit Outsourcing"). Determine whether:
- The arrangement maintains or enhances the quality of internal audit and internal control.
 - Key bank employees and the vendor clearly understand the lines of communication and how the bank will address internal control or other problems noted by the vendor.
 - The board and management perform sufficient due diligence to verify the vendor's competence and objectivity before entering into the outsourcing arrangement.
 - The bank has an adequate process for periodically reviewing the vendor's performance and ensuring that the vendor maintains sufficient expertise to perform effectively throughout the life of the arrangement.

- The arrangement compromises the role or independence of a vendor who also serves as the bank's external auditor.
5. If the bank has fiduciary powers, determine the quality of the fiduciary audit function and whether it complies with the audit standards in 12 CFR 9.9, Audit of Fiduciary Activities. Determine whether:
- A suitable audit of all fiduciary activities is completed at least once during each calendar year or under a continuous audit program.
 - Audit results, including significant actions taken as a result of the audit, are noted in the board minutes.
 - If the bank uses a continuous audit, the results of all discrete audits performed since the last audit reports, including all significant action, are noted in the board minutes at least once during the calendar year.
6. Determine the quality of the bank's anti-money laundering program audit function and whether it complies with 12 CFR 21.21, Bank Secrecy Act compliance. Determine whether:
- Compliance testing is completed on an annual basis.
 - If the testing is not completed annually, the risk analysis used by management to set the testing schedule is reasonable and the frequency is comparable to other audit efforts.
 - The audit covered all regulatory provisions and the bank's policies and procedures for complying with BSA/AML/OFAC regulations.

Objective 4: Determine whether the bank has implemented an appropriate external audit function.

1. If the bank has no external audit function, determine management's rationale and any mitigating factors (e.g., strong internal audit and internal control systems, limited complexity of operations/low-risk). Consider:
- The bank's size.
 - The nature, scope, and complexity of bank activities.
 - The bank's risk profile.
 - Actions (taken or planned) to minimize or eliminate identified weaknesses.

- The extent of the bank's internal auditing program.
 - Any compensating internal controls in place.
2. Determine which of the following types of external audit programs the bank has:
 - Financial statement audit.
 - Attestation report on management's assertion of financial reporting internal control.
 - Balance sheet audit.
 - Agreed-upon procedures (e.g., directors' examination, specialized audits such as IT, fiduciary, or compliance/BSA).
 3. If a financial statement audit was performed, determine what type of opinion was issued (unqualified, qualified, adverse, or disclaimer).
 4. Determine whether the external audit program is performed by an independent public accountant (IPA) or other independent external party and whether the program is appropriate given the bank's size, the nature and extent of its activities and operations, and its risk profile.
 5. Review the engagement letter and assess its adequacy. Consider:
 - The purpose and scope of the audit.
 - The period of time to be covered by the audit.
 - The reports expected to be rendered.
 - Any limitations placed on the auditor's scope or work.
 6. Arrange with bank management to meet with the external auditor to discuss:
 - The external audit's scope, results or significant findings, and upcoming audit plans or activities.
 - Reports, management letters, and other communications (written or oral) with the bank's board or audit committee.
 - Audit planning methodologies, risk assessments, sampling techniques, and (if applicable) 12 CFR 363 control attestations.
 - How much the external auditor relies on the work of internal auditors and the extent of external audit's assessment and testing of financial reporting controls.

- Assigned audit staff experience and familiarity with banking and bank auditing, particularly in specialized areas.
7. Determine whether the board of directors or its audit committee and the external auditor have discussed and resolved any financial, employment, business, or non-audit service relationships that compromise or appear to compromise the external auditor's independence.
 8. Examiners are not required to review external audit work papers. However, external audit work papers may be subject to OCC review if the review of internal audit discloses significant issues (i.e., insufficient internal audit coverage) or questions are otherwise raised about matters that are normally within the scope of an external audit program. Examiners should consider whether to review external audit work papers for particular areas where problems or questions exist. Examiners should also consider reviewing appropriate external audit work papers when:
 - An unexpected or sudden change occurs in the bank's external auditor.
 - A significant change occurs in the bank's external audit program.
 - Issues are raised that affect the bank's safety and soundness.
 - Issues are raised about the independence, objectivity, or competence of the external auditor.

Review of External Audit Work Papers

Examiners should meet with bank management and the external auditor, consult with their district accountant, and obtain approval from the supervisory office ADC before reviewing external audit work papers. These discussions may make the work paper review unnecessary, or it may help examiners focus their review on the most relevant work papers. Examiners should not make a blanket request to review all external audit work papers. All requests should go through bank management, be specific as to areas of greatest interest, and provide reasons for the request.

Examiners should consider requesting that the external auditor make available, for the specific areas to be reviewed, related planning documents and other information pertinent to the area's audit plan (including the sample selection process). Consider having examiners

responsible for reviews of other bank activity areas review the external audit work papers associated with those activities. If bank management or the external auditor fails to provide access to the work papers, the EIC should contact the supervisory office ADC, district accountant, and district counsel to discuss how the situation might be resolved.

Objective 5: Using the findings from the audit review and other areas under examination, assess the bank's internal control system.

1. Assess the bank's control environment. As appropriate, consider:
 - The organizational structure of the bank (e.g., centralized or decentralized, authorities and responsibilities, and reporting relationships).
 - Management's philosophy and operating style (e.g., formal or informal, conservative or aggressive, success of risk strategy).
 - External influences affecting operations and practices (e.g., independent external audits).
 - The goals, objectives, attention, and direction provided by the board of directors and its committees, especially the audit or risk management committees.

2. Evaluate the bank's internal risk assessment system. As appropriate, consider:
 - The effectiveness of the system to identify, measure, monitor, and control the risks.
 - The responsiveness of the system to changing risk conditions.
 - The competency, knowledge, and skills of personnel.
 - Adequacy of blanket bond coverage in relation to the bank's risk profile.

3. Assess the bank's control activities. As appropriate, consider:
 - Quality of policies, procedures, and audit.
 - Quality and timeliness of management and staff training.
 - Timeliness of risk analysis and control processes.
 - Approvals and authorization for transactions and activities.

- Supervision and oversight of payments against uncollected funds (potential for kiting).
 - Segregation or rotation of duties to ensure that the same employee does not originate a transaction, process it, and then reconcile the general ledger account.
 - Vacation requirements or periodic unannounced rotation of duties for personnel in sensitive positions.
 - Safeguards for access to and use of sensitive assets and records, including wire transfer activities.
 - Internal review of employee accounts and expense reports.
 - Dual control or joint custody over access to assets (e.g., cash, cash collateral, official checks, and consigned items).
 - Independent checks or verifications on function (e.g., lending and wire transfer) performance and reconciliation of balances.
 - Timely account reconciliation and resolution or clearing of outstanding items.
 - Accountability for the actions taken by bank staff and the responsibilities/authorities given to them.
4. Assess the bank's accounting, information, and communication systems. As appropriate, determine whether:
- MIS identify and capture relevant internal and external information in a timely manner.
 - Systems ensure accountability for assets and liabilities.
 - Information systems ensure effective communication of positions and activities.
 - Business resumption and contingency planning for information systems are adequate.
5. Evaluate the bank's self-assessment and monitoring systems. As appropriate, consider:
- Periodic evaluations, self-assessments, or independent audits of internal control.
 - Whether the system ensures timely and accurate reporting of deficiencies.
 - Processes to ensure timely modification of policies and procedures, as needed.
 - Any audit requirements established by the bank's blanket bond company as specified in the insurance application and policy.

Objective 6: Determine whether expanding the scope of the supervisory activity or developing a plan for corrective action is warranted.

1. If the review of audit or internal control, including the work paper review, discloses significant audit or control discrepancies or weaknesses that are not mitigated by a satisfactory or strong risk management program, consider whether expanded examination procedures (including internal control questionnaires (ICQs)) should be performed to identify the extent of problems and determine their effect on bank operations. Consider expanding procedures if any of the following issues are identified:
 - Concerns about the competency or independence of internal or external audit.
 - Unexplained or unexpected changes in internal or external auditors or significant changes in the audit program.
 - Inadequate scope of the overall audit program, or in key risk areas.
 - Audit work papers in key risk areas that are deficient or do not support audit conclusions.
 - High growth areas without adequate audit or internal control.
 - Inappropriate actions by insiders to influence the findings or scope of audits.

2. If, after completing Step 1, significant concerns remain about the adequacy of audit, the adequacy of internal control, or the integrity of the bank's financial controls, consider whether to select appropriate verification procedures to determine the root causes of the concerns and the effect on bank operations. Examiners will use verification procedures if any of the following issues are identified:
 - Key account records are significantly out of balance.
 - Management is uncooperative or poorly manages the bank.
 - Management attempts to restrict access to bank records.
 - Significant accounting, audit, and internal control deficiencies remain uncorrected from prior 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.

Note: There may be other situations where examiners believe audit or controls warrant further investigation. In those cases, examiners should consider the risk posed by any noted weaknesses and use judgment in deciding whether to perform verification procedures.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, district counsel, and the district accountant should also be notified when direct confirmations are being considered.

In lieu of having examiners perform the verification procedures, the EIC may consider having the bank expand its audit program to address the weaknesses or deficiencies. However, this alternative should 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. The EIC may also consider having the bank contract with an independent third party to perform the verification procedures, especially if management's capabilities and commitments are inadequate or there are substantive problems in having the bank or its internal audit function perform the procedures. If used, these alternatives must resolve each identified supervisory problem in a timely manner. Supervisory follow-up will include a review of audit work papers in the areas where the bank audit was expanded.

Objective 7: Conclude the audit and internal control review.

1. Determine quality of audit (strong, satisfactory, weak) and internal controls (strong, satisfactory, weak).

2. If warranted, develop action plans to address audit or control deficiencies before conducting the exit meeting. Consider management's ability to correct the bank's fundamental problems.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (e.g., separate comment, part of management/administration, MRA) for inclusion in the report of examination.
4. Incorporate the assessments into assigned CAMELS/ITCC and risk assessment ratings.
5. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the audit and internal control review that are relevant to other areas being reviewed.
6. Communicate conclusions regarding the quality of audit and the system of internal controls to the EIC or examiner responsible for consolidating conclusions from the "Management" section.
7. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
8. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
9. In discussion with the EIC, provide preliminary strategy recommendations for the next supervisory cycle.

Capital

Conclusion: Capital is rated (1, 2, 3, 4, 5).

Complete the appropriate objectives in this section to assign the capital component rating. In assigning the rating, the examiner should consult with the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- 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 the allowance 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 the capital markets and other sources of capital, including support provided by a parent holding company.

Note: A financial institution is expected to maintain capital commensurate with the nature and extent of risks to the institution and the ability of management to identify, measure, monitor, and control these risks. When evaluating the adequacy of capital to assign the capital component rating, examiners should consider the bank's risk profile.

CORE ASSESSMENT

Minimum Objective: Determine the capital component rating and any potential impact on the bank's risk assessment.

At the beginning of the supervisory activity, hold discussions with management covering:

- The bank's present condition and future plans (e.g., dividends, growth, new products, and strategic initiatives, including any plans to raise and deploy significant new injections of capital).
- Actual or planned changes in controlling ownership.

As requested, follow up on significant capital audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- The bank's current risk-based capital computation.
- Results from OCC supervisory activities.
- Results from other areas of this and other supervisory activities that may affect capital adequacy (e.g., earnings, asset quality).
- Canary system information.
- UBPR and other OCC models.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the capital review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the capital review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
3. If not previously provided, obtain and review the following:

- The bank's current risk-based capital computation.
 - Findings from monitoring activities.
 - A list of shareholders that own 5 percent or more, and their percentage of ownership.
3. If necessary, update information about controlling ownership in core knowledge.
 4. As appropriate, calculate and distribute capital limits and shareholder information to other examiners.

Objective 2: Determine the adequacy of capital.

1. Review applicable information to identify trends. Consider:
 - Results from monitoring activities.
 - Reports used by bank management to monitor and project capital requirements.
 - Canary system information.
 - UBPR and other OCC model calculations to compare the bank's ratios with those of peer banks.
 - The bank's present condition and future plans.
2. Obtain capital-related information from the examiner assigned to review board minutes.
3. Consider the impact of the following on current or future capital adequacy:
 - Dividends.
 - Earnings.
 - Asset quality and allowance adequacy.
 - Historical and planned growth.
 - On- and off-balance-sheet activities.
 - Strategic initiatives, including any plans to raise and deploy significant new injections of capital.
 - Financial plans and budgets, including replacement costs for fixed assets and technology.
 - New products, services, or distribution channels.
 - Related organizations.

4. Evaluate the sources of capital. Consider:
 - Earnings retention.
 - Ownership capacity — condition of principal shareholders, parent, or subsidiaries.
 - History of public or private offerings.

Objective 3: Determine the risk to capital posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk has an adverse impact on current or future capital adequacy. Refer to the section “Risk Assessment System,” as needed.

Objective 4: Determine the quality of risk management systems through discussions with key risk managers and analysis of applicable information.

1. Assess the bank’s system of internal control over the capital accounts. Take into consideration the relevant controls listed in objective 5 of the “Audit and Internal Control” section of the core assessment. Also take into consideration other controls pertinent to capital.
2. Assess the timeliness, completeness, accuracy, and relevance of MIS for capital. Consider the sources of reports, controls over the preparation of reports, and whether the reports’ accuracy is independently validated. This review should be coordinated with the examiners responsible for all functional areas of the examination, including internal control, to avoid duplication of effort. Findings should be communicated to the examiner reviewing IT.

Objective 5: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 6: After completing any additional procedures, determine whether risks and concerns indicate the need to perform additional verification procedures.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 7: Conclude the capital review.

1. Adjust the bank's reported capital ratios to reflect the results of the examination and distribute them to appropriate examining personnel. Consider:
 - Asset charge-offs.
 - Examiner-directed additions to the allowance for loan and lease losses (ALLL).
 - Errors in financial reporting.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the capital review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., capital adequacy, MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
6. In discussion with the EIC, provide preliminary strategy recommendations for the next supervisory cycle.

Asset Quality

Conclusion: Asset quality is rated (1, 2, 3, 4, 5).

Complete this section's objectives to assign the asset quality component rating. In assigning the rating, the examiner should consult with the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The quality of risk selection and underwriting standards, soundness of credit administration practices, and effectiveness of risk identification practices.
- The risk rating profile of the loan portfolio, including trend of multiple pass grades (if applicable) and 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, 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 policy exceptions including exceptions to underwriting and risk selection standards.
- The volume and nature of credit documentation and collateral exceptions.

Note: The examiner should consider the ability of management to identify, measure, monitor, and control both the current and planned level of credit risk when assigning the component rating.

CORE ASSESSMENT

Minimum Objective: Determine the asset quality component rating, the adequacy of the ALLL, the quantity of credit risk, and the quality of credit risk management.

