Description of document: Various Office of the Comptroller of the Currency (OCC) Supervisory Memoranda, 2000-2020

Requested date: 20-November-2020

Release date: 16-June-2021

Posted date: 11-October-2021

Source of document: FOIA Request
OCC
Disclosure Services
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
[Submit FOIA Request online (PAL)]

Office of the Comptroller of the Currency

Washington, DC 20219

June 16, 2021

This is in response to your letter dated November 20, 2020, which was received in my office on November 30, 2020 for processing under the Freedom of Information Act (FOIA), 5 U.S.C. 552.

You requested a copy of the following OCC Supervisory Memos:

- SM 2020-08 - Fiscal Year 2022 Bank Supervision Strategy Planning Guidance
- SM 2020-06 - Temporary Guidance for Compliance Related Supervisory Activities During the COVID-19 Emergency
- SM 2020-05 - Artificial Intelligence
- SM 2020-04 - Fulfilling the Full Scope, On-Site Examination Requirement in Light of COVID-19
- 2020-03 - Frequently Asked Questions About Financial Services for Marijuana-Related Businesses
- 2019-01 - Discussion Points Related the Flood Disaster Protection Act Requirement for Flood Insurance Coverage on Commercial Building Contents
- 2018-05 - Examiner Guidance to Supplement OCC Bulleting 2018-14, “Installment Lending: Core Lending Principles for Short-Term Small-Dollar Installment Lending”
- 2018-03 - Examiner Guidance on the Volcker Rule
- 2018-01 - Using Supervisory Guidance in Communications with Banks
- 2014-02 - Supervision of End-User Derivatives and Trading Activities
- 2013-05 – Immediate Public Availability of Formal Enforcement Actions and Other Actions
- 2013-02 - Rescission of OCC Internal Issuances
- 2012-03 - Considerations of bank Secrecy Act/Anti-Money Laundering Examination Findings in the Uniform Interagency Rating Systems and OCC’s Risk Assessment System
- 2008-06 - Review of Liquidity at Banks in a Stressed Environment
- 2008-03 - Classifying Bank Holdings of Financial Institution Securities in the Current Market Turmoil
- 2006-04 - Sharing Information with Office of Foreign Assets Control
- 2000-04 - OCC Supervision and Gramm-Leach- Bliley Act of 1999
- 2000-01 - Financial Modernization Legislation - Effect on OCC Supervision

Your request is granted in part and denied in part. Enclosed are copies of the OCC Supervisory Memos cited in your request. Certain information has been deleted by the authority of 5 U.S.C. 552(b)(5) and 12 C.F.R. 4.12(b)(5) relating to inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency; and, 5 U.S.C. 552(b)(6) and 12 C.F.R. 4.12(b)(6), relating to personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

If you consider any of the above to be an improper denial of your request, you may appeal such denial to OCC. The appeal should be filed within 90 days of the date of this letter, should state the circumstances and reasons or arguments in support of the appeal, and be submitted via our online FOIA application at https://foia-pal.occ.gov/ or mailed to:

Manager, Disclosure Services & Freedom of Information Act Officer
Communications Division
Office of the Comptroller of the Currency
Suite 3E-218
Washington, DC 20219

By filing an appeal, you preserve your rights under FOIA and give the agency a chance to review and reconsider your request and the agency's decision.

If you would like to discuss our response before filing an appeal to attempt to resolve your dispute without going through the appeals process, you may contact our FOIA Public Liaison, Frank Vance, for assistance at:

Disclosure Services
Communications Division
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
(202) 649-6758
Frank.Vance@occ.treas.gov

If you are unable to resolve your FOIA dispute through our FOIA Public Liaison, the Office of Government Information Services (OGIS), the Federal FOIA Ombudsman's office, offers mediation services to help resolve disputes between FOIA requesters and Federal agencies. The contact information for OGIS is:

Office of Government Information Services
National Archives and Records Administration
8601 Adelphi Road–OGIS
College Park, MD 20740-6001

(202) 741-5770 (fax)
(877) 684-6448 (phone)
ogis@nara.gov
ogis.archives.gov

Sincerely yours,

Frank D. Vance, Jr.

Frank D. Vance, Jr.
Manager, Disclosure Services
& Freedom of Information Act Officer
Communications Division

Enclosure(s)

#2021-00072-F

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

MM 00-1

Washington, DC 20219

INTERNAL GUIDANCE ONLY, NOT FOR EXTERNAL DISTRIBUTION

To: All Examining Personnel

From: Leann G. Britton, Senior Deputy Comptroller, Bank Supervision Operations (b)(6)
Wayne Rushton, Senior Deputy Comptroller, Bank Supervision Policy (b)(6)

Date: January 10, 2000

Subject: Financial Modernization Legislation --
Effect on OCC Supervision

On November 12, the President signed into law the Gramm-Leach-Bliley Act of 1999 (GLBA). This important, far-reaching and complicated legislation addresses a number of significant issues affecting both national banks and the examination process. Examiners should review the new OCCnet site dedicated to financial modernization legislation at *OCCNet/CCO/financial.htm* for information on the substantive provisions of GLBA. This memorandum, with the attached questions and answers, focuses on the effect of GLBA on OCC's bank supervision process.

