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OCC Releases Study of Capital Allocation Practices
at Large Banks

WASHINGTON, D.C. -- The Office of the Comptroller of the Currency (OCC) today released a study of capital allocation practices at selected large national banks. The OCC released the study to highlight this promising new risk management tool which is drawing increased attention among bankers, particularly in the largest companies.

"I welcome the development of capital allocation and other financial management tools that give banks more information about the relative risks and rewards of individual product lines and services," said Comptroller of the Currency Eugene A. Ludwig. "I encourage banks to consider using innovative tools such as capital allocation to help them decide whether to enter particular lines of business, to make decisions about pricing products and services, and generally to better measure, monitor, and control risk in their institutions."

Capital allocation is a process by which economic capital is assigned to transactions, products, customers, business lines, and/or organizational units to provide management with risk-adjusted profitability measures. The use of capital allocation techniques is being driven by the increased competition in financial services and advances in information technology. Banks' growing need for sophisticated risk management systems and bank regulators' new risk-based supervision have also combined to spur the broader use of capital allocation by larger banks. Capital allocation is not related to calculating a bank's regulatory capital requirements, which all banks are required to meet.

"Good capital allocation processes can provide bank managers and directors with valuable information for decision-making and strategic planning," said Mr. Ludwig. Noting that even the most effective capital allocation methods now have some limitations, he said that they "need to be adapted to the specific needs and requirements of each institution."

The study, *Capital Allocation: A Study of Current and Evolving Practices in Selected Banks*, is based on a survey of capital allocation practices at 10 large national banks. Examiners who conducted the survey said they believed this tool would be most useful for large, sophisticated companies where senior executives are removed from day-to-day pricing decisions and need information on risk-taking decisions facing the bank. The process creates a framework for better informed decisions that result in improved bank performance and enhanced safety and soundness.

The study found that capital allocation processes and the objectives for these systems varied significantly among banks and that even the companies that are leaders in this area are still

working to enhance their processes. The study also found that the following seven elements make the capital allocation process more effective:

1. It is part of a disciplined management process.
2. The focus is on maximizing shareholder value.
3. It is consistent with the corporate risk governance framework.
4. It is comprehensive (including all significant risks/activities).
5. It applies quantitative and qualitative analyses.
6. It is well understood, and effectively controlled and communicated internally.
7. It is embraced as a credible tool for decision-makers.

For a copy of *Capital Allocation: A Study of Current and Evolving Practices in Selected Banks*: write to Comptroller of the Currency, Communications Division, Washington, DC 20219; or fax your request to (202)874-4448; or call (202) 874-5043 to order by phone; or visit the OCC's Public Reference Room at 250 E Street, S.W. in Washington, D.C. (9 a.m.-noon and 1-3 p.m., Monday-Friday).

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.