At the beginning of the supervisory activity, hold discussions with management covering actual or planned:

- Changes in the administration of the loan portfolio.
- Changes in the lending area's management or staff.
- Changes in loan products, marketing, loan acquisition channels (including third-party relationships), lending policies or practices, or loan growth.
- Changes in the number of loan policy, credit, and collateral exceptions.
- Changes in the loan review process or loan grading system.
- Other changes in external or internal factors that could affect loan quality.

As requested, follow up on significant asset quality audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Canary system information.
- UBPR and other OCC models.
- Past-due and nonaccrual reports.
- Risk-rating distribution reports.
- Problem and "watch" loan lists.
- Insider loan list.
- Concentration of credit reports.
- ALLL analysis.
- List of participations (whole and in-part) purchased and sold since the last examination.
- All loan review reports and any responses since the last examination.
- The detail of any "other asset" accounts that are material to the financial statements.

Review an appropriate sample of loans. The sample should generally include:

- At least five newly advanced credits, including loan commitments.
- Large insider loans.
- Past-due and nonaccrual loans.
- Previously criticized loans and loans from the bank's problem and "watch" loan lists.

The size of the sample should be based on the trends and overall risk posed by those segments of the loan portfolio. The purpose of the review is to determine whether the loans evidence any changes in the bank's risk selection, the bank's underwriting practices, its credit administration, its risk-rating criteria, or any other aspect of its credit risk management. This may be accomplished by reviewing credit files, approval documents, and loan committee minutes. Documentation of credit file reviews can normally be limited to summary comments detailing the loan classification and the facts supporting it. Loan review discussions and meetings to discuss findings are to be held onsite.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the asset quality review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the asset quality review.

These procedures apply to both commercial and retail credit portfolios, unless specifically stated otherwise. Refer to the "Loan Portfolio Management" booklet of the *Comptroller's Handbook* for additional guidance on assessing the quality of risk management and setting the scope of asset quality reviews.

1. Review the supervisory information to identify any previous problems in this area that require follow-up.
2. Discuss with the examiner responsible for completing the “Audit and Internal Control” section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
3. If not previously provided, obtain and review reports management uses to supervise the loan portfolio, including but not limited to:
 - Loan trial balances.
 - Risk rating reports.
 - Past-due and nonaccrual reports.
 - Problem and “watch” loan lists, including retail workout programs.
 - Concentration of credit reports.
 - Insider loan lists.
 - List of participations (in-whole or in-part) purchased and sold since the last examination.
 - Overdraft list.
 - Most recent ALLL analysis.
 - Loan policy, loan underwriting, credit, and collateral exception reports.
 - Findings from monitoring activities.
 - Latest loan review report, including any responses from bank officers.
4. Review the UBPR, Canary system information, and other OCC models, and request information to assess the size, composition, and trends in the loan portfolio and any off-balance-sheet exposures. Consider:
 - Current and planned loan growth in relation to bank capital and risk limits.
 - Pockets of high growth.
 - Internal portfolio management reports (loan policy exceptions, credit exceptions, collateral exceptions, concentrations of credit, etc.).
 - Unfunded loan commitments.
 - Deteriorating trends in asset quality indicators.
 - Any other information related to the risk characteristics of the loan portfolio, including:

- Local/national economic indicators.
 - Trends at other local financial institutions.
 - New products planned or already initiated.
5. Determine, during discussions with management:
- How the bank administers the loan portfolio and monitors loan quality.
 - Whether loan products, lending practices (underwriting and risk selection standards, out-of-area lending, etc.), or service distribution channels have changed significantly.
 - Whether any external or internal factors could affect loan quality (e.g., local industry reduction or expansion, management and lending staff changes, changes in credit concentrations, changes in product lines).
6. Obtain asset quality-related information from the examiner assigned to review board minutes. Review, as appropriate, minutes of the loan committee meetings to review the bank’s lending practices.
7. As appropriate, obtain the bank’s current loan policies and review any changes made since the last examination. **Note:** The policies should be used mainly as reference tools when completing the loan sample and determining exception levels.
8. Use bank reports to select an appropriate sample of loans from the bank’s loan portfolio (commercial, retail, etc.) Consult with the EIC when selecting the sample. Consider:
- Large-dollar commercial loans.
 - Loan participations (in whole or part) purchased and sold.
 - Loans sourced or originated through brokers and other third parties.
 - Significant loan concentrations.
 - New loans in new loan products and in seasoned products or portfolios experiencing rapid growth.
 - Loans securitized and sold which the bank services for investors.
 - Insider loans and loans to affiliates.
 - Lower rated “pass” and “watch” loans.

- Loans previously identified as structurally weak, loans that are exceptions to lending policies, risk selection, and underwriting standards.
- Higher risk lending products, such as leveraged finance, high loan-to-value real estate loans, and subprime loans.
- Loans or lending concentrations to businesses or industries exhibiting signs of weakness or higher risk.
- Loans on the problem loan list and loans previously classified, significant past-dues, nonaccruals, troubled debt, and restructured loans. (**Note:** Loans that are not reviewed in detail should be discussed without preparing line sheets.)

Since credit risk typically poses the largest single risk to a bank's earnings and capital, and loans are the largest asset concentration in most banks, the OCC usually samples a significant percentage of loan portfolios. Examiners use a statistically valid sampling technique or take a judgmental sample.

The size and composition of the loan sample should be commensurate with the quantity of credit risk, the adequacy of risk management, the bank's condition, and the objectives of the asset quality review. Examiners should use judgment when determining the focus and extent of testing.

The types of loans in the sample are as important as how much of the portfolio is reviewed. The sample should be skewed toward the predominant risks in the portfolio. The higher the risk posed to the bank, the more comprehensive the coverage and testing.

In a stable, well-managed bank exhibiting few signs of change, examiners should sample a smaller number of new and pass-rated credits for the purpose of determining the continued adequacy of loan quality and credit risk management.

If the number of exceptions to sound underwriting practices or risk selection practices is significant, or if a bank's risk identification or credit administration is suspect or deficient, the examiner should expand the sample to determine the problems' cause, their seriousness, and their effect on credit quality. Additional samples may also be required, for example, when banks have significant growth, the loan or product mix changes, credit or economic conditions deteriorate, strategic direction or key personnel change, or loan portfolio management is suspect or deficient. The additional sample should target lending areas that prompted the expanded loan coverage.

9. Use reports or information obtained directly from external sources to verify the balances of any assets serviced by third parties. Examiners should reconcile the balances indicated on the bank's financial records to the information provided by the third party. Any material differences should be investigated thoroughly.

Objective 2: Determine, by testing loans independently, the quantity of credit risk inherent in the loan portfolio.

1. Analyze credits and discuss loans sufficiently to determine a risk rating for each loan reviewed. The analysis should include a review of related debt.
2. Document and support the reasons for each loan rating. Refer to PPM 5400-8 (rev), "Supervision Work Papers," for documentation and work paper requirements.
3. Maintain a list of commercial loans identified as having structural weaknesses during the examiner's analysis of the individual credits.
4. Maintain a list of loans for which the examiner's or management's ability to rate the loan was impaired because of a lack of sufficient information on credit or collateral. Consider:
 - Patterns or root causes of exceptions.
 - Relation of exceptions to credit processes.
 - The impact on credit risk.
5. For retail loans, perform a portfolio analysis. Consider:
 - Size of the portfolio and rate of growth.
 - Changes in products, marketing channels, underwriting standards, operations, and technology.
 - Level and trends in delinquencies and losses by product.
 - The impact on credit risk.
 - Levels and trends in re-agings, extensions, deferrals, renewals, and rewrites.
 - Dependence on third-party vendors and the adequacy of controls regarding the relationship.

6. Based on the results of the portfolio analysis of retail loans, select a sample of loans to determine the bank's underwriting and account management practices.
7. Determine conformity with OCC 2000-20, "Uniform Retail Credit Classification and Account Management Policy":
 - Review past-due retail loans (residential real estate, consumer loans, check credit, etc.) and discuss with management. (Unless warranted, detailed line sheets **should not** be prepared.)
 - As appropriate, review the policies and controls, and determine the practices for re-aging open-end accounts and extensions, deferrals, renewals, and rewrites of closed-end loans.
8. Determine the credit risk inherent in the loan portfolio as a whole, considering the risk-rating profile, underwriting and risk selection practices, concentrations, loan policy exceptions, credit and collateral exceptions, pricing, collateral coverage, adequacy of analysis and credit administration practices, economic indicators, etc.

Objective 3: Determine the quantity of credit risk associated with other assets.

1. As appropriate, obtain and review a list of the following items:
 - Other real estate (ORE).
 - Repossessed assets.
 - Cash items.
 - Other asset accounts with material balances.
2. If the level of credit risk associated with ORE appears significant, review a sample of ORE to determine whether management applies proper accounting treatment. Consider:
 - Timing and recognition of losses.
 - Accounting for expenses.
 - Risk to capital or adequacy of ORE reserves.
3. Obtain a list of classified investments and other appropriate findings regarding the quality and composition of investments from the examiner evaluating the investment portfolio.

4. In discussion with bank management and based on the review of other assets listed above, determine which items should be classified or charged off.

Objective 4: Determine the adequacy of the ALLL.

1. Evaluate the method used to determine the ALLL balance. Consider:
 - The reasonableness of management's process.
 - The quality and adequacy of the supporting documentation.
 - Findings from the asset quality review.
 - Applicable OCC and interagency guidance.
2. If the ALLL methodology is considered flawed, consult with the EIC to independently determine the adequacy of the ALLL balance. If the ALLL is determined to be inadequate:
 - Calculate the necessary provision to restore the ALLL to an adequate level.
 - Direct bank management to make any necessary adjustments to the call report.
 - As appropriate, share these findings with other examining personnel.

Objective 5: Determine the quality of credit risk management systems through discussions with key risk managers, analyses of applicable information, including loan review reports.

1. Determine whether the number and nature of credit, collateral, and policy exceptions; risk rating changes; or other loan review findings raise concerns about the quality of the credit administration function.
2. Determine whether loan management and personnel are adequate to effectively oversee the quantity of credit risk inherent in the loan portfolio. Consider:
 - Staffing size.
 - Staffing expertise.
 - Compensation systems.

3. Assess the timeliness, completeness, accuracy, and relevance of MIS for credit risk. Consider the sources of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated. Risk management reports should cover major sources of credit risk identified in objectives 3 and 4 above. This review should be coordinated with the examiners responsible for all functional areas of the examination, including internal control, to avoid duplication of effort. Findings should be communicated to the examiner reviewing IT.
4. Using the findings from achieving the previous objectives, consult with the EIC and other appropriate examining personnel to make preliminary judgments on the adequacy of portfolio risk management systems. Consider whether:
 - Management recognizes and understands existing and emerging risks.
 - Management measures risk in an accurate and timely manner.
 - The board establishes, communicates, and controls risk limits.
 - Management accurately and appropriately monitors established risk levels.
5. Assess the bank's system of internal control over the credit function. Examiners should take into consideration the relevant controls listed in objective 5 of the "Audit and Internal Control" section of the core assessment. Examiners should also take into consideration other controls pertinent to the credit function.

Objective 6: Using the findings from meeting the previous objectives, determine whether the bank's risk exposure from asset quality is significant.

Develop preliminary assessments of quantity of credit risk, quality of credit risk management, aggregate credit risk, and direction of credit risk. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

In consultation with the EIC and other examining personnel, identify any significant risks that should be considered in the risk assessment conclusions.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the asset quality review.

1. Provide and discuss with management a list of credit and collateral exceptions, policy exceptions, loans with structural weaknesses, classified assets, assets listed as special mention, and loan write-ups, as appropriate.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the asset quality review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., asset quality, concentrations, MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations, concentrations).

6. In discussion with the EIC, provide preliminary conclusions about:
- The quantity of credit risk.
 - The quality of credit risk management.
 - The aggregate level and direction of credit risk or any other applicable risk. As appropriate, complete the summary conclusions in the section “Risk Assessment System.”
 - Supervisory strategy recommendations.

Management

Conclusions: Management is rated (1,2,3,4,5).

Complete this section's objectives to assign the management component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- Conclusions from all areas.
- The level and quality of board and management oversight and support of all the bank's activities.
- 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 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 to the institution's size, complexity, and risk profile.
- The adequacy of audit and internal control systems to promote effective operations and reliable financial and regulatory reporting, safeguard assets, and 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 are affected by, or susceptible to, a dominant influence or 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.

Note: In determining the component rating for management, examiners assess the capability of the board of directors and management to identify, measure, monitor, and control the risks of an institution's existing and planned activities.

CORE ASSESSMENT

Minimum Objective: Determine the management component rating, the aggregate level of reputation and strategic risk, and consider the potential impact of these findings on the bank's risk assessment.

At the beginning of the supervisory activity, hold discussions with management covering actual or planned changes in:

- Senior management or the board.
- The strategic plan or planning function.

As requested, follow up on significant management audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Board minutes and reports since the last examination.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the management review.

Other Assessment Objectives: **NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.**

Objective 1: Determine the scope of the management review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.

3. As appropriate, obtain and review the following:
 - Board and significant committee minutes since the last examination.
 - Current organizational chart.
 - Findings from OCC monitoring activities.
 - List of directors and their backgrounds.
 - Recent representative packet of board meeting materials.
 - List of significant pending litigation, including a description of the circumstances.
 - Details about the bank's blanket bond insurance.
 - List of related organizations (e.g., parent holding company, affiliates, operating subsidiaries, chain and parallel-owned banking organizations).
 - Summary of payments to bank affiliates.
4. Update the list of directors and executive officers in work papers and Examiner View, as appropriate.

Objective 2: Determine the adequacy of management and board oversight.

1. At the beginning of the supervisory activity, discuss with senior management and other members of management, as appropriate:
 - Major risks (current or planned) and management's strategies to control them.
 - Changes, or planned changes, in senior management or the board since the last examination.
 - The board or board committee structure.
 - Plans for growth or acquisition. Consider:
 - Board-approved strategic plan.
 - Financial and operational plans.
 - Changes in products, services, delivery channels, service providers, etc.
 - Resources and staffing necessary to accomplish strategic goals.
 - The potential impact of management succession plans.
2. Review, as appropriate, the minutes of board and significant committee meetings held since the last examination. Identify:

- Areas of significant risk in the bank that are not being reported appropriately to the board.
 - Potential or actual violations of law or regulations. Report any violations of insider laws, regulations, and policies to the EIC.
 - Actual or planned changes in bank operations or strategy and whether these were approved as part of the bank's strategic planning process.
 - Individuals or factions exercising control over the bank.
 - Directors who are involved in the management of the bank, and the degree of their involvement.
 - Designated BSA officer.
 - Changes in the bylaws or articles of association.
 - Directors who do not regularly attend board or committee meetings. Determine:
 - Why they do not attend.
 - Whether these individuals are fulfilling their fiduciary responsibilities.
3. After reviewing board minutes, provide examiners of other functional areas with any significant information acquired about those areas. Consider having the examiner responsible for a functional area review minutes of any committee that oversee it.
 4. Review how the board and management select and retain competent staff. Consider as appropriate:
 - Requirements for annual performance reviews of senior management.
 - Length of vacancies in key positions.
 - Reasonableness of employment contracts.
 - Compensation programs.
 - Recruitment methods.
 5. Review the bank's vulnerability to self-dealing and the level of compliance with established laws, regulations, and policies regarding insider transactions and activities.
 6. Review pending or threatened litigation with management to determine whether litigation has a potentially significant impact on the financial condition of the bank.