First and foremost, GLBA does not change the OCC's core mission of ensuring the safety and soundness of the national banking system. The statute's most significant change for examiners is its emphasis on the concepts of "functional regulation," namely, that banking activities are regulated by banking regulators, securities activities by securities regulators, and insurance activities by insurance regulators. The functional regulation provisions limit the circumstances under which the OCC and the other federal bank regulators may examine or require reports from certain affiliates and subsidiaries of national banks. While these provisions may alter the OCC's direct responsibility over certain national bank affiliates and subsidiaries, they do not change the OCC's vital interest in understanding and assessing all risks affecting national banks. The OCC's supervisory process will continue to focus on reviewing and assessing the consolidated risk of a national bank, its systems for monitoring and controlling operational and financial risks, including those that arise from intercompany transactions, and its compliance with laws under our specific jurisdiction. The implementation of GLBA, however, will require greater cooperation and communication between the OCC and other functional regulators, including the SEC and state insurance commissioners. The ADCs for Specialties/Operations are spearheading the effort to open communication channels and develop closer working relations with our regulatory counterparts in the insurance and securities industries. Once the initial contacts have been made, it is expected that Large Bank EICs and ADCs with portfolio responsibilities will work directly with functional regulators on institution issues. This would include the coordination of supervisory activities, communication of critical issues, and exchange of necessary information. We will shortly provide guidance in this area to ensure consistent treatment with respect to all functional regulators.

Over the past year, the OCC has undertaken various efforts in anticipation of moving toward a greater degree of functional regulation. In late 1998, a Functional Supervision Working Group was formed to commence development of policy guidance related to our role in a functional regulatory scheme. Additionally, the OCC has held meetings with the SEC and state insurance commissioners to discuss supervisory approaches and information sharing. GLBA has added some urgency and new direction to those efforts.

The attached series of questions and answers are intended to shed light on some of the practical implementation issues for OCC supervision resulting from GLBA. Some important issues remain, and we are committed to keeping you informed as these matters are resolved. In the meantime, examiners are encouraged to read closely the materials in the attachment and the other documents provided on the financial modernization OCCnet site. Special attention should be paid to the different effective dates of the various sections of GLBA. Please address any immediate questions on the impact of GLBA on OCC supervision to Kay Kowitt (BSOP) or Kevin Bailey (BKSP). Questions relating to specific business lines should be directed to the following contacts: Asset Management - Lisa Lintecum; Broker-Dealer and other Treasury activities - Kathy Dick; Insurance - Vernon Stafford; and CRA - Ralph Sharpe or David Hammaker. These subject matter experts will coordinate, to the extent necessary, with Law Department personnel to secure necessary legal reviews and ensure consistency of application.

Attachment

Gramm-Leach-Bliley Act
Questions & Answers
Immediate Impact on OCC Supervision

Q1. The "Functional Regulation" provisions of GLBA placed limitations on the OCC's and the other Federal banking regulators' authority to examine, establish capital requirements for, require reports from and take other actions with regard to "functionally regulated" subsidiaries and affiliates of a national bank. How will these provisions affect examinations?

A1. The "functional regulation" provisions of GLBA will limit our ability to directly examine or directly require reports from a functionally regulated company, but it will not eliminate such authority. For example, if the OCC wants a report directly from a company supervised by the SEC, CFTC, or State insurance commissioners, the OCC must first ask the appropriate functional regulator to obtain the report. If the report is not made available, the OCC may require the functionally regulated entity to provide the report directly only if such report is necessary to assess: (1) a material risk to the national bank; (2) compliance with a law that the OCC has specific jurisdiction to enforce against the entity; or (3) the systems for monitoring and controlling financial and operational risks within the holding company that could pose a threat to the national bank's safety and soundness. These provisions are **effective March 11, 2000.** From a practical perspective, however, it is important to recognize that GLBA does not restrict examiners from seeking information on a functionally regulated entity from other sources, such as the owner/affiliate national bank. In this regard, supervisory information on functionally regulated entities may become available during routine discussions with bank management and through regular reviews of existing bank reports.

Examiners should still consider the overall risk of the national bank as part of the normal supervisory process, including that risk originating in, or resulting from, functionally regulated subsidiaries or affiliates. When performing such a review, examiners should focus on the effectiveness of bank systems for monitoring and controlling operational and financial risks and intercompany transactions, and its compliance with laws under our specific jurisdiction. To the extent possible, examiners should make use of examinations and reports of the primary supervisor for information on the functionally regulated company. However, as noted above, GLBA does permit a more direct examination and assessment of that company, if certain thresholds are met.

Enhanced communication between the OCC and the functional regulator will be critical under this new regime. A cooperative relationship with the SEC, NASD, state insurance commissioners and the CFTC will ensure that both the OCC and functional regulators have timely, useful information necessary to fulfill their respective statutory mandates. In this environment, an OCC assessment of the overall risk profile of a national bank with a subsidiary or affiliate that is an SEC-registered broker, dealer, investment adviser, investment company, a State-regulated insurer, or a CFTC-regulated firm, may involve greater reliance on the work of other agencies, especially as it relates to the operations of the functionally regulated entity.

Q2. How should the EIC of a multi-faceted bank (one that offers and underwrites banking, brokerage and insurance products) assess the comprehensive risks to a national bank? Will the scope of an EIC's work be limited to the analysis of information provided by the functional regulators even though the scope is incomplete or does not address financial issues or other risks? In these circumstances, is there an opportunity for the OCC to seek more information to make an informed safety and soundness assessment?

A2. While recognizing the responsibilities of other agencies, the OCC's supervisory process will still focus on the need to assess and review a bank's risk on a consolidated basis, to review systems for monitoring and controlling financial risks, intercompany transactions, and compliance with laws under our specific jurisdiction. GLBA provides a framework for bank regulators to follow when directly requesting reports or contemplating an examination of a functionally regulated activity.

Although the focus of the OCC's efforts going forward will be at the bank level, as well as non-functionally regulated subsidiaries and affiliates, our assessments of a bank's condition have always considered the risks posed by the economy, interest rate movements, asset values, and specific bank activities. In addition, we have considered the risks posed to a bank by activities conducted by third parties, affiliates, and subsidiaries. We expect OCC examiners to continue to consider risks posed to national banks from each of these sources.

As noted in answer to question 1 above, the scope of an EIC's work need not be limited to the information provided by functional regulators. Examiners need to consider the overall risk of the national bank, including that risk originating in, or resulting from, functionally regulated subsidiaries or affiliates. In that analysis, examiners should utilize, to the extent possible, reports developed by functional regulators. If such reports, however, are insufficient for our purposes, GLBA does authorize the OCC to seek information directly from the functional entity, consistent with statutory thresholds. In addition, GLBA does not preclude or limit the OCC from seeking necessary information from bank management.

Q3. GLBA narrowed the broad exemption of banks from the definitions of "broker" and "dealer" under the Securities Exchange Act. Consequently, securities activities not covered by the revised exemption will likely have to be moved out of the bank to an SEC registered broker/dealer subsidiary or affiliate effective May 11, 2001, and would thereafter come under SEC supervision. Does this mean that the OCC no longer supervises any of these securities activities?

A3. No. GLBA replaced the broad exemption of banks from the definitions of "broker" and "dealer" under the Securities Exchange Act with a series of new transaction-based exemptions. While these provisions may result in restructuring of certain bank broker and dealer activities, the OCC remains the primary supervisor of securities activities conducted in the bank. Registered broker/dealer activities conducted in subsidiaries and affiliates are subject to the oversight of the SEC.

As banks assess their current and planned preferred corporate structure for securities activities after GLBA, it is possible that we will see some lines of business move into national banks and others move out. As banks reorganize these activities, we will have to modify our supervisory approach. OCC supervisory efforts will focus on a bank's oversight of its functionally regulated securities activities and the impact of those activities on the bank's overall safety and soundness. This same supervisory approach applies to arrangements where the bank has contracted with a third party broker/dealer to offer retail brokerage services. Our risk assessments will analyze the significance of the business line to the bank's reputation, revenue contribution, capital adequacy, and the effectiveness of the bank's risk management systems. The OCC's existing supervisory responsibility over GSA and MSRB activities of national banks is not affected by this legislation.

Q4. I am particularly concerned about the impact of GLBA on trust examinations. How does the statute affect those examinations?

A4. As described above, GLBA eliminated the current exemption of banks from the definitions of "broker" and "dealer" in the Securities Exchange Act. However, banks will continue to be exempt from SEC regulation if they conduct their activities within a series of transaction-specific exemptions. A number of these exemptions relate to fiduciary activities of national banks. The exemption most relevant to Asset Management activities provides that a bank will not be considered a "broker" if it effects securities transactions in a trustee capacity, or effects transactions in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principles. For this purpose, GLBA adopts the OCC's definition of "fiduciary capacity" from Part 9.

GLBA also modifies, **effective in May 2001**, the current definition of "investment adviser" by eliminating the exemption for banks that advise registered investment companies. Whether a bank advises registered investment companies through a subsidiary, affiliate, or separately identifiable department or division of the bank (SIDD), that subsidiary, department or division must register as an investment adviser. Significantly, GLBA does not require banks to register those investment advisers that advise trust accounts, common or collective investment funds, institutional clients, or private banking.