7. Review insurance policies (blanket bond, liability, fixed assets and equipment, operating activities, etc.) to determine whether they are current and provide adequate coverage. Consider:
 - Blanket bond coverage in relation to the bank's risk profile and control systems.
 - Compliance with any requirements established by the blanket bond company.
 - Board involvement in the insurance process.

8. Review the relationship — financial or operational — between the bank and the bank's related organizations. Determine whether the transactions between the bank and its related organizations are legal and conform to proper accounting standards and guidance. Consider the impact on:
 - Earnings
 - Capital
 - Funds management practices
 - Management

9. Review how management plans for new products and services. Consider as appropriate:
 - Due diligence or feasibility process.
 - Financial projections.
 - Risk analysis.
 - Legal opinions.

Objective 3: Determine the quality of risk management systems.

After completing the previous objectives, consult with other appropriate examining personnel to make preliminary judgments on the adequacy of risk management systems. Consider whether:

- Management recognizes weaknesses and understands existing or emerging risks.
- Management measures risk in an accurate and timely manner.
- The board establishes, communicates, and controls risk limits.

- Management accurately and appropriately monitors established risk levels.

In consultation with other examining personnel, determine whether findings from other areas (e.g., quantity of risk, quality of risk management practices, direction of risk, or aggregate risk) affect the management conclusion. Refer to the section “Risk Assessment System,” as needed. Comment as necessary.

Objective 4: Conclude the management review.

1. Develop, in consultation with the supervisory office, action plans to address deficiencies before conducting the exit meeting. Consider management’s ability to correct the bank’s fundamental problems.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the management review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures, the conclusions on the quality of audit and the system of internal control, and any other applicable examination findings to compose appropriate comments (e.g., management/administration, MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
6. In discussion with all examining personnel, draw preliminary conclusions about:
 - The quantity of risk.
 - The quality of risk management.
 - The aggregate level and direction of transaction, reputation, compliance, strategic, or any other applicable risk. As appropriate, complete the summary conclusions in the section “Risk Assessment System.”
 - Supervisory strategy recommendations.

Earnings

Conclusion: Earnings are rated (1,2,3,4,5).

Complete this section's objectives to assign the earnings component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- 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 risks such as interest rate, foreign currency translation, and price risks.

Note: In rating earnings, the examiner should also assess the sustainability of earnings and any potential impact on earnings of the quantity of risk and the quality of risk management.

CORE ASSESSMENT

Minimum Objective: Determine the earnings component rating and any potential impact on the bank's risk assessment.

At the beginning of the supervisory activity, hold discussions with management covering:

- Actual or planned changes in the bank's budget or budgeting process.
- The bank's present condition and future plans.
- Earnings trends or variances.
- Changes in the bank's call report preparation processes and whether any refilings have occurred.

As requested, follow up on significant earnings audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Canary system information.
- UBPR and other OCC models.
- Budget and variance reports.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the earnings review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the earnings review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
3. If not previously provided, obtain and review the following:
 - Most current balance sheet and income statement.
 - Most recent budget, variance reports, and related items.
 - Most recent annual and quarterly reports.
 - Findings from OCC monitoring activities.

Objective 2: Determine the quality and composition of earnings.

1. Review applicable information to identify trends. Consider:

- Results from OCC monitoring activities.
 - Management reports used to monitor and project earnings.
 - UBPR and other OCC model calculations to compare the bank's ratios with those of peer banks.
 - Canary system information for potential impact on future earnings.
 - The bank's present condition and future plans.
2. Obtain earnings-related information from the examiner assigned to review board minutes.
 3. As necessary, discuss earnings trends and variances with management. Coordinate discussions with those examining other functional areas.
 4. Analyze earnings composition. Focus on:
 - Core earnings.
 - Net interest margins.
 - Noninterest income and expenses.
 - Loan loss provisions.
 - Off-balance-sheet items.
 - Changes in balance sheet composition.
 - Loan and deposit pricing.
 - Earnings from affiliate transactions.
 - Earnings from high-risk lines of business.
 5. If the bank has fiduciary powers, obtain fiduciary-related earnings information and evaluate the quantity and quality of fiduciary earnings. Refer to the factors listed in UITRS including:
 - The level and consistency of profitability in relation to business volume and characteristics.
 - Methods used to allocate direct and indirect expenses.
 - Effects of fiduciary settlements, surcharges, and other losses.
 6. Determine the root causes of any significant trends and the impact of nonrecurring items. Consider:
 - Whether earning trends are improving, stable, or declining.
 - Bank earnings compared with:

- Budget.
 - Peer group.
 - Adequacy of bank earnings in relation to:
 - Debt service requirements of the bank’s owner.
 - Dividend-paying capacity. (If appropriate (and in conjunction with the examiner reviewing capital), review and discuss with management the bank’s dividend plans.)
7. As appropriate, adjust the bank’s reported earnings to reflect the results of the examination and project the current year’s net income. Distribute adjustments to appropriate examining personnel.

Objective 3: Determine the adequacy of the bank’s budgeting process.

Review and determine the reasonableness of the bank’s budget. Consider:

- Economic, market, and other assumptions.
- Historical performance of the budgeting process.
- Examination results.
- Changes in bank management or strategies.
- Variance reports and other supplemental budgeting reports.

Objective 4: Determine the adequacy of management processes to prepare call reports and the validity of call report data.

1. If not previously provided, obtain and review the following:
 - Most recent call report.
 - The bank’s work papers for that call report.
2. Review and determine the adequacy of the bank’s process for preparing call reports. Determine whether the process is periodically and independently verified.
3. As appropriate, verify call report data. Consider:
 - Asking other examiners whether their findings agree with call report information.
 - Determining whether follow-up is needed.

- Testing call report accuracy by randomly checking selected call report line items against the bank's work papers and source documents. Consider having the examiners assigned to review the other functional areas verify the appropriate schedule in the call report.

Objective 5: Determine the risk to bank earnings posed by the aggregate level or direction of any applicable risks.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk has an adverse impact on the bank's current or future earnings. Refer to the section "Risk Assessment System," as needed.

Objective 6: Determine the quality of risk management systems through discussions with key risk managers and analysis of applicable internal or external audit reports.

1. Assess the bank's system of internal control over income and expense accounts. Examiners should take into consideration the relevant controls listed in objective 5 of the "Audit Functions and Internal Control" section of the core assessment. Examiners should also take into consideration other controls pertinent to earnings.
2. Assess the timeliness, completeness, accuracy, and relevance of MIS for earnings. Consider the source of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated. This review should be coordinated with the examiners responsible for all functional areas of the examination, including internal control, to avoid duplication of effort. Findings should be communicated to the examiner reviewing IT.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the earnings review.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose appropriate comments (e.g., earnings, MRA) for the report of examination.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the earnings review that are relevant to other areas being reviewed.
3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
5. In discussion with the EIC, provide preliminary strategy recommendations for the next supervisory cycle.

Liquidity

Conclusion: Liquidity is rated (1,2,3,4,5).

Complete this section's objectives to assign the liquidity component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. Consider the following factors from UFIRS:

- The adequacy of liquidity sources to meet 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.
- How much the bank relies 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.

CORE ASSESSMENT

Minimum Objective: Determine the liquidity component rating, the quantity of liquidity risk, and quality of liquidity risk management.

At the beginning of the supervisory activity, hold discussions with management covering actual or planned:

- Changes in liquidity risk management.
- Changes in liquidity planning or funding sources and needs.
- Changes in investment strategy.
- Changes in the liquidity policy or contingency funding plan.

As requested, follow up on significant liquidity audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Canary system information.
- UBPR and other OCC models.
- Liquidity reports.
- Investment trial balance.
- ALCO minutes and reports since the last supervisory activity.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the liquidity review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the liquidity review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
3. Obtain and review the following items:
 - Most recent liquidity reports.
 - Contingency funding plan.
 - The investment trial balance.
 - List of investments purchased and sold (within a reasonable time frame).
 - List of securities acquired using the bank's lending authority.

- Findings from monitoring activities.
 - Any other information or reports management uses (asset/liability committee packages and minutes, etc.).
 - Canary system information.
 - Any other OCC-generated filters that pertain to liquidity (e.g., FHLB borrowings).
4. Discuss current investment, liquidity, and funds management strategies with appropriate management.

Objective 2: Determine the adequacy of liquidity and the quantity of liquidity risk.

1. Review the UBPR, Canary system information, and the bank's most recent liquidity reports. Identify volume and trends in funding by reviewing:
 - Sources of funding, e.g., retail vs. wholesale.
 - Projected funding needs vs. available sources.
 - Wholesale funding that may be credit sensitive.
 - Funding concentrations.
 - Use and reliance on liabilities with short-term maturities.
 - Asset growth projections.
 - Liquid assets, including:
 - Federal funds sold.
 - Free securities (i.e., unpledged).
 - Saleable loans.
 - Off-balance-sheet commitments.
 - Other liquidity reports used by management to manage liquidity.
 - Contingency funding plan.
2. Evaluate the adequacy of sources of funds to meet anticipated or potential needs. Consider:
 - Money market assets relative to short-term liquidity needs.
 - Other currently available asset liquidity relative to overall liquidity needs, e.g., free (unencumbered) securities.
 - Other potential sources of asset liquidity (securitization, loan sales, cash flow from loans, investments, and off-balance-sheet contracts, etc.).

- Estimated capacity to borrow under established Federal funds lines relative to short-term liquidity needs.
 - The bank's capacity to increase deposits through pricing and direct-marketing campaigns to meet medium- and long-term liquidity needs.
 - The bank's capacity to borrow under the FHLB collateralized note program or other similar collateralized borrowing facilities.
 - The capacity to issue longer-term liabilities and capital instruments to meet medium- and long-term funding liquidity needs. Options may include:
 - Deposit note programs.
 - Medium-term note programs.
 - Subordinated debt.
 - Stock.
 - The capacity to borrow from the discount window.
3. Evaluate the quality of the investment portfolio as a potential source of liquidity. Consider the:
- Percentage and quality of investment portfolio that is unpledged.
 - Level and impact of portfolio depreciation.
 - Maturity distribution and average life sensitivity of the investment portfolio.
 - Distribution of securities designated held-to-maturity and available-for-sale.
 - Trends in monthly cash flow from the investment portfolio.
 - Potential impact of embedded options on the cash flow patterns.
 - Volume and quality of securities not priced (**Note:** often these securities show a constant price of par).
4. Review the types and levels of funding from wholesale sources. Determine how much the bank relies on wholesale funding sources. Consider:
- Deposits originating from Internet sources.
 - Federal funds purchased and repurchase agreements.
 - Foreign deposits.
 - Eurodollars.
 - FHLB borrowings.
 - Brokered deposits.

5. Discuss wholesale funding with bank management to determine:
 - How wholesale funding fits in the overall asset/liability strategy.
 - What types of mismatches exist.
 - Whether the wholesale funding strategy is meeting profit expectations.
6. If the bank relies significantly on wholesale funding, including all non-relationship, high-cost funding programs and Internet-based retail solicitation programs, review factors that influence credit-sensitive funds providers. Consider:
 - Current asset quality and potential for deterioration.
 - Earnings performance and expectations.
 - Changes in senior bank management.
 - Negative media attention.
 - Rating agency “watch” or downgrade announcements.
 - Adverse changes in CAMELS/ITCC.
 - Legal restrictions, such as brokered deposits, interbank liabilities, pass-through deposit insurance, Fed discount window borrowing, and prompt corrective action.
7. Considering the foregoing and the relevant risk assessment factors from the “Risk Assessment System,” consult with the EIC and other appropriate examining personnel to determine the quantity of liquidity risk.

Objective 3: Determine the quality of liquidity risk management.

1. Obtain liquidity-related information from the examiner assigned to review board minutes. Review, as appropriate, minutes of any committees responsible for overseeing liquidity risk.
2. Determine whether the board has clearly articulated policies and guidelines outlining lines of authority/responsibility for the management of liquidity and its tolerance for liquidity risk. Consider:
 - Has a measurement system that captures and quantifies risk been established?

- Are limits/guidelines defined and communicated to management?
 - Are the limits/guidelines reasonable?
 - Do the planning, budgeting, and new product areas consider liquidity when making decisions?
3. Determine whether management has planned for adequate sources of liquidity to meet current and potential funding needs.
 4. Review the contingency funding plan and determine whether it adequately details management responsibilities, quantifies potential funding needs/sources under multiple scenarios, and prioritizes management action to respond to funding needs. Ensure that the plan is appropriate given the complexity of the bank's circumstances.
 5. Determine whether strategies used to achieve the desired mix and maturities of assets and liabilities are adequate. Consider:
 - Discussing with management the bank's liquidity risk strategies.
 - Competitive pressures in the bank's market, considering all funding sources (e.g., branch network, wholesale funding, Internet banking, etc.).
 - Maturity matching through normal runoff and reinvestment.
 - Asset purchases or sales or borrowings and subordinated debentures.
 - Pricing of loans and deposits.
 - Existence of off-balance-sheet items, such as credit lines, derivative contracts, and other commitments.
 6. Assess the timeliness, completeness, accuracy, and relevance of MIS for liquidity. Consider the sources of reports, controls over the preparation of reports, and whether the reports' accuracy is independently validated. This review should be coordinated with the examiners responsible for all functional areas of the examination, including internal control, to avoid duplication of effort. Findings should be communicated to the examiner reviewing IT. Consider whether MIS monitors:
 - Compliance with risk limits.
 - Sources and uses.
 - Funding concentrations.
 - Funding costs.

- Availability under wholesale funding lines.
 - Projected funding needs.
7. Assess the system of internal control over liquidity. Examiners should take into consideration the relevant controls listed in objective 5 of the “Audit and Internal Control” section of the core assessment. Examiners should also take into consideration other controls pertinent to liquidity.
 8. Using the findings from the foregoing, consider the relevant factors from the section “Risk Assessment System”; consult with the EIC and other appropriate examining personnel to determine the quality of liquidity risk management.

Objective 4: Determine the composition and quality of the investment portfolio.

Follow the guidelines outlined in OCC Bulletin 98-20, “Investment Securities — Policy Statement,” OCC Bulletin 2002-19, “Unsafe and Unsound Investment Portfolio Practices,” and OCC Bulletin 2000-23, “Bank Purchases of Life Insurance.”

1. Review the UBPR and the bank’s MIS to evaluate:
 - Investment yields and market values.
 - Impact of depreciation or amortization on earnings performance or capital adequacy.
 - Significant holdings of nonrated securities, bank-owned life insurance, below-investment-grade securities, zero or low coupons, and long maturities.
2. From discussions with management and by reviewing internal reports, determine whether there is an appropriate credit due diligence process to ensure that all nonrated securities are the equivalent of investment grade.
3. From discussions with management and by reviewing internal reports, determine whether there is an appropriate due diligence process to ensure that all securities acquired using the bank’s lending authority conform to lending policies for credit analysis, underwriting, and approval.