The immediate impact of these changes on OCC supervision of national banks' fiduciary activities, especially in light of the delayed effective date of the statute, will likely be negligible. The OCC remains responsible for supervising all trust and retirement services of national banks, as well as transfer agent, sweep accounts, safekeeping and custody services, including securities lending. Banks may continue to offer common and collective funds to their fiduciary clients. GLBA does not restrict the OCC's ability to examine any brokerage or advisory activities within the bank -- the functional regulation provisions discussed above only restrict the ability of the OCC to examine or request reports from functionally regulated subsidiaries, affiliates or third parties.

As a result of the elimination of the exemption for banks providing investment advice to SEC-registered mutual funds, banks may reorganize their investment advisory function. Some banks may elect only to register the advisory function that advises registered mutual funds and to maintain an unregistered advisory division. Other banks may elect to consolidate their advisory functions in a registered adviser. OCC supervisory efforts will be shaped by the industry's choices in this area. Particularly for registered investment advisers, our supervisory efforts will focus on the effectiveness of risk management systems the bank uses rather than a review of the adviser itself.

Q5. How is it contemplated that functional regulation will work if a bank advising registered mutual funds chooses to organize all investment advisory and management services (including trust services, private client groups and retirement services) under the registered investment advisor? Will we continue to examine these services?

A5. At a minimum, we will continue to assess the bank's ability to manage risks associated with the registered investment advisory activities. Our focus at the bank level will be to determine if proper due diligence and effective risk management systems are in place to control financial, reputation and legal risks associated with these activities. We anticipate that over the next 18 months, our supervisory policy position will evolve based upon ongoing discussions with the SEC as we seek to clarify our respective roles over investment advisory activities.

Q6. Although I recognize states are the primary supervisor of insurance activities, I am troubled by the risk my bank is taking on in its bank insurance subsidiary. Can I assess the risk that activity poses to the bank?

A6. Yes. Although the OCC has previously recognized the primary role of the States in the oversight of insurance, the OCC still has an interest in the risk assumed by national banks, regardless of source. Therefore, examiners should still assess the consolidated risk profile of national banking companies providing insurance products, utilizing, to the extent possible, reports developed by the state insurance commissioner or other information available from bank management. In performing such a review, examiners should focus on the effectiveness of bank systems for monitoring and controlling operational and financial risks and intercompany transactions, and its compliance with laws under our specific jurisdiction.

Q7. How does GLBA affect CRA examinations?

A7. Effective immediately, CRA examination cycles for banks with total assets of $250MM or less will be changed. The CRA examination cycle is three, four, or five years, depending upon the asset size and rating of the institution.

Banks with an overall CRA rating of Outstanding and total assets of $250MM or less at the most recent CRA examination will be examined no sooner than 60 months following the close date of the most recent CRA examination. Banks with an overall CRA rating of Satisfactory and total assets of $250MM or less at the most recent CRA examination will be examined no sooner than 48 months following the close date of the most recent CRA examination. Banks may be removed from the four/five year examination cycle for the following reasons: a) in connection with an application for a deposit facility; or b) for reasonable cause (for example, a change in CRA status from small bank to large bank, as defined under the CRA regulation), after consultation with and approval by the Deputy Comptroller for Compliance Operations. For all other banks (both (1) banks with total assets of $250MM or less with a less than Satisfactory overall rating and (2) banks with total assets greater than $250MM), the CRA examination cycle should be based on the risk present in the institution, but in no event longer than a three years.

Q8. How does GLBA affect overall staffing?

A8. GLBA should not adversely affect on-board staff levels. Resources freed-up by longer intervals between CRA examinations for smaller banks will be redirected to FDICIA examinations and other safety and soundness and compliance work. Similarly, since we still need to be knowledgeable about the securities and insurance activities of banks and their affiliates, we will need staff to provide such analysis and support.

Q9. What is the impact of GLBA on the OCC oversight of federal branches and agencies?

A9. The new law does not generally affect the OCC's supervision of federal branches and agencies. The advantages of having a federal license to operate in the U.S. are not diminished by GLBA.

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Revised doc # SM 2000-4

Washington, DC 20219

To: All Examining Personnel

From: Leann G. Britton, Senior Deputy Comptroller, Bank Supervision Operations
Emory W. Rushton, Senior Deputy Comptroller, Bank Supervision Policy

Date: April 10, 2000

Subject: OCC Supervision and Gramm-Leach-Bliley Act of 1999

In his *Message to All Employees* last week, Comptroller Hawke previewed his remarks to the New York Bankers Association regarding the effects of the Gramm-Leach-Bliley Act of 1999 (GLBA) on bank supervision and related issues. For examiners, the preeminent point of those remarks is that the OCC remains the primary supervisor of national banks - and that our comprehensive responsibilities for maintaining the health of the national banking system are undiminished by GLBA. Along with that reaffirmation, the Comptroller emphasized the need for close cooperation and coordination among all involved regulators to ensure top quality supervision with minimum overlap and burden. This memorandum will discuss those principles in more detail.