4. If the bank has implemented a bank-owned life insurance program, review the due diligence process and the documentation supporting legitimate insurance need.
5. From discussions with management and by reviewing internal reports, assess the trend in credit quality of the investment portfolio between examinations. Determine whether there has been a significant change in the credit risk profile and whether that change has been appropriately managed.
6. From discussions with management and by reviewing internal reports, determine whether there are any issues in the portfolio that are ineligible, in default, or below investment grade. For defaulted or below-investment-grade securities, classify based upon BC 127(rev)²⁰ and distribute findings, as appropriate, to the examiners reviewing asset quality, earnings, and capital adequacy.
7. Review credit information for securities purchased under the “reliable estimates” authority [12 CFR 1.3(i)], nonrated securities, and below-investment-grade securities.
8. Review the bank’s process for setting and monitoring settlement limits with securities dealers.

Objective 5: Using the findings from meeting the foregoing objectives, determine the significance of liquidity risk.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk identified during the liquidity review has had, or is expected to have, an adverse impact on the bank’s capital or earnings. Refer to the section “Risk Assessment System,” as needed. Comment as necessary.

Objective 6: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risk.
- Management is able to correct any fundamental problems.

²⁰ OCC Banking Circular 127(rev), “Uniform Classification of Assets and Appraisal of Securities.”

- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 7: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 8: Conclude the liquidity review.

1. Provide the examiner evaluating asset quality with a list of classified investments, and communicate findings to other examining personnel, as appropriate.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the liquidity review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (on, e.g., liquidity adequacy, liquidity management processes, or MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
6. In discussion with the EIC, provide preliminary conclusions about:
 - The quantity of liquidity risk.

- The quality of liquidity risk management.
- The aggregate level and direction of liquidity risk or any other applicable risk. As appropriate, complete the summary conclusions in the section “Risk Assessment System.”
- Supervisory strategy recommendations.

Sensitivity to Market Risk

Conclusion: Sensitivity to market risk is rated (1,2,3,4,5).

Complete this section's objectives to assign the sensitivity to market risk component rating. In assigning the rating, the examiner should consult the EIC and other appropriate examining personnel. (**Note:** Market risk includes interest rate risk, price risk, and foreign currency translation risk.) Consider the following factors from UFIRS:

- The sensitivity of the financial institution's earnings or the economic value of its equity 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 (IRR) exposure arising from nontrading positions.
- The nature and complexity of market risk exposure arising from any trading and foreign operations.

CORE ASSESSMENT

Minimum Objective: Determine the sensitivity to market risk component rating, the quantity of risk and the quality of risk management for interest rate risk, price risk, and foreign currency translation risk.

At the beginning of the supervisory activity, hold discussions with management covering actual or planned:

- Changes to the IRR policy (i.e., limit structures, risk measurement).
- Changes in the IRR management process.
- Material changes in the bank's asset and liability structure.
- Changes in the investment portfolio's impact on IRR.
- Changes in the level of price or foreign currency translation risk.

As requested, follow up on significant sensitivity to market risk audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Canary system information.
- UBPR and other OCC models.
- IRR reports.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the sensitivity to market risk review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the sensitivity to market risk review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
3. Obtain and review the UBPR, Canary system information, other appropriate OCC-generated information, and the most recent bank-prepared reports used to monitor and manage IRR.

Objective 2: Determine the appropriateness and effectiveness of the risk management practices of the investment portfolio. Follow the guidelines outlined in OCC Bulletin 98-20, "Investment Securities — Policy Statement," OCC Bulletin 2002-19, "Unsafe and Unsound Investment Portfolio Practices," and OCC Bulletin 2000-23, "Bank Purchases of Life Insurance."

1. Evaluate board and senior management oversight. Consider:

- Procedures for approving major policies.
 - Annual review of investment strategies and policies.
 - The establishment of risk limits and procedures to ensure compliance.
 - How well board members and management not involved directly or daily in investment activities understand those activities.
2. Review pre-purchase analyses of recent investments, and determine whether the analyses provide adequate information to understand the price sensitivity of the security.
 3. Determine whether the limits (pre-purchase and portfolio sensitivity) established by management are reasonable and serve as an appropriate subset of bank-wide IRR limits, given the bank's capital, earnings and management's expertise.
 4. Determine how well management monitors the investment portfolio. Consider:
 - Whether significant risks in the bank's investment activities are understood and properly reported.
 - The completion and documentation of stress testing on the types of securities as required in the bank's investment policy or procedures.
 - Periodic evaluations of aggregate risk exposure and the overall performance of the investment portfolio.

Objective 3: Determine the quantity of interest rate risk.

Note: The examiner should refer to the "Interest Rate Risk" booklet of the *Comptroller's Handbook* for additional guidance on the considerations listed below.

1. Review exposure to on- and off-balance-sheet positions. Consider:
 - The composition and risk characteristics of asset and liability maturity and cash flow structures.
 - The volatility of the net interest margin over time.
 - The level and impact of basis risk, yield curve risk, options risk, and repricing risk.
 - The support provided by low-cost, stable nonmaturity deposits.

2. Review the level and trend of earnings-at-risk as indicated by the bank's risk measurement system. Risk to earnings should be measured under a minimum change in interest rates of plus or minus 200 basis points within a twelve-month horizon.
3. Review the exposure to the bank's economic value of equity (EVE). If the bank has a significant volume of medium-term to longer term repricing risk and/or options-related positions, review the level and trend of exposure to the economic value of equity. Risk to EVE should be measured under a minimum change in interest rates of plus or minus 200 basis points within a twelve-month horizon.
4. Review the use of derivative products. If the bank's exposure to derivative products is new or is of significant volume, expand the review and refer to the "Risk Management of Financial Derivatives" booklet of the *Comptroller's Handbook*.
5. Evaluate the ongoing performance and effectiveness of any hedging strategies.
6. Using the findings from performing the previous objectives and considering the relevant factors from the section "Risk Assessment System," consult with the EIC and other appropriate examining personnel to determine the quantity of interest rate risk.

Objective 4: Determine the quality of risk management for interest rate risk.

1. Obtain interest rate risk-related information from the examiner assigned to review board minutes. Review, as appropriate, minutes of any committees responsible for overseeing IRR.
2. Determine whether the board has approved policies establishing responsibility for the management of IRR, communicating risk tolerance, and providing sound guidelines for the management of IRR.
3. Assess the effectiveness of management and the board in overseeing IRR. Consider:
 - The existence and reasonableness of board-approved limits for earnings and/or economic value-at-risk.

- Compliance with established risk limits.
 - The adequacy of controls over the IRR management process.
 - Management’s understanding of IRR and ability to anticipate and respond appropriately to changes in interest rates or economic conditions.
4. Determine whether the risk management system used to measure earnings-at-risk is appropriate for the level and complexity of the bank’s exposure. Determine whether the major assumptions used to measure earnings-at-risk are reasonable.
 5. Determine whether the risk management system used to measure economic value-at-risk is appropriate for the level and complexity of the bank’s exposure. Determine whether the major assumptions used to measure the economic value-at-risk are reasonable.

Note: Calculating the EVE in base-case and rising and falling interest rate environments is the most effective risk measurement method for banks with significant longer term or options-related risk positions.

6. Determine whether assumptions used in the risk measurement system are documented with sufficient detail so as to allow verification of their reasonableness and accuracy.
7. Evaluate management’s ability and effectiveness in managing IRR. Consider:
 - The level of understanding of the dynamics of IRR.
 - The ability to respond to competitive pressures in financial and local markets.
 - Whether a balanced presentation of risk and return are appropriately considered in asset/liability strategies.
 - The ability to anticipate and respond to adverse or changing economic conditions and interest rates.
 - Whether staff skills are appropriate for the level of complexity and risk.
8. Assess the timeliness, completeness, accuracy, and relevance of MIS. Consider the sources of reports, controls over report preparation, and whether reports’ accuracy is independently validated. This review should be coordinated with the examiners responsible for all functional

areas of the examination, including internal control, to avoid duplication of effort. Findings should be communicated to the examiner reviewing IT.

9. Determine whether a competent, independent review process periodically evaluates the effectiveness of the IRR management system. In reviewing measurement tools, evaluators should determine whether the assumptions used are reasonable and whether the range of interest rate scenarios considered are appropriate. Refer to the “Interest Rate Risk” booklet of the *Comptrollers Handbook* and OCC Bulletin 2000-16, “Risk Modeling —Model Validation,” for more guidance on independent reviews.
10. Assess the adequacy of the system of internal control over IRR. Examiners should take into consideration the relevant controls listed in objective 5 of the “Audit and Internal Control” section of the core assessment. Examiners should also take into consideration other controls pertinent to IRR.
11. Using the findings under this objective, determine whether the risk management system to identify, measure, monitor, and control IRR is effective.
12. Using the findings from the foregoing, consider the relevant factors from the section “Risk Assessment System”; consult with the EIC and other appropriate examining personnel to make preliminary judgments on the quality of risk management systems.

Objective 5: Determine the level of price risk or foreign currency translation risk.

1. If the bank engages in trading activities, has investments denominated in foreign currencies, or engages in any other activity that subjects the bank to price risk or foreign currency translation risk, consider:
 - The quantity of risks in relation to bank capital and earnings.
 - The quality of risk management systems including:
 - The ability or expertise of bank management.
 - The adequacy of risk management systems.

2. Determine whether appropriate accounting treatment is used with respect to trading (FAS 115) and foreign currency translation (FAS 52) accounts.

Objective 6: Using the findings from meeting the foregoing objectives, determine the significance of market risk (IRR, price risk, or foreign currency translation risk) to the bank's capital and earnings.

In consultation with the EIC and other examining personnel, decide whether the aggregate level or direction of any risk noted during the review of sensitivity to market risk has had, or is expected to have, an adverse impact on the bank's capital or earnings. Refer to the section "Risk Assessment System," as needed. Comment as necessary.

Objective 7: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 8: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 9: Conclude the review of the bank's sensitivity to market risk.

1. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., sensitivity to market risk, MRA) for the report of examination.

2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the sensitivity of to market risk review that are relevant to other areas being reviewed.
3. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
4. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
5. In discussion with the EIC, provide preliminary conclusions about:
 - The quantity of risk.
 - The quality of risk management.
 - The aggregate level and direction of interest rate, price, foreign currency translation, or any other applicable risk. As appropriate, complete the summary conclusions in the section “Risk Assessment System.”
 - Supervisory strategy recommendations.

Information Technology

Conclusion: URSIT composite rating is (1,2,3,4,5).

Complete this section's objectives to assign the information technology (IT) composite rating using as a guide OCC Bulletin 99-3, "Uniform Rating System for Information Technology (URSIT)." The composite URSIT rating should reflect:

- The adequacy of the bank's risk management practices.
- Management of IT resources.
- The integrity, confidentiality, and availability of automated information.
- The degree of supervisory concern posed by the institution.

In assigning the rating, the examiner should consult the EIC, the examiners assigned to review management and audit, and other examining personnel, as appropriate. Although the OCC does not assign URSIT component ratings to the financial institutions it supervises, risks arising from the areas covered by the component ratings are considered when assigning the URSIT composite rating.

CORE ASSESSMENT

Minimum Objective: Determine the IT composite rating, the quantity of transaction risk, and the quality of transaction risk management.

At the beginning of the supervisory activity, hold discussions with management covering:

- Actual security events or service interruptions during the supervisory cycle.
- Changes in the financial condition of, or quality of service provided by, IT vendors/servicers.
- Actual or planned changes in vendors, systems, applications, distribution channels, or personnel.
- Changes in the information security or contingency planning processes.
- Changes in the processes or reports management uses to monitor IT activity.

- Impact of the changes noted above on the bank's written information security program.

As requested, follow up on significant IT audit issues identified by the examiner reviewing the bank's audit program.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Results of tests of the bank's information security program and management's response.
- Results of tests of the bank's contingency plan and management's response.
- Annual report to the board required by 12 CFR 30, appendix B.
- Recent IT-related MIS reports including resulting fraud and processing losses.
- Documentation for major IT initiatives.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the information technology review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the information technology review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.

3. If not previously provided, obtain and review lists describing the complexity of the bank’s processing environment and reports management uses to supervise the IT area, including but not limited to:
 - A list of technology vendors/servicers, description of the products or services provided, and bank’s analysis of vendors’/servicers’ financial condition.
 - A list of computer systems and networks.
 - A list of software and applications that support financial information processing or the risk management process.
 - Reports used to monitor computer activity, network performance, system capacity, security violations, and network intrusion attempts.

4. Determine during discussions with management:
 - How management administers and controls IT activities throughout the organization.
 - Any significant changes in systems, applications, distribution channels, or personnel since the prior examination or any planned changes.
 - How management monitors the quality and reliability of outsourced services and support functions.

Using the information obtained above, determine which IT processes, systems, or applications represent the most significant risks to the bank to review during this supervisory activity. The following chart provides some areas examiners should consider:

IT Processes	Systems	Applications
Board oversight	Mainframe or midrange system	Core applications (e.g., general ledger, loans, deposits)
Information security	In-house networks	Electronic banking
Business continuity	Departmental LANs	Wire transfer
Vendor management	Item processing systems	Trust processing
Project management	Imaging systems	Mortgage processing
Providing services to other financial institutions		
In-house programming		

Examiner should also consider:

- New regulatory guidance.
- Actual or planned organizational changes.

- The significance of the system or application in supporting bank products and services.
 - The volume or average dollar size of transactions processed.
 - The overall complexity of the bank’s IT environment.
 - Management reliance on the application or its output.
 - Recent audit coverage provided internally or externally.
 - The scope of the most recent OCC supervisory activity and changes since that review.
5. If an area of higher risk is identified such as in-house programming or providing automated services to other financial institutions, expand the review as necessary to assess the additional risks inherent in such activities using procedures from the *FFIEC IT Examination Handbook*.

Objective 2: Assess the adequacy of IT management and determine compliance with 12 CFR 30, appendix B, “Guidelines Establishing Standards for Safeguarding Customer Information.”²¹

1. Obtain technology-related information from the examiner assigned to review board minutes. Review, as appropriate, minutes of any committees responsible for overseeing and coordinating IT resources and activities to determine user involvement and organizational priorities.
2. Review organizational charts, job descriptions, compensation, turnover, and training programs to ensure that the bank has a sufficient number of technology personnel with the expertise the bank requires (consider the bank’s outsourcing arrangements, as appropriate).
3. Review the effectiveness of the bank’s management and monitoring of vendor or servicer activities. Consider the guidance in OCC Advisory Letter 2000 -12, “Risk Management of Outsourcing Technology Services”²² in evaluating:
 - Vendor/servicer selection process.

²¹ The guidelines were mandated by Section 501 of GLBA and were effective July 1, 2001. Issued jointly by the financial regulatory agencies, they are set forth in OCC Bulletin 2001-8, “Guidelines Establishing Standards for Safeguarding Customer Information.”