A. <u>OCC Mission Unchanged</u>

Contrary to the impression created by many published reports, GLBA did not dramatically change the supervisory landscape for insured depository institutions. In fact, GLBA reaffirmed the present supervisory structure (see Appendix A) and, as the Comptroller noted in his remarks, reinforced the role of the primary supervisor. It also strengthened the mandate to the FRB to focus its examination activities on holding companies and non-bank affiliates, and to use the examination reports of primary supervisors when seeking information, in each case "to the fullest extent possible." Hence, the mission of the OCC remains to ensure the continued safety and soundness of the national banking system. This includes understanding and assessing all risks affecting national banks, including risks that originate in, or result from, functionally regulated subsidiaries or affiliates. Consequently, examiners should continue to review and assess this consolidated risk and the systems for monitoring and controlling risk. Moreover, while GLBA introduced some minimum clarifying requirements for inter-agency consultation and coordination in matters of mutual interest, we do not expect those requirements to adversely affect our supervisory capabilities or results.

B. Coordination with "Functional" Regulators

GLBA codified the concept of "functional regulation," namely, that banking activities are to be primarily regulated by banking regulators, holding company activities by the holding company regulator, securities activities by securities regulators, and insurance activities by insurance regulators. The functional regulation provisions, which went into effect on March 11, 2000, limit the circumstances under which the OCC and the other federal bank regulators may require reports of, examine, and take remedial actions against bank affiliates and subsidiaries deemed to be functionally-regulated entities. However, as noted in our Memorandum to you dated January 10, 2000 (MM-00-1), GLBA does not restrict examiners from seeking information on a functionally regulated entity from other sources, such as the owner/affiliated national bank, in order to evaluate the consolidated risk profile of the bank. In this regard, supervisory information on these entities may be discussed or requested by examiners during routine meetings with bank management and through regular reviews of existing bank reports.

The implementation of functional supervision provisions of GLBA will of course require greater cooperation and communication between the OCC and functional regulators -- namely the Securities and Exchange Commission (SEC), state insurance regulators, and the Commodities Futures Trading Commission (CFTC). The specific limitations and requirements on our dealings with functional regulators are set forth in OCC Memorandum MM-00-1 and in material available at the financial modernization homepage on the OCCnet at http:*//occnet.occ/cco/financial.htm.* Please review these materials and ask questions of the identified experts if you are in doubt about any part of these conditions.

We do not expect significant problems to arise from our implementation of GLBA, but it is critically important that we conduct our supervision in such a way that we do not inadvertently violate the law's intent. To guard against this possibility, and to ensure consistency nation-wide, we are establishing a process for determining when and how to make or respond to requests for reports of examination or to conduct examination activities involving functionally regulated entities. Specific operational guidance will be issued shortly. In the interim, any requests for information from or by functionally regulated entities should be discussed with Ned Pollock, Senior Advisor to the Senior Deputy Comptroller for Bank Supervision Operations.

C. Coordination with Other Federal Banking Agencies

The OCC responsibilities for supervisory coordination with the other Federal banking agencies were largely unaffected by GLBA. Both the FDIC and the FRB continue to have legitimate interests in national bank activities and both will continue to need specific information about national banks from time to time. As in the past, examiners should endeavor to be fully responsive to these legitimate needs. Certain provisions of GLBA, however, do alter the relationship among the banking agencies, especially between the OCC and the FRB. As is discussed more fully below, these provisions reinforce the role of the OCC as primary regulator of national banks.

Section 111 of GLBA states that the FRB is to give significant deference to bank examinations conducted by the primary regulator in performing its responsibilities as holding company regulator. Specifically, this provision of GLBA requires the FRB (1)"to the fullest extent possible," to limit the focus and scope of their holding company examinations to the holding company and to those non-bank subsidiaries that could have a materially adverse effect on the bank subsidiary; and (2) "to the fullest extent possible," to use the examination reports prepared by a bank's primary regulator when seeking information. (b)(5)

(b)(5)

While recognizing that there may be situations where the FRB has information needs not available through OCC sources, we believe existing OCC reports of examination, memoranda and work papers should generally address the FRB's supervisory information requirements with respect to national banks. OCC district and large bank staff should continue to routinely share completed reports of examination and other supporting materials with their FRB and FDIC counterparts. In addition, you should continue to inform your counterparts of significant events and information regarding national banks and non-functionally regulated subsidiaries during the interim between scheduled examinations.

(b)(5)

(b)(5) While we are aware that some FRB staff have promoted the impression that GLBA gave the FRB comprehensive new powers over banks, our direct discussions with senior FRB officials here in Washington confirm that is not the FRB's official position. Certainly, the single "umbrella" reference in GLBA did not materially alter the FRB's pre-existing examination authority over national banks; nor should it affect OCC's overall relationship with the FRB. Examiners should continue to assist the FRB in assessing the overall risk associated with the national bank's parent company, and to the extent appropriate and practical, should coordinate examinations of areas of mutual interest in the bank, the parent company, or non-functionally-regulated affiliates.

Comptroller Hawke has met with FRB representatives and stated the OCC's position, with which they agreed, that before FRB examiners make any direct contact with a national bank seeking information, they should first consult and coordinate with the OCC's EIC and determine the extent to which their needs can be satisfied through the use of information in our possession.

If examiners encounter situations that are inconsistent with the deference GLBA provides to the OCC as primary regulator of national banks, they should immediately contact their Deputy Comptroller.

D. <u>Future Efforts</u>

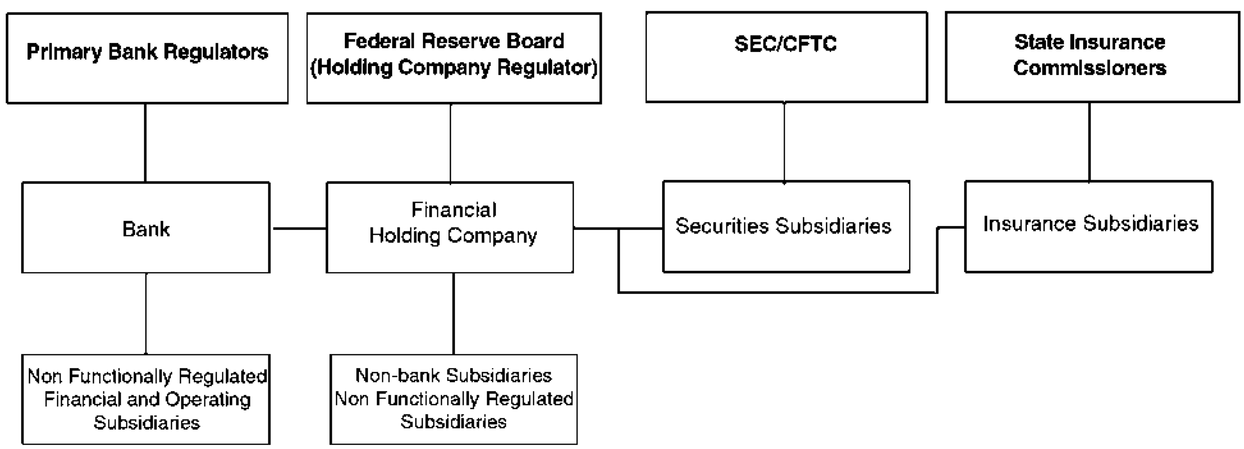
OCC representatives have already participated in several GLBA-related meetings among the federal banking regulators, SEC, CFTC, and banking and insurance regulators from the states for the purpose of developing information-sharing and general coordination. We remain committed to keeping you informed as these and similar matters are resolved. If you have any questions, please do not hesitate to contact us.

Attachments

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

Appendix A

Post-GLBA Financial Institution Supervision



Withheld pursuant to exemption

(b)(5)

of the Freedom of Information and Privacy Act

Page 014

Withheld pursuant to exemption

(b)(5)

of the Freedom of Information and Privacy Act

Page 015

Withheld pursuant to exemption

(b)(5)

of the Freedom of Information and Privacy Act

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Revised doc # SM 2006-4

Washington, DC 20219

To: Distribution

From: Douglas W. Roeder, Senior Deputy Comptroller, Large Bank Supervision (b)(6)
Timothy W. Long, Senior Deputy Comptroller, Midsize/Community Bank Supervision (b)(6)

Date: July 14, 2006

Subject: Sharing Information with Office of Foreign Assets Control

PURPOSE

This memorandum establishes a policy for the sharing of information between the OCC and the Office of Foreign Assets Control ("OFAC") concerning OFAC compliance by national banks, federal branches and agencies, and their operating subsidiaries. The purpose of this policy is to ensure the timely sharing of non-public OCC information with OFAC pursuant to the terms of the Memorandum of Understanding between the OCC and OFAC dated April 11, 2006 ("OFAC MOU") or any other information sharing request or communication and to further ensure that all necessary information is promptly provided by the OCC to OFAC.

For purposes of this memorandum, "information sharing" means any written, telephonic, or oral communication regarding compliance with the OFAC regulations by specific national banks or their operating subsidiaries, and "non-public OCC information" shall have the meaning set forth in 12 C.F.R. § 4.32(b). Communications with OFAC that do not meet this definition include discussions concerning OFAC compliance policies, interagency working group efforts, and cooperation in enforcement actions undertaken by the OCC and OFAC.[1]

The policy set forth in this memorandum is intended to recognize the necessity for greater and more timely communication between OFAC and the OCC regarding OFAC compliance by national banks and their operating subsidiaries. Clarifying the procedures to be followed regarding this information sharing will ensure effective and timely communication between OFAC and the OCC.

All information provided to the OCC by OFAC should be accorded confidential treatment consistent with the OFAC MOU and the OCC's information disclosure regulation (12 C.F.R. § Part 4).

[1] Enforcement & Compliance and District Office lawyers who are working on active enforcement matters with OFAC lawyers may share information directly related to that matter with OFAC lawyers without first consulting with the DSS.