²² The OCC has issued additional guidance in OCC Bulletin 2001-47, “Third-Party Relationships: Risk Management Principles” and OCC Bulletin 2002-16, “Bank Use of Foreign-Based Third-Party Service Providers.”

- Contract guidelines, including customer privacy protections.
 - Monitoring of vendor or servicer performance under the contract, including availability of financial information and access to operations and security audits of the servicer.
 - As applicable, availability of, or access to, application source code and documentation for programs not developed or maintained by the bank. (Generally applies to turnkey software.)
4. Review documentation supporting major projects or initiatives to determine the effectiveness of technology planning, implementation, and follow-up activities. Consider:
- The decision process, including options considered and the basis for final selection.
 - The reasonableness of implementation plans, including periodic milestones.
 - The effectiveness of monitoring of implementation activities.
 - Whether validation testing of new programs or systems is conducted prior to putting the programs into production.
5. Review the bank's information security program for conformance with 12 CFR 30, appendix B, "Guidelines Establishing Standards for Safeguarding Customer Information." The program must:
- Be approved and overseen by the board.
 - Be adjusted, as appropriate, for changes in the bank's (or servicer's) processing environment or systems.
 - Include an annual report to the board (or committee) describing the overall status of the program and the bank's compliance with the guidelines.
6. Review MIS reports for significant IT systems and activities to ensure that risk identification, measurement, control, and monitoring are commensurate with the complexity of the bank's technology and operating environment. MIS should be timely, accurate, complete, and relevant. Consider:
- Systems capacity, including peak processing volumes.
 - Up-time performance and processing interruptions.
 - Network monitoring including penetration attempts and intruder detection.

- Activity logs and security reports for operations, program and parameter changes, terminals use, etc.
- Volume and trends of losses from errors, fraud, or unreconciled items.

Objective 3: Assess the adequacy of controls to assure the integrity of data and the resulting MIS.

Note: The review should be coordinated with the examiners responsible for the major CAMELS/TCC areas and the internal control portion of the examination to avoid duplication of effort.

1. Evaluate the separation of duties and responsibilities in the operation and data processing areas. Consider:
 - Input preparation and balancing.
 - Data entry.
 - Operation of the computer system.
 - Processing of rejects and unposted transactions.
 - Balancing of final output.
 - Statement and report preparation and distribution.
2. Evaluate the adequacy of input/output controls and reconciliation procedures for batch capture and image capture systems. Consider:
 - Establishment of dollar and item count control totals.
 - Review of output and exception reports.
 - Reconciliation of application balances to general ledger accounts.
 - Balancing and reconciliation of ATM and ACH activity.
3. Review controls and audit trails over master file change requests (such as address changes, due dates, loan payment extensions or renewals, loan or deposit interest rates, and the service charge indicator). Consider:
 - Individuals authorized to make changes and potential conflicting job responsibilities.
 - Documentation/audit trail of authorized changes.
 - Procedures used to verify the accuracy of master file changes.

4. Assess adequacy of controls over changes to systems, programs, data files, and personal-computer-based applications. Consider:
 - Procedures for implementing program updates, releases, and changes.
 - Controls to restrict and monitor use of data-altering utilities.
 - Process management uses to select system and program security settings (i.e., whether the settings were made based on using sound technical advice or were simply default settings).
 - Controls to prevent unauthorized changes to system and programs security settings.
 - Process and authorizations to change application parameters.
5. Determine whether employees' levels of online access (blocked, read-only, update, override, etc.) match current job responsibilities.
6. Evaluate the effectiveness of password administration for employee and customer passwords considering the complexity of the processing environment and type of information accessed. Consider:
 - Whether passwords are confidential (known only to the employee/customer).
 - Whether the procedures to reset passwords ensure that confidentiality is maintained.
 - Frequency of required changes in passwords.
 - Password design (number and type of characters).
 - Security of passwords while stored in computer files, during transmission, and on printed activity logs and reports.
7. Determine whether the bank has removed/reset default profiles and passwords from new systems and equipment and determine whether access to system administrator level is adequately controlled.

Objective 4: Evaluate the effectiveness of controls to protect data confidentiality, i.e., to prevent the inadvertent disclosure of confidential information.

1. Evaluate systems used to monitor access and detect unauthorized internal or external attempts to access the bank's systems (i.e., intruder detection).

2. Evaluate control and security for data transmitted to or from remote locations. Consider:
 - Type of data transmitted.
 - Use of encryption or other security techniques (e.g., firewalls).
 - Access to network components (servers, routers, phone lines, etc.) that support data transmission.
3. Evaluate controls over remote access (by modem or Internet link) to ensure use/access by authorized users only.

Objective 5: Assess the adequacy of the bank's policies and procedures to ensure the availability of automated information and ongoing support for technology-based products and services.

1. Review the written business resumption contingency plan to ensure that the plan is consistent with the requirements of interagency guidelines. Consider whether:
 - The plan complies with the corporate-wide focus of interagency guidelines.
 - The board of directors or a board committee annually reviews the plan.
 - The plan adequately addresses all mission-critical activities or services.
2. Review the annual validation of the contingency plan, including backup/alternate site test findings. Determine whether the board and senior management were apprised of the scope and results of the backup test.
3. If third-party servicers provide mission-critical activities or systems, ensure that the bank's recovery plan is compatible with the business recovery plans of the servicers.
4. Evaluate planning for event management activities. Consider:
 - Emergency procedures and evacuation plans.
 - Response to network attack or penetration.
 - Reporting to appropriate regulatory or law enforcement agencies.

5. Assess processes and procedures to prevent destruction of electronic files and other storage media. Consider:
 - Frequency of file backup.
 - Access to backup files and storage media (disks, tapes, etc.).
 - Location of off-site file storage.
 - Virus protection for networks and PCs.
6. Determine whether only authorized personnel have access to the computer area, electronic media, supplies of negotiable items, and whether equipment and networks supporting mission-critical services are appropriately secured. Consider physical security as well as environmental controls.

Objective 6: Assess the bank's processes for managing information security risk and transaction risk using the findings from meeting the foregoing objectives, by discussing the processes with key managers, and by analyzing applicable internal or external audit reports.

1. Determine whether the volume and nature of fraud and processing losses, network and processing interruptions, customer-reported processing errors, or audit criticisms lower the quality of automated activities and services.
2. Determine whether the bank's risk assessment process for customer information and its test of key controls, systems, and procedures in the bank's information security program are commensurate with the sensitivity of the information and the complexity and scope of the bank's activities.
3. Assess the timeliness, completeness, accuracy, and relevance of MIS for transaction risk. Consider the source of reports, controls over report preparation, and independent validation of report accuracy. Risk management reports should cover major sources of transaction risk identified above.
4. Using the findings from meeting the previous objectives, combined with the information from the EIC and other appropriate examining personnel, make preliminary judgments on the quality of transaction risk management systems. Consider whether:

- Management recognizes and understands existing and emerging risks.
- Management measures risk in an accurate and timely manner.
- The board establishes, communicates, and controls risk limits.
- Management accurately and appropriately monitors established risk limits.

Objective 7: Using the findings from meeting the foregoing objectives, identify any significant risk exposures from the review of information technology.

Develop preliminary assessments of quantity of transaction risk, quality of transaction risk management, aggregate transaction risk, and direction of transaction risk. Refer to the section “Risk Assessment System,” as needed. Comment as necessary.

In consultation with the EIC and other examining personnel, identify any findings from the information technology review that have significance for other risk rating categories.

Objective 8: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller’s Handbook* or *FFIEC IT Examination Handbook* for expanded procedures.

Objective 9: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided on a case-by-case basis after consultation with the ADC. Direct confirmation with the bank’s customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 10: Conclude the review of the bank's IT activities.

1. Provide management with a list of deficiencies for consideration.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the IT review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., IT, MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
6. In discussion with the EIC, provide preliminary conclusions about:
 - The quantity of risk.
 - The quality of risk management.
 - The aggregate level and direction of transaction risk or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."
 - Supervisory strategy recommendations.

Asset Management

Conclusions: Aggregate asset management risk is (low, moderate, high).

UITRS ratings: Composite (1,2,3,4,5)

Management (1, 2, 3, 4, 5)

Operations, Internal Controls, and Auditing (1,2,3,4,5)

Earnings (1,2,3,4,5),

Compliance (1,2,3,4,5)

Asset Management (1,2,3,4,5)

The examiner will complete appropriate objectives from this section to assign the asset management aggregate risk rating. This rating is derived from an assessment of the quantity of risk and the quality of risk management for those activities.

In accordance with OCC Bulletin 98-46, "Uniform Interagency Trust Rating System," the examiner will assign the Uniform Interagency Trust Rating System (UITRS) composite and component ratings. In the UITRS, fiduciary activities are assigned a composite rating based on an evaluation and rating of five essential components of an institution's fiduciary activities. These components address management; operations, internal controls, and auditing; earnings; compliance; and asset management.

In assigning the aggregate risk rating and the UITRS rating, the examiner will consult the EIC; the examiners assigned to review management, audit and internal control, IT, and earnings; and other examining personnel as appropriate.

The following core assessment for asset management includes some expanded procedures under each objective. Additional booklets of the *Comptroller's Handbook* covering specific management topics are now under development. As these other asset management booklets are completed, the related expanded procedures will be removed from the "Community Bank Supervision Handbook."

CORE ASSESSMENT

Minimum Objective: Determine the quantity of risk and the quality of risk management for asset management and assign the UITRS composite and component ratings.

At the beginning of the supervisory activity, hold discussions with management covering:

- Actual or planned changes in:
 - Management, key and operational staff including portfolio managers and advisers.
 - Board and fiduciary committee structure and oversight.
 - Facilities and operating systems, processes and controls.
 - Policies, procedures, and controls.
- New products and services.
- New or expanded third-party vendor relationships, including investment advisers.
- Strategic plans for asset management activities.
- The asset management business plan, budget, or budgeting process.
- Asset management earnings performance.
- Significant transactions with related parties including businesses of directors, officers, or employees of the institution and bank affiliates.

Obtain and review the following information and documents, as appropriate:

- Results from OCC supervisory activities.
- Most recent committee minutes and information packages.
- Asset management organizational chart.
- Most recent financial reports, including budget and variance reports.
- Canary reports and appropriate UBPR pages.
- Policies and procedures if significant changes or additions have been made.
- Compliance reports and follow-up.
- Call report Schedule RC-T Fiduciary and Related Services for significant changes in account types and volumes.

As requested, follow up on significant asset management audit issues identified by the examiner reviewing the bank's audit program:

- Discuss any outstanding asset management audit issues with management.

- If warranted based on the above discussions, or if requested by the examiner reviewing audit, obtain and review a risk-based sample of internal asset management audit reports and management follow-up.
- Discuss with management any changes in the scope, personnel, or frequency of the asset management audit function that could increase or decrease the function's reliability.

Select an appropriate sample of fiduciary accounts opened since the last examination and determine whether:

- The accounts were opened in compliance with policy and applicable law.
- The risks associated with the new accounts are consistent with the bank's business plan and risk tolerance.

Note: The accounts selected for this review should be representative of the type and size of accounts opened during the time period under review.

If the bank's activities, risk profile, or risk controls have changed significantly, or if review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures, as appropriate. If this review does not result in any significant changes or issues, conclude the review of asset management activities.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the asset management review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. As necessary, obtain and review the following information:
 - Asset management organizational chart and manager job descriptions.
 - Policies and operating procedures.
 - Strategic and business plans.
 - Committee minutes and information reports.
 - Asset management reports provided to the board of directors.

- Compliance reviews and management responses.
 - Descriptions of data processing and accounting systems including third-party vendor arrangements.
 - Management reports that include business development, financial, statistical, investments, cash management, and delinquency information.
 - Administrative reports such as cash flow, transaction, and tickler reports.
 - Operational reports such as transaction posting, balancing, and reconciliation reports.
 - Fee schedules.
 - A report on significant losses and settlements sustained since the last fiduciary supervisory activity.
 - Regulatory reports.
3. Discuss with the examiner responsible for completing the “Audit and Internal Control” section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required.
 4. Discuss pending litigation and insurance coverage pertaining to asset management activities with the examiner responsible for evaluating bank management.

Objective 2: Determine the quality and effectiveness of board and management supervision of asset management lines of business.

1. Evaluate board supervision by considering the following:
 - Committee structures, responsibilities, and reporting standards.
 - Management selection and appraisal processes.
 - Strategic planning and monitoring processes.
 - Information reports received from committees and management.
 - Policy review and approval processes.
 - Oversight of audit and compliance functions.
 - The use of legal counsel and the monitoring of litigation.
 - Insurance coverage reviews.
2. Evaluate management by reviewing the quality of the following:

- Management and support staff, including competence, turnover, and succession planning.
 - Policies and procedures, including compliance.
 - Information reports.
 - Internal controls.
 - Audit and compliance functions, including responses to deficiencies and recommendations.
 - Supervision of third-party service providers.
 - Insurance coverage and review processes.
 - Litigation management.
 - Complaint resolution processes.
3. Consider the findings from the other examination sections and incorporate them into the board and management evaluation.

Objective 3: Determine the quantity of risk and quality of risk management relating to the administration of fiduciary accounts.

1. Obtain and review the information submitted in response to the request letter, and determine the types and level of risk associated with the administration of fiduciary accounts. Discuss the following with management:
 - The volume and types of fiduciary accounts under administration.
 - The types and level of policy exceptions, audit and internal control deficiencies, and law violations internally identified and reported.
 - The amount and status of significant litigation and client complaints.
2. Review policies and procedures for fiduciary account administration. The policies and procedures should address:
 - Compliance with applicable fiduciary law.
 - Account administration guidelines.
 - Policy exceptions including monitoring and reporting processes.
 - Customer complaint resolution procedures.
3. Review the fiduciary account acceptance process. Determine whether the process:
 - Is formalized and adequately documented.

- Ensures that appropriate information is obtained and effectively used.
 - Includes an appropriate approval process for policy exceptions.
 - Complies with 12 CFR 9.6(a), Pre-acceptance Reviews.
4. Select a risk-based sample of recently accepted fiduciary accounts. If appropriate, the sample should focus on accounts with higher risk potential such as personal trusts with complex family relationships or unique asset types, insider accounts, complex retirement accounts, and successor and co-trustee accounts.

For each account, determine compliance with internal policy and applicable law and whether the account acceptance process was adequate and effective including the pre-acceptance and initial post acceptance review required by 12 CFR 9.6 (a) and (b).

5. Select a risk-based sample of older fiduciary accounts, including personal, retirement, and corporate trust accounts. Review each account and determine whether administrative processes and controls are adequate and effective. Consider whether account administration:
- Complies with the terms of the governing instrument and is consistent with the needs and circumstances of account beneficiaries;
 - Complies with federal, state, and local laws, and court orders and directions;
 - Includes account reviews in accordance with 12 CFR 9.6(c) and other applicable law;
 - Avoids unauthorized conflicts of interest and self-dealing;
 - Charges and reports accurate account fees and complies with the compensation provisions of 12 CFR 9.15; and
 - Adequately reviews third-party vendor services, if applicable, for proper performance and appropriate and reasonable fees.
6. For personal fiduciary accounts, evaluate the following:
- Cash management processes:
 - Identify and review large, uninvested or undistributed funds and discuss them with management. Determine whether administration is appropriate and complies with 12 CFR 9.10, Fiduciary Funds Awaiting Investment or Distribution.

- Review account overdrafts, giving attention to large and longstanding items. Determine why they exist and discuss management’s plans to clear them.
 - Discretionary distribution processes:
 - Is the decision-making authority for discretionary distributions expressly defined and communicated to all personnel?
 - Are decisions fully documented and authorized by designated personnel or committees?
 - Are distributions consistent with the guidelines established in the governing instrument?
7. For retirement accounts, determine compliance with the applicable sections of ERISA, particularly the prudence requirements of section 404, including asset diversification and compliance with plan provisions.

If potential violations of ERISA were identified during the retirement account review, in consultation with the EIC, report to the Asset Management Division for possible referral to the Department of Labor. Refer to Trust Banking Circular 18, “Adoption of Interagency Agreement on ERISA.”

8. For corporate trust accounts, determine whether the bank is fulfilling all its duties and responsibilities, which may include serving as paying agent, disbursing agent, registrar, and trustee.

Objective 4: Determine the quantity of risk and the quality of risk management relating to conflicts of interest and self-dealing.

1. Obtain and review the information submitted in response to the request letter and determine whether conflicts of interests have been reported internally. Discuss the following with management:
 - Processes used to identify, assess, and resolve conflicts of interest;
 - Significant changes in policies, processes, personnel, or controls; and
 - Internal or external factors that could affect conflicts of interests.
2. Review policies and procedures developed to control the risks associated with conflicts of interest and self-dealing. Consider the requirements of:

- 12 CFR 9.5, Policies and Procedures.
 - 12 CFR 9.12, Self-dealing and Conflicts of Interest.
 - 12 CFR 12.7(a), Securities Trading Policies and Procedures;
 - ERISA.
 - Other federal and state law and court rulings.
 - Industry practices relating to employee ethics and acceptable behaviors.
3. Determine whether conflicts of interest or self-dealing were identified during the fiduciary account administration review and whether policies, processes, and controls are effective.
 4. Review processes and controls for discretionary funds awaiting investment or distribution and determine compliance with the provisions of 12 CFR 9.10. Determine whether:
 - Discretionary funds are not allowed to remain uninvested or undistributed any longer than is reasonable for the proper management of the account and consistent with applicable law;
 - The bank obtains a rate of return for the funds that is consistent with applicable law; and
 - For discretionary funds that are deposited with the bank (depositing them may be prohibited by applicable law), the bank sets aside adequate collateral for the portion of the funds not FDIC-insured.
 5. Review processes and controls governing fiduciary compensation and compliance with 12 CFR 9.15, Fiduciary compensation. Consider whether:
 - Fiduciary-related compensation complies with applicable law. If not set or governed by applicable law, fees must be reasonable for the services provided.
 - Bank officers or employees act as co-fiduciary with the bank in the administration of fiduciary accounts and receive compensation for such services. The payment of compensation to a bank officer or employee serving as a co-fiduciary with the bank is prohibited unless specifically approved by the bank's board of directors.
 - Revisions or changes in fees charged to fiduciary accounts with set or fixed fee schedules are appropriate and properly authorized.

- Fee concessions for officers, directors, and other employees are granted under a general policy that is uniformly applied and approved.
 - Management obtains proper authorization for charging cash sweep and termination fees.
6. Review the process used by the bank to vote its own bank stock (12 USC 61). Determine whether:
- The bank complies with applicable law when voting shares of its own bank holding company stock when electing directors.
 - The bank considers the best interest of beneficiaries when deciding to vote proxies for companies in which directors, officers, employees, or related organizations have an interest that might interfere with the bank's judgment.
7. Review brokerage placement practices. Determine whether:
- Brokerage allocation decisions and brokerage fees are monitored to ensure that fees are reasonable relative to the services provided.
 - Soft-dollar arrangements fall within the safe harbor provisions of section 28(e) of the Securities and Exchange Act of 1934.
 - Brokerage fees are not subject to arrangements that impair the bank's judgment or prevent the best execution of trades.
 - Trades are fair and equitably allocated to all accounts, subject to applicable law.
8. If the bank uses an affiliated broker to effect securities transactions for fiduciary accounts, determine whether:
- Applicable law does not prohibit the use of an affiliated broker.
 - The bank does not profit from securities transactions executed through an affiliated broker (payment by bank to the affiliated broker can only cover the cost of executing the transaction).
 - The bank maintains adequate documentation justifying fees paid to affiliated brokers.
 - The bank provides adequate disclosure of such relationships to affected clients, or obtains proper consent from parties with capacity to give consent.

Objective 5: Determine the quantity of risk and the quality of risk management relating to investment management services.

1. Obtain and review the information submitted in response to the request letter and determine the types, number of accounts, and level of risk associated with investment management services. Discuss the following with management:
 - The volume and types of assets under management or administration.
 - The types and level of policy exceptions, internal control deficiencies, and law violations internally identified and reported.
 - The amount and status of significant litigation and client complaints.

2. Review investment management policies and procedures. Policies should address the following:
 - Compliance with applicable law including 12 CFR 9.11 and state investment law.
 - Business goals and objectives, investment philosophy, fiduciary responsibilities, ethical culture, risk tolerance standards, and a risk management framework.
 - Descriptions of investment products and services.
 - The use of investment policy statements.
 - Periodic investment portfolio reviews.
 - Investment research, including economic and capital market analyses and reporting.
 - Securities trading and brokerage placement processes.
 - Selecting and monitoring third-party service providers.
 - Portfolio management information systems and technology applications.
 - Administration of proxy voting.

3. If the board has delegated investment management supervision to one or more committees, review each committee's composition, charter, meeting frequency, attendance, information reports, and board reporting processes for consistency with board guidance and regulatory requirements.

4. Evaluate the processes used to develop, approve, implement, and monitor fiduciary account investment policies.

Note: For additional guidance refer to the “Investment Management Services” booklet of the *Comptroller’s Handbook* and OCC Bulletin 96-25, “Fiduciary Risk Management of Derivatives and Mortgage-backed Securities.”

5. Evaluate investment selection and acquisition processes. Consider:
 - Processes used to research, value, and estimate rates of return and correlations for potential investments.
 - Processes used to value portfolio assets and account for portfolio transactions.
 - Portfolio trading systems and controls.
6. Evaluate the adequacy and effectiveness of risk reporting and exception tracking processes. Does the division maintain appropriate management reports relating to investment performance, risk levels, and policy exception identification and follow-up?
7. If the bank delegates investment management authority, review the process used to select and monitor third-party investment managers or advisors. Refer to OCC Bulletin 2001-47, “Third-party Relationships: Risk Management Principles,” for guidance.
8. Select an appropriate sample of fiduciary accounts for which the bank serves as discretionary manager or provides investment advice for a fee. If possible, select the sample from accounts used in the fiduciary account administration review under objective 3. Review the sample selected for compliance with investment criteria established in:
 - Governing instrument or contract.
 - Federal, state, and local law.
 - Account’s investment policy statement, if applicable.
 - Internal policies and procedures.
 - Contracts with third-party investment advisors.

Determine whether the risks associated with individual portfolio investments are appropriate and effectively managed.

9. For marketable securities, review the following:
 - The quality of investment research and documentation, including the use of third-party vendors.
 - The use of approved securities lists.
 - Approval authorities and policy exception tracking systems.
 - Monitoring processes to ensure compliance with applicable law and internal policies and procedures.

10. For investment company securities, review the following:
 - The quality of the investment analysis, selection, and approval processes.
 - The quality of information reports and investment performance monitoring.
 - The receipt and application of fees and other forms of compensation from the investment companies.
 - Management's knowledge and expertise to formulate and implement investment strategies using investment company securities.
 - If the bank maintains a list of investment companies eligible for investment, review the master list of investment company securities and determine whether unapproved investment company securities are held. If so, determine whether the investments in such funds:
 - Are appropriately approved and adequately documented.
 - Comply with applicable law.
 - Are included on exception reports and adequately monitored.
 - If proprietary investment company securities are purchased for discretionary fiduciary accounts, determine whether:
 - There is adequate documentation showing that the investment is prudent and consistent with the account's investment policy.
 - Appropriate disclosures have been made regarding the affiliate relationship, the nature of services provided, and the amount of fees paid to the affiliate.
 - A copy of the investment prospectus is provided to appropriate parties.

11. For closely held businesses, determine whether:

- Bank employees serve on the board of directors, or in a similar capacity, of a closely held company. If so, does the bank:
 - Maintain adequate insurance coverage.
 - Reimburse the account for the payment of benefits or fees to the bank or its employees for representing the interests of beneficiaries, unless the governing document specifically authorizes the bank to receive such compensation.
- Closely held ownership interests are managed in accordance with the terms of the governing instrument and other applicable law. Consider:
 - Role of the bank and its fiduciary duties and responsibilities.
 - The quality and timeliness of decisions to acquire, retain, or dispose of such assets.
 - The quality of business valuation processes.
 - The receipt and use of appropriate financial information on the business and its industry.
 - The quality of relationships with account beneficiaries, family members, and other investors.

12. For discretionary real estate investment, determine whether:

- Decisions to acquire, retain or dispose of the investment were appropriate and supported.
- Real estate valuation and inspection processes are adequate.
- Appropriate financial information on the real estate and its market is periodically obtained and evaluated.
- Title to property is properly perfected.
- An environmental review was performed, if appropriate, and completed prior to acceptance or acquisition.
- Adequate insurance coverage is maintained with the bank as loss payee.
- Real estate taxes are paid on time.
- Farm management accounts are properly administered and documented. Consider whether:
 - The bank has signed a contract with the owner that clearly details the bank's responsibilities.
 - The bank has signed leases with tenants that detail each party's responsibilities.
 - The farm manager keeps adequate records, including financial statements, tax returns, and periodic reports on the operation.

13. For real estate loans, evaluate the quality of:
 - Loan underwriting standards.
 - Collection processes and past-due trends.
 - Collateral valuation and inspections processes.
 - Tax payment processes.
 - Insurance coverage.
 - Management of environmental liability issues.
14. For mineral interests, determine whether:
 - The receipt of lease, royalty, and delay rental payments is timely.
 - The bank takes appropriate action if payments are not received.
 - Working interests are reviewed for profitability and potential environmental hazards.
 - Expenditures are analyzed and approved before they are paid.
15. Review a sample of the bank's collective investment funds and determine whether such funds are managed in compliance with 12 CFR 9.18.

Objective 6: Determine the quantity of risk and the quality of risk management for fiduciary operations.

Note: This review should be coordinated with the examiners responsible for the major CAMELS/I areas and the "Audit and Internal Control" portion of the examination to avoid duplication of effort.

1. Obtain and review the information relating to asset management operations submitted in response to the request letter. If applicable, consider:
 - Audit reports of operational areas. Follow up on significant deficiencies and determine whether effective corrective action has been taken.

- Control self-assessment and compliance reports. Follow up on significant deficiencies and determine whether effective corrective action has been taken.
2. Discuss the following with the examiner reviewing information technology (IT) and follow up with management as needed:
 - Existing IT systems and planned changes to IT systems.
 - Whether IT systems are sufficient to support current and planned fiduciary activities.
 - The quality of the bank's information security and business resumption and contingency planning processes.
 - The quality of the bank's process for selecting and monitoring third-party vendors.
 - Logical access controls on computer systems to adequately segregate duties.
 3. Evaluate the quality of written policies and procedures. Consider:
 - Approval authorities and accountability standards.
 - Separation or rotation of duties and vacation requirements.
 - Dual control or joint custody standards for financial records and assets.
 - Data input preparation, documentation, and balancing functions.
 - Information generation and reporting standards.
 - Asset and funds disbursement standards.
 - Third-party vendor administration.
 - Information security, business resumption, and contingency planning systems.
 4. If the bank has outsourced data processing or other operational functions, evaluate the bank's process for selecting and monitoring third-party vendors. Discuss the process with management and document significant weaknesses. Consider the following in reaching conclusions:
 - The quality of the due diligence review process.
 - The contract negotiation and approval process.
 - Risk assessment processes.
 - Compliance and audit division participation.

- Monitoring processes, such as the assignment of responsibility, the frequency of reviews, and the quality of information reports.
- Problem resolution processes.

For more information, refer to OCC Advisory Letter 2000-9, "Third-Party Risk," and Advisory Letter 2000-12, "Risk Management of Outsourcing Technology Services."

5. Review fiduciary record keeping for compliance with 12 CFR 9.8 and other applicable law. Determine whether the bank:
 - Adequately documents the establishment and termination of each fiduciary account and maintains adequate records.
 - Retains fiduciary account records for a period of three years from the termination of the account or the termination of any litigation relating to the account, whichever comes later.
 - Maintains fiduciary account records separate and distinct from other records of the bank.
6. Review transaction processing and record keeping controls. Consider:
 - The timeliness and accuracy of transaction documentation and posting.
 - The management of routine and non-routine manual instructions.
 - Transaction and account balancing processes and controls.
 - Controls over the release or disbursement of assets or funds.
 - Reconciliation functions and exception reporting standards.
 - Controls for suspense (house) accounts.
7. Evaluate the security trade settlement processes. Determine whether:
 - Proper trade instructions are received and documented.
 - Trade tickets are properly controlled and contain required information.
 - Broker confirmations are reconciled to trade tickets.
 - Failed trades are promptly identified and effectively addressed.
 - Confirmations are sent as required and contain required information.
 - Depository position changes are matched to changes on the bank's accounting system.

8. Review securities trading record keeping for compliance with 12 CFR 12. Determine whether the bank:
 - Maintains the minimum records (12 CFR 12.3).
 - Provides customer notifications that are consistent with 12 CFR 12.4 and 12 CFR 12.5.
 - Maintains appropriate securities trading policies and procedures (12 CFR 12.7).

9. Evaluate asset custody and safekeeping processes and controls (12 CFR 9.13). Determine whether:
 - Fiduciary assets are placed in joint custody or control of not fewer than two fiduciary officers or employees.
 - Fiduciary account assets are kept separate from bank assets and other fiduciary account assets.
 - A third-party custodian or depository holds fiduciary assets. If so, determine whether such action is consistent with applicable law and supported by adequate safeguards and controls.
 - Fiduciary assets physically held by the bank are kept in a controlled vault or securities cage with access controls such as dual controls, vault entry records, asset tickets, physical security measures (12 CFR 21), and periodic vault counts.
 - The bank has adequate controls over unissued checks and securities.

10. Review policies and procedures established to prevent free riding (refer to Banking Circular 275, "Free Riding in Custody Accounts").

11. Review policies and procedures for the administration of corporate actions such as stock dividends, stock splits, and proxy voting.