INFORMATION TO BE SHARED

The OCC will share information with OFAC related to OFAC's administration and enforcement of economic sanctions against targeted foreign countries, groups and persons. This includes information about compliance with OFAC requirements and, to the extent permitted by law,[2] information about violations of OFAC requirements at entities supervised by the OCC.

Under the terms of the OFAC MOU, the OCC is obligated to provide OFAC with:

- Examination findings of any apparent, unreported OFAC violations;
- Examination findings of "significant deficiencies"[3] in the policies, procedures or processes for ensuring compliance with OFAC regulations; and
- Information relating to the OCC's examination findings regarding a bank's policies, procedures and processes for ensuring OFAC compliance, upon OFAC's written request in cases where OFAC has initiated a review of a bank based on "significant deficiencies" identified by the OCC, or based on other evidence within OFAC's investigative purview.

PROCEDURES

Primary Contact Point

The OCC has designated the Director of Special Supervision (the "DSS") as the primary contact for information sharing between the OCC and OFAC. Set forth below are the procedures that OCC employees should follow upon receiving information requests from OFAC and when OCC employees have information that they believe the OCC should share with OFAC. In the DSS' absence, all information sharing requests should be directed to the Deputy Comptroller for Special Supervision (or designee).

OCC Information to be Shared with OFAC

Pursuant to the Mid-size/Community Bank and the Large Bank delegations, the DSS should be notified promptly, and provided a copy of, relevant portions of any Report of Examination or other supervisory correspondence addressing all apparent, unreported OFAC sanctions violations, and any significant deficiencies in policies, procedures, and processes for ensuring compliance with OFAC regulations. However, nothing herein shall discourage examination personnel from conducting the research necessary to determine whether an apparent unreported violation exists. Such research may include direct discussions with OFAC personnel, without mentioning the bank involved. Further, when examining personnel conclude that apparent unreported sanctions violations exist, they should direct the banking organization to provide information directly to OFAC as required by OFAC regulations.

[2] The Right to Financial Privacy Act, 12 U.S.C. § 3401, *et seq.*, ("RFPA") will restrict the OCC's ability to share the "financial records" of bank customers with OFAC. Questions should be directed to OCC Law Department personnel.

[3] Under the OFAC MOU, a "significant deficiency means: a systemic or pervasive compliance deficiency or reporting and recordkeeping violation, including a situation where a banking organization fails to respond to supervisory warnings concerning OFAC compliance deficiencies or systemic violations."

Requests for Information from OFAC

Pursuant to this policy, if any employee receives a request for non-public OCC information from OFAC, the employee shall promptly inform the DSS of that request. The DSS will then coordinate with the requesting party from OFAC and the OCC employee to provide OFAC with the information needed in a timely manner. No OCC employee should share non-public OCC information with OFAC without first consulting with the DSS. Similarly, OCC employees in the District offices should not share non-public OCC information directly with OFAC. Rather, all information sharing from the District offices should be coordinated through the DSS as the primary point of contact for this purpose. The DSS will be responsible for receiving information sharing requests from OFAC, conducting a review of the requests to determine what information is needed to process the request, contacting OFAC to share the non-public OCC information requested as appropriate, and logging any sharing of OFAC information. If any OCC employee receives a request for information from the DSS so the DSS can share that information with OFAC, the employee shall respond promptly to the DSS' request. In responding to such requests, the DSS will consult with appropriate Law Department personnel, as necessary.

Information Provided by OFAC to the OCC

The OCC will receive certain information from OFAC under the terms of the OFAC MOU. The OCC also may obtain additional information upon written request. The DSS will be the primary contact person for this information and will forward any information received from OFAC under the terms of the OFAC MOU to the appropriate Assistant Deputy Comptroller, or Examiner-in-Charge. All information provided to the OCC by OFAC should be accorded confidential treatment and appropriately safeguarded consistent with the OFAC MOU.

Recordkeeping

All non-public OCC information that the DSS provides to,or receives from, OFAC pursuant to the OFAC MOU shall be recorded and maintained by the Special Supervision Division. The entries should include (as appropriate), the following information:

- Name of OCC employee(s) that received an information sharing request from OFAC;
- Date of the information sharing request received from OFAC;
- Name of the OFAC employee who made the request and/or the OFAC employee who is to receive information from the OCC;
- Bank name and charter number about which information is being shared;
- Brief description of the information shared and copies of any documents provided to OFAC (such as ROE's, memoranda, letters, notices, and orders); and
- Date information provided to OFAC.

Nothing in this policy is intended to replace legal advice and guidance given by District counsel and Washington headquarters units concerning compliance with the OFAC regulations.

For any questions concerning this policy, please contact Ronald G. Schneck, Director for Special Supervision at (202) 874-5133.