12. Review processes and controls for the escheatment of unclaimed items. Consider whether the bank ages outstanding checks and suspense (house) account entries and files escheatment reports with the proper jurisdiction.

13. Review processes and controls for managing collateral set aside for self-deposits of fiduciary assets and compliance with 12 CFR 9.10(b).

14. Review the distribution of proxy materials and the disclosure of information about shareholders whose securities are registered in a bank nominee name for compliance with SEC Rules 17 CFR 240.14-17. Determine whether the bank:
 - Obtains a clear consent or denial for disclosure of beneficial owner information and maintains adequate records of beneficial ownership information for each account.
 - Appropriately passes information received from issuers, such as proxies and annual reports, to beneficial owners.
 - Responds to issuers' requests for information in a timely and appropriate manner.

15. If the bank serves as transfer agent for a "qualifying security" under section 12 of the Securities Exchange Act of 1934, determine whether the bank has registered as a transfer agent by filing Form TA-1 with the OCC (17 CFR 240.17A).

If the bank is a registered transfer agent, refer to the "National Bank Transfer Agents' Guide" for additional information and open the Registered Transfer Agent Examination. If the bank is a transfer agent, but is not required to register, ensure that appropriate controls are in place.

Objective 7: Assess the bank's retail brokerage program and determine the level of risk it poses to the bank and the effectiveness of program risk management.

Note: Most retail nondeposit investment products sales programs involve arrangements with affiliated or unaffiliated securities brokers that are regulated by the SEC. The Gramm-Leach-Bliley Act's functional regulation requirements apply.

1. If not previously provided, obtain and analyze bank-level information applicable to the retail brokerage program:
 - Board and oversight committee minutes and reports.
 - Policies and procedures.
 - Risk management, compliance, and internal audit reports.
 - Financial information.
 - Written agreement between the bank and the retail broker.
 - Complaints, litigation, settlement information.

2. Determine the level of risk to the bank from the program. Consider:
 - Nature and complexity of activities.
 - Financial significance to the bank's earnings and capital.
 - Identified deficiencies.
3. Assess the effectiveness of the bank's oversight and risk management systems:
 - Evaluate the appropriateness of the board and senior management reports for overseeing the bank's retail brokerage program.
 - Evaluate the effectiveness of the initial and ongoing due diligence process in selecting and monitoring the securities broker.
 - Determine the effectiveness of the bank's controls systems (compliance, internal audit, independent risk management).
 - Determine the bank's compliance with applicable legal requirements including provisions covering transactions between affiliates and the bank (12 USC 371c and c-1), consumer protection requirements (12 CFR 14), and privacy of consumer information (12 CFR 40).

Objective 8: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank's risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate asset management booklets of the *Comptroller's Handbook* for expanded procedures.

Objective 9: After completing any expanded procedures, determine whether additional verification procedures should be performed.

The extent to which examiners perform verification procedures will be decided case by case after consultation with the ADC. Direct confirmation with the bank's customers must have prior approval of the ADC and district deputy comptroller. The Enforcement and Compliance Division, the district

counsel, and the district accountant should also be notified when direct confirmations are being considered.

Objective 10: Conclude the review of the bank's asset management activities.

1. Provide and discuss with management a list of recommendations, as appropriate.
2. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the asset management review that are relevant to other areas being reviewed.
3. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., asset management activities, retail brokerage, violations, MRA) for the report of examination.
4. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
5. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
6. In discussion with the EIC, provide preliminary conclusions about:
 - The quantity of asset management risk.
 - The quality of risk management.
 - The aggregate level and direction of asset management risk or any other applicable risk. As appropriate, complete the summary conclusions in the section "Risk Assessment System."
 - Supervisory strategy recommendations.

Consumer Compliance

Conclusion: Consumer compliance is rated (1,2,3,4,5).

Complete this section's objectives to assign the compliance rating using the Uniform Interagency Consumer Compliance Rating System. The compliance rating should reflect:

- The quantity of compliance risk.
- The adequacy of the bank's risk management practices in light of the quantity of compliance risk.
- The degree of reliance that can be placed on the bank's risk management systems, including the compliance review/audit function.
- The degree of supervisory concern that is posed by the bank's consumer compliance system.

In assigning the rating, the examiner should consult with the EIC, the examiners assigned to review audit and internal controls, and other examining personnel as appropriate.

In determining the appropriate scope for the compliance examination, examiners will take into account the results of any internal screening and targeting processes that identify potential high-risk situations. In the BSA/AML/OFAC area, transaction testing would be appropriate for banks with higher risk characteristics and weak controls. Fair lending transaction testing must be completed for all banks on the final fair lending screening list. If the remaining areas of compliance risk are low, examiners should use the appropriate procedures in the minimum objective as their starting point to scope the remaining compliance work. Even when all compliance areas are consistently identified as low-risk, examiners should periodically expand supervisory activities beyond the minimum objective to include transaction testing to ensure that all control systems continue to be effective.

CORE ASSESSMENT

Minimum Objective: Determine the compliance rating, the quantity of compliance risk, and the quality of compliance risk management.²³ Assess

²³Guidance is provided for quantity of risk and quality of risk management for the following areas: BSA/AML/OFAC, Consumer Lending Regulations, Consumer Deposit Regulations, Fair Lending, and

compliance with all appropriate consumer deposit and lending laws and regulations, including Flood Disaster Protection Act (FDPA) and Bank Secrecy Act (BSA), anti-money laundering, and Office of Foreign Assets Control (BSA/AML/OFAC) systems.

At the beginning of the supervisory activity, determine what transaction testing, if any, should be included. The extent of transaction testing should reflect the bank's compliance risk profile, results of OCC compliance filters, audit coverage and results, and the time elapsed since the last testing.

Hold discussions with management covering actual or planned:

- Changes in key personnel who are responsible for compliance and training that weaken or strengthen the bank's compliance program.
- Changes to the Bank Secrecy Act Compliance Program and procedures (designation of BSA officer, internal controls, independent testing, customer identification program, employee training, and audit). (12 CFR 21.21)
- Changes in the FDPA compliance procedures or in the volume of loans originated in designated flood areas. (12 CFR 22)
- Change in the number and type of customers, products, services, and geographies at risk for money laundering.
- Changes in products, services, customer base, or delivery channels that affect the quantity of compliance risk, including those offered through affiliated and nonaffiliated third parties.
- Significant changes in the volume of products and services offered which would affect consumer compliance.
- Significant changes in third-party relationships and contracts.
- Changes in the bank's process for ensuring that employees understand and follow new regulations or changes to existing regulations.
- Any other factors that may have changed the bank's risk profile.

As requested, follow up on significant compliance audit issues identified by the examiner reviewing the bank's audit program:

- Discuss any outstanding compliance audit issues with management.
- If warranted based on the above discussions, or if requested by the examiner reviewing audit, obtain and review a risk-based sample of internal compliance audit reports and management follow-up.

Other Consumer Regulations.

- Discuss with management any changes in the scope, personnel, or frequency of the compliance review or audit function that could increase or decrease the function's reliability.

Contact the examiner assigned to review information technology to determine whether there have been any changes in vendor systems, software, and applications used to support compliance and BSA/AML/OFAC activities. If yes, determine what due diligence process the bank used to test the systems or software and whether appropriate training was provided to staff.

Obtain and review the following information and documents, as appropriate:

- Board, Compliance Committee, and BSA/AML/OFAC Committee minutes to determine how important compliance is to management and the board of directors.
- Compliance reviews, including those related to the Flood Disaster Protection Act, responses and corrective action.
- Results of OCC's previous compliance and BSA/AML/OFAC supervisory activities and management responses.
- Board-approved BSA Compliance Program, including compliance with 12 CFR 21.21.
- Results of the most recent CRA examination.
- Results of the most recent fair lending supervisory activity (fair lending screening results if not reviewed recently). Considering the high risk factors, determine whether the bank should be added to the fair lending screening list.
- Complaint information from the OCC's Customer Assistance Group (CAG) and the bank.

If the bank's activities, risk profile, or risk controls have changed significantly, or if the review of the above information raises substantive issues, the examiner should expand the activity's scope to include additional objectives or procedures as appropriate. If this review does not result in any significant changes or issues, conclude the compliance review.

Other Assessment Objectives: NOTE: Examiners should select the appropriate objectives and procedures necessary to assess the bank's condition and risks.

Objective 1: Determine the scope of the compliance review.

1. Review the supervisory information to identify any previous problems that require follow-up in this area.
2. As necessary, obtain and review the information below to determine the complexity of the bank's compliance environment and systems management uses to supervise compliance:
 - Organizational charts, job descriptions, turnover, and communication channels to determine how management communicates and manages risk through policies, procedures, compliance reviews, and internal controls.
 - Bank's training programs and criteria for compliance training for key personnel. Determine whether programs are appropriate based on functions performed and the likelihood of noncompliance.
 - If applicable, documentation supporting new product development, or initiatives to determine the effectiveness of compliance and planning.
 - Complaint information from the OCC's Customer Assistance Group (CAG) and the bank.
3. Discuss with the examiner responsible for completing the "Audit and Internal Control" section of the core assessment whether there are any significant audit findings that require follow-up, or whether a review of audit work papers is required. If needed, compliance worksheets²⁴ located in the consumer compliance booklets of the *Comptroller's Handbook* can be used as a guide for the work paper review.
4. Using overall results from the "Audit and Internal Control" section of the core assessment, determine to what extent examiners can rely on compliance and BSA/AML/OFAC reviews/audits by area to set the scope of the compliance supervisory activities. Consider:

²⁴ Compliance worksheets are also available online and in the Examiner's Library.

- Whether the compliance review/audit covers all applicable consumer and BSA/AML/OFAC regulation requirements for all products and services and all departments of the bank, such as trust and private banking, as well as the bank's Internet site and electronic banking, if applicable.
- Whether the compliance review/audit appropriately addresses moderate and high quantity of risk areas identified and includes appropriate sample sizes.
- Adequacy of documentation and frequency of reviews/audits.
- Whether the system for ensuring corrective action is effective.

Objective 2: Assess fair lending risk.

The OCC's fair lending screening process is designed to assist supervisory offices in the annual identification of institutions believed to present the highest fair lending risk. The screening process uses HMDA and complaint data to identify high-risk banks. However, the assessment of fair lending risk is the primary responsibility of the supervisory office. The screening process only complements the supervisory office's fair lending risk assessment activities. Supervisory offices have the opportunity to request that banks be removed from the list that results from the screening process. In addition, supervisory offices should review bank compliance systems in all community banks in order to identify those with inadequate fair lending processes and systems. Should the activities in the core assessment not be sufficient to determine whether a bank's fair lending processes and systems are adequate, or should the core assessment or other supervisory activities result in substantive concerns about fair lending, the steps that follow assist the examiner in determining whether the bank should be added to the OCC's fair lending screening list. Regardless of the outcome, the analysis should be documented in Examiner View.

If a bank is selected for a fair lending examination through the screening process or if the supervisory office determines that the bank should be added to the fair lending screening list, the supervisory office should update the bank strategy to address the areas of weakness. The supervisory office should consider requesting that a compliance team member assist or conduct the examination.

1. Review the findings from objective 1 and identify higher risk areas for fair lending (as needed, refer to quantity of risk indicators and quality of risk management indicators in appendix A).

2. If the bank has performed a fair lending self-evaluation and management shares it with the OCC, review the results. Refer to the “Other Explicit Illegal Limitations on Credit Worksheet” (12 CFR 202 – Regulation B) in the “Fair Lending Examinations” booklet of the *Comptroller’s Handbook* for guidance.
3. Considering the high risk factors, and in consultation with and approval from the EIC and supervisory office ADC, determine whether the bank should be added to the fair lending screening list. When necessary, consult with the compliance ADC.
4. If the supervisory office determines that a fair lending examination should be initiated, develop a written document outlining the reasons for adding the bank to the fair lending screening list.
5. Conduct a fair lending examination using selected procedures from the “Fair Lending Examinations” booklet of the *Comptroller’s Handbook*.

Note: Violations of the Fair Housing Act may require referral to the Department of Housing and Urban Development. Violations of the Equal Credit Opportunity Act or the Fair Housing Act that are the result of a pattern or practice may require referral to the Department of Justice. If these conditions are identified, refer to the supervisory office ADC and the compliance ADC for guidance.

Objective 3: Assess the adequacy of the bank’s anti-money laundering program and determine compliance with BSA/AML/OFAC regulations.

1. Review the findings from objective 1 and identify higher risk areas for BSA/AML/OFAC (as needed, refer to the quantity of risk and quality of risk management indicators in appendix A).
2. Obtain and review the following to determine any impact to overall BSA/AML/OFAC risk:
 - A list of products, services, customers, and geographies with a high risk for money laundering.
 - The Currency Transaction Report (CTR)/Suspicious Activity Report (SAR) download (also known as the FinCEN download) for the past 12 months.

- A list of the accounts held by nonresident aliens.
3. Select a sample of higher risk accounts for transaction testing. The sample size should be based on the level of aggregate BSA/AML risk, and include a review of the account opening and credit file information, and account statements from the previous three months. The sample should include high-risk entities such as:
- Private banking, trust nonresident alien, international brokered deposits, and foreign correspondent accounts for high-risk countries.
 - Accounts with significant cash activity or wire activity involving high-risk countries.
 - Money service businesses.
 - Private investment companies.
4. Determine the quality of BSA/AML/OFAC risk management based on your review of the quality of risk management indicators and the BSA/AML/OFAC audit worksheet if audit work papers were reviewed during the completion of the “Audit and Internal Control” section of the core assessment. As appropriate, consider:
- Confirming from the audit review the adequacy of the bank’s audit / compliance review function and BSA internal controls through the identification of any audit gaps and insufficient sampling.
 - Referring to the “BSA/AML/OFAC” booklet from the *Comptroller’s Handbook* for guidance if the bank offers products and services not covered by the audit worksheet.
5. Determine the adequacy of the Office of Foreign Assets Control (OFAC) compliance system. Consider whether:
- A qualified person has been designated to maintain OFAC sanction information and file OFAC reports when required.
 - The updates of OFAC sanction information in bank systems are timely and appropriate personnel are informed.
 - Blocked accounts are appropriately established when required.

Objective 4: Determine the bank's compliance with lending regulations.

1. Review the findings from objective 1 and identify higher risk areas in consumer lending regulations (as needed, refer to the quantity of risk and quality of risk management indicators in appendix A).
2. Determine whether, if the bank actively markets to new customers by offering alternative delivery channels (e.g., Internet banking) and widespread advertising, the bank has adequate internal controls and trained staff to handle these delivery channels. Determine whether all advertisements are reviewed and approved by the compliance officer. (Reg Z, including APR and triggering terms)
3. If the bank offers complex loan products, or the bank's products change frequently, determine whether the bank has adequate systems and knowledgeable personnel to accurately calculate annual percentage rates. (Reg Z)
4. If the bank's lending area contains a participating community and has special flood hazard areas, determine whether the bank has internal systems in place to ensure that flood insurance is obtained at loan origination and maintained throughout the life of the loan. (FDPA)

Select a limited sample of residential and commercial real estate loans for testing. The testing should include a review of the flood determination forms, borrower notification, and amount of coverage.

5. If the bank has a broker relationship and either pays or receives a high amount of fees, verify that the bank does not pay or receive a fee merely for the referral. (RESPA section 8)

Objective 5: Determine the bank's compliance with deposit regulations.

1. Review the findings from objective 1 and identify higher risk areas in consumer deposit regulations (as needed, refer to the quantity of risk and quality of risk management indicators in appendix A).
2. If the bank actively markets to new customers by offering alternative delivery channels (e.g., Internet banking) and widespread advertising, determine whether the bank has adequate internal controls and trained staff to handle these delivery channels. Determine whether all

advertisements are reviewed and approved by the compliance officer. (Regulation DD)

3. Determine whether the bank has trained staff and adequate procedures to handle unauthorized transactions and errors reported by customers. (Regulation E, 12 CFR 205.11)
4. If the bank offers several complex deposit products, determine whether the bank has adequate systems and knowledgeable personnel to accurately calculate annual percentage yields. (Regulation DD – APY)
5. If the bank places a large number of holds, determine whether the bank has adequate systems and knowledgeable personnel to place the holds in accordance with the exceptions cited in 12 CFR 229.13. (Regulation CC)

Objective 6: Determine the bank’s compliance with other consumer regulations.

1. Review the findings from objective 1 and identify higher risk areas in other consumer regulations (as needed, refer to the quantity of risk and quality of risk management indicators in appendix A).
2. If the bank discloses information to nonaffiliated third parties [outside the statutory exceptions], determine whether the bank has adequate systems to ensure that customers are provided a clear, conspicuous opt-out notice on an annual basis. (Privacy)
3. If the bank uses prescreened lists for solicitation purposes, verify that the bank uses the same criteria to evaluate the application that it used to prescreen the applicant. (FCRA, permissible purpose)
4. If the bank receives requests from government agencies for customer’s financial records, determine whether the bank has adequate procedures to ensure compliance with the Right to Financial Privacy Act.
5. If the bank operates a Web site that collects information from, or is directed to, children under the age of 13, determine whether the bank has adequate procedures and trained personnel to ensure compliance with the requirements of the Children’s Online Privacy Protection Act (COPPA).

6. If the bank acts as a “debt collector,” determine whether there is bank staff responsible for ensuring that the bank complies with the Fair Debt Collection Practices Act.

Objective 7: Using the findings from meeting the foregoing objectives, determine whether the bank’s risk exposure from consumer compliance is significant.

Develop preliminary assessments of quantity of compliance risk, quality of compliance risk management, aggregate compliance risk, and direction compliance risk. Refer to the “Risk Assessment System,” as needed. Comment as necessary.

Objective 8: Determine whether to expand the procedures or develop a plan for corrective action. Consider whether:

- Management is able to adequately manage the bank’s risks.
- Management is able to correct any fundamental problems.
- To propose a strategy to address any weaknesses identified and discuss the strategy with the supervisory office.

Refer to the appropriate booklets of the *Comptroller’s Handbook* for expanded procedures.

Objective 9: Conclude the consumer compliance review.

1. Provide and discuss with management a list of deficiencies and violations.
2. In consultation with the EIC determine whether to recommend civil money penalties or an enforcement action (refer to 42 USC 4012a(f)). Note: A strong presumption exists for issuing a cease and desist order when a violation of 12 CFR 21.21, Bank Secrecy Act Compliance Program, is cited.
3. In consultation with the EIC and other examining personnel, identify and communicate to other examiners as appropriate any conclusions and findings from the consumer compliance review that are relevant to other areas being reviewed.

4. Use the results of the foregoing procedures and any other applicable examination findings to compose comments (e.g., Compliance, MRA) for the report of examination or other supervisory communication such as a board letter.
5. Update, organize, and reference work papers in accordance with PPM 5400-8 (rev).
6. Update Examiner View (e.g., ratings, core knowledge, MRA, violations).
7. In discussion with the EIC, provide preliminary conclusions about:
 - The quantity of risk.
 - The quality of risk management.
 - The aggregate level and direction of compliance, transaction, and reputation risk, or any other risk, as they relate to compliance. As appropriate, complete the summary conclusions in the section "Risk Assessment System."
 - Supervisory strategy recommendations.

Examination Conclusions and Closing

Conclusion: The bank is rated (1,2,3,4,5).
The bank's overall risk profile is (low, moderate, high).

To conclude the supervisory cycle, examiners will meet all objectives under this section, regardless of the bank's risk designation.

Objective 1: Determine and update the bank's composite rating and other regulatory ratings, as appropriate.

1. Consider findings from the following areas:
 - Audit and internal control.
 - Capital adequacy.
 - Asset quality.
 - Management capability.
 - Earnings quality and quantity.
 - Liquidity adequacy.
 - Sensitivity to market risk.
 - Information technology.
 - Asset management.
 - Compliance with consumer laws, rules and regulations.
 - Performance under the Community Reinvestment Act.

2. Ensure that the evaluation of all component ratings has considered the following items as outlined in UFIRS:
 - Institution's size.
 - Institution's sophistication.
 - Nature and complexity of bank activities.
 - Bank's risk profile.

Note: While the regulatory ratings remain point-in-time assessments of a bank's financial, managerial, operational, and compliance performance, the description of each component in the *Comptroller's Handbook* contains explicit language emphasizing management's ability to manage risk. Therefore the conclusions drawn in the risk assessment system should have

an appropriate impact on the corresponding component and/or composite rating.

Objective 2: Determine the risk profile using the risk assessment system.

Draw and record conclusions about quantity of risk, quality of risk management, aggregate risk, and the direction of aggregate risk for each of the applicable risk categories. Refer to the matrix in appendix A for additional guidance in assessing aggregate risk.

Note: Using the assessments made of the nine individual risks, the examiner can establish the institution's overall risk profile. The **overall risk profile** is not an average, but a combination of the assessments of the nine individual risks. In establishing the overall risk profile, examiners use judgment to weigh the nine risks by the relative importance of each risk.

Objective 3: Finalize the examination.

At a minimum, the ROE examination conclusions and comments should include:

- A summary of scope and major examination objectives, including:
 - A recap of significant supervisory activities during the examination cycle and how those activities were used to evaluate the bank's overall condition.
 - Discussions of any significant expansion of the standard core assessment.
 - Statements of the bank's overall condition and conclusions on ratings.
 - Discussions of any excessive risks or significant deficiencies in risk management and their root causes.
 - A summary of actions and commitments to correct any significant deficiencies and planned supervisory follow-up.
 - Notice to the board if any civil money penalty referrals are being made.
 - A statement about any applicable section 914 requirements.
1. The EIC, or designee, should finalize any required ROE comments. The comments should include significant risk-related concerns. Refer to appendix C for a detailed summary on requirements for the content of the ROE.

2. In consultation with key examining personnel, the EIC should determine whether the bank's condition and risk profile warrant including any of the recommended MRA in the report of examination. If so, refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for specific guidance.
3. Discuss examination conclusions and review any required draft comments with the ADC or the appropriate supervisory office official.
4. Summarize examination conclusions and the bank's condition in the "Examination Conclusions and Comments" page of the report.
5. If any component area is rated 3 or worse, or if the risk profile causes sufficient concern, the EIC should contact the supervisory office before the exit meeting to develop a strategy for addressing the bank's deficiencies.
6. Hold an on-site exit meeting with management to summarize examination findings:
 - Inform management of areas of strengths as well as weaknesses.
 - Solicit management's commitment to correct material weaknesses.
 - Discuss the bank's risk profile including conclusions from the risk assessment system.
 - Offer examples of acceptable solutions, if appropriate.
7. Provide bank management with an approved draft of examination conclusions, MRA comments, and violations of law to allow managers to review the comments for accuracy.
8. Perform a final technical check to make sure that the report is accurate and acceptable. The check should ensure that:
 - The report meets established guidelines.
 - Comments support all regulatory ratings, as applicable.
 - Any numerical totals are accurate.
 - Any numerical data in the report and other supervisory comments are consistent with the bank's records.
 - Violations of law are cited accurately.

9. If there are MRA comments in the report, they should also reflect conclusions on management's ability to:
 - Resolve noted problems or issues.
 - Manage the current level of risk (including the likely effects of inaction).
10. Verify that all appropriate information and approvals have been entered in Examiner View and approve the examination.
11. Prepare the supervisory strategy for the next supervisory cycle. Follow specific guidance in the "Planning" section of this booklet and in the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.
12. Complete and distribute assignment evaluations.
13. Schedule the board meeting (if it is not already scheduled).

Objective 4: Prepare for and conduct a meeting with the board of directors.

1. Before completing the supervisory cycle, prepare for the board meeting by:
 - Drafting a preliminary agenda (formal or informal).
 - Preparing any handouts, graphics, or audiovisual material for the meeting.
 - Reviewing the backgrounds of all board members.
 - Drafting responses to expected questions and comments.
2. Conduct the meeting after the board, or an authorized committee, has had the opportunity to review the draft report or a synopsis of examination findings. At the meeting, provide graphics and handouts, when appropriate, to describe:
 - The objectives of OCC's supervision and how the OCC pursues those objectives.
 - Strategic issues including growth, products, and strategies.
 - Major concerns or issues, including significant risks facing the bank.
 - The bank's success or failure in correcting previously identified deficiencies.

- The potential impact of failing to correct deficiencies.
- What the OCC expects the bank to do and when (i.e., action plans, supervisory strategies, and commitments).
- What the bank is doing well.
- Industry issues affecting the bank.

Note: During the supervisory cycle, the ADC must attend at least one board meeting or an examination exit meeting that includes board member participation.

3. Document details of the meeting in Examiner View as a significant event. Include the following information:
 - The date and location of the meeting and the names of attendees.
 - Major items discussed.
 - A brief summary of the directors' reactions to the OCC briefing. (The entry documenting the meeting can refer the reader to the follow-up analysis comment for further details on any commitments obtained from the board or senior management.)

Community Bank Periodic Monitoring

Periodic monitoring activities are a key component of supervision by risk. Each bank's supervisory strategy outlines, in detail, the specific monitoring activities that will be performed and the timing of those activities. The timing of the activities is driven by the supervisory objectives rather than predetermined calendar dates. While the timing of these activities should be risk-based, there is a presumption that some type of quarterly contact with bank management is preferred for a majority of national banks.

The objectives of periodic monitoring include but are not limited to:

- Identifying significant (actual or potential) changes in the bank's risk profile,
- Ensuring the validity of the supervisory strategy, and
- Achieving efficiencies during onsite activities.

The specific objectives of periodic monitoring for a particular bank are determined by the portfolio manager in consultation with the supervisory office, and are based on knowledge of the bank's condition and risks. Depending on the circumstances and the bank's risk profile, periodic monitoring may be as limited as a brief phone call to bank management or a review of bank financial information. If circumstances warrant, periodic monitoring may also be more in-depth, and could include a comprehensive analysis of various CAMELS/ITCC components or a visit to the bank. ***It is the joint responsibility of the supervisory office's assistant deputy comptroller and the portfolio manager to determine the depth and breadth of the activities needed to achieve supervisory objectives.*** When conducting monitoring activities at a newly chartered bank, examiners should supplement their analyses with the guidance in PPM 5400-9, "De Novo and Converted Banks."

Following are procedures examiners may perform during periodic monitoring activities. These procedures are provided only as a guide for examiners. The portfolio manager should perform whichever procedures are appropriate, consistent with the bank's condition and risk profile.

Conclusion: The bank's risk profile (has/has not) changed and the supervisory strategy (is/is not) valid.

Objective: Determine whether any significant trends or events have occurred that change the bank's risk profile or require changes to the supervisory strategy using, at a minimum, available Canary information.

1. Review quarterly financial information using the UBPR, bank supplied information, call reports, or OCC models for significant financial trends or changes. The financial review of low-risk banks should be very brief if no anomalies are detected.

For higher risk banks, it may be appropriate to supplement financial information with:

- Budget and pro forma financial statements.
- Management and board reports.
- Loan review, audit, and compliance management reports.
- Board and committee minutes.

2. Discuss with bank management financial trends and changes in bank operations, controls, and management. Examiners may conduct this discussion by telephone or during an on-site meeting. Focus particular attention on areas of significant change or plans for significant growth.

Possible discussion topics include:

- Financial performance and trends.
- Plans to raise or deployment of significant new injections of capital.
- Significant issues identified by internal and external audit, and management's corrective action on those issues.
- Activities that may affect the bank's risk profile, including changes in:
 - Products, services, distribution channels, or market area.
 - Policies, underwriting standards, or risk tolerances.
 - Management, key personnel, organizational structure, or operations.
 - Technology, including operating systems, technology vendors/servicers, critical software, Internet banking, or plans for new products/activities that involve new technology.
 - Control systems (audit, loan review, compliance review, etc.) and their schedule or scope.

- Legal counsel and pending litigation.
 - Purchase, acquisition, or merger considerations.
 - Broad economic and systemic trends affecting the condition of the national banking system, as identified by OCC national or district risk committees.
 - Trends in the local economy or business conditions.
 - Public information disclosed since the last review:
 - Recent media coverage.
 - Market or industry information for publicly traded companies, such as 10Q and securities analyst reports.
 - Changes in asset management lines of business.
 - Issues regarding consumer compliance or CRA.
 - Other issues that may affect the risk profile.
 - Management concerns about the bank or about OCC supervision.
3. Perform, as appropriate, any follow-up on previously identified weaknesses.
 4. In consultation with the appropriate supervisory office official, determine whether the results of the monitoring activities necessitate changes to the CAMELS/ITC component ratings.
 5. Determine whether the results of the monitoring activities affect the supervisory strategy with regard to:
 - Types of supervisory activities planned.
 - Scope of the reviews.
 - Timing or scheduling.
 - Resources (expertise, experience level, or number of examiners).
 6. Update Examiner View, as necessary, to reflect:
 - Any changes to:
 - Supervisory strategy.
 - Core knowledge.
 - Examination conclusion/analysis comments.

Note: Documentation in Examiner View and work papers should be sufficient to support conclusions based on the extent of findings and

work performed.²⁵ **For example, if the bank's risk profile or CAMELS/ITC ratings have not changed, the only required Examiner View documentation is a statement that the monitoring objectives were met and that the bank's risk profile has not changed since the prior review.**

7. If there are significant changes that require a change to CAMELS/ITC ratings or the risk assessment system, open the appropriate CAMELS/ITC component(s) in Examiner View, document any additional supervisory work performed and the effect of the changes on the risk assessment system, CAMELS/ITC ratings, and the supervisory strategy, if any. If significant issues are identified, send written communication or conduct a meeting with the board or management. Any significant change in an aggregate risk assessment or any CAMELS/ITC rating must be communicated in writing to the board of directors.

²⁵ See guidelines in PPM 5400-8 (rev), "Supervision Work Papers," PPM 5000-34 and the "Bank Supervision Process" booklet of the *Comptroller's Handbook*.