Attachment: OFAC MOU (http://www.ustreas.gov/offices/enforcement/ofac/civpen/mou_final.pdf)

Distribution:

District Deputy Comptrollers
District Counsel
Assistant Deputy Comptrollers
Williams
Stipano
Gillespie
Nishan
Rushton
Dailey
Evers
Jee
Goulet
Jaedicke
Wagner
Quill
Schneck
Kelly
Vivenzio
Sexton
Bylsma
Friend
Kane

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Revised doc # SM 2008-3

Washington, DC 20219

To: All Examiners and Examination Support Personnel

From: The Committee on Bank Supervision
Timothy W. Long, Senior Deputy Comptroller and Chief National Bank Examiner
Jennifer C. Kelly, Senior Deputy Comptroller, Midsize Community Bank Supervision
Douglas W. Roeder, Senior Deputy Comptroller, Large Bank Supervision

Date: July 8, 2008

Subject: Classifying Bank Holdings of Financial Institution Securities in the Current Market Turmoil

The existing dislocation in various credit markets and the subsequent decline in the market value of many financial institutions' securities have given rise to several examiner inquiries on potentially classifying trust preferred obligations of regulated financial institutions. Single-issuer trust preferred security issues have clearly been under stress and have in some cases experienced noticeable market depreciation.

The attached interagency guidance on classification of securities was issued in 2004 and provides bank supervisors with flexibility in making decisions about securities classifications. Given the unprecedented nature of the current operating environment, we believe it is particularly important for OCC examiners to consistently apply this policy when evaluating financial institution debt. As such, we would like classification decisions on securities issued by regulated financial institutions or their holding companies to be made on a centralized basis through Washington D.C. Headquarters. Classification inquiries should be directed to Kerri Corn, Director for Market Risk, who will act as the central point of contact to ensure policy, accounting, and supervision are involved in the discussion of holdings in question and the determination of appropriate actions. This process will enable the OCC to assess the level and composition of the exposures and to ensure consistent application of classification treatment across the agency and across the regulatory community. Additionally, CMR and the Office of the Chief Accountant will be issuing guidance to assist examiners in their assessment of other than temporary impairment for these types of holdings.

OCC 2004-25a: Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Revised doc # SM 2008-6

Washington, DC 20219

To: All Examiners

From: Committee on Bank Supervision
Timothy W. Long, Senior Deputy Comptroller & Chief National Bank Examiner
Jennifer C. Kelly, Senior Deputy Comptroller, Midsize/Community Bank Supervision
Douglas W. Roeder, Senior Deputy Comptroller, Large Banks

Date: October 3, 2008

Subject: Review of Liquidity at Banks in a Stressed Environment

The ongoing turmoil in the financial markets continues to put direct and indirect pressure on bank liquidity. A flight to quality and the increasing cost of liquidity has affected financial institutions reliant on wholesale funding. The magnitude of credit losses to date has been significant. Despite unprecedented government intervention, the financial markets have not stabilized.

There is a long established link between the credit and liquidity markets. Although many community banks have not been directly affected by the fallout, virtually all are touched by the ongoing shocks in terms of pricing, wholesale funding availability, collateral valuations and acceptance. Liquidity problems generally do not occur in isolation. Deteriorating loan quality often precedes liquidity problems, but investment quality is now a significant factor in some banks as well due to valuation uncertainty. Credit problems affect other risk areas including earnings capacity, capital accretion or retention, and reputations. The strong and well documented link between credit issues and liquidity risk makes it important for examiners to thoroughly evaluate liquidity risk management in banks with asset quality problems.

For many banks, loan growth long ago outstripped the growth and availability of retail deposits. Consequently, many banks moved to wholesale funding sources such as FHLB advances. Traditional core deposits sources such as MMDAs and CDs under $100 thousand are now more rate and credit sensitive. As a result, some banks now include MMDAs and CDs in with other wholesale sources such as fed funds purchased, repos, brokered deposits, and FHLB advances.

A bank's investment portfolio serves as both a source of liquidity and interest income. The instability in the mortgage markets, however, has caused securities based on mortgage loans, as well as the loans themselves, to have uncertain values making them difficult to convert to cash for liquidity purposes. Many banks have significant holdings of mortgage-backed securities (MBS) and structured products such as CMOs and CDOs, which were perceived to have a deep, liquid market. As a result of the current market disruption, these securities no longer possess the clear valuations and marketability necessary to support their use for liquidity purposes.

Market events have drastically changed the environment within which banks manage liquidity, and as result, many banks require more sophisticated liquidity risk management practices. For example, some FHLB banks have reduced the collateral weightings (i.e., increased haircuts) on loans and securities pledged as collateral, as well as the eligibility of certain types of instruments. In some cases, the FHLB took delivery of collateral at banks perceived to have increased asset quality or financial problems. In these instances, collateral may have been subsequently refused due to quality or documentation concerns, further reducing the bank's borrowing capacity. This phenomenon is new to many community bankers, particularly those that have viewed these funds as available at a moment's notice.

Credit quality issues and constant media coverage are stressing bank liquidity at a pace not experienced before. Our most vulnerable banks are those with a combination of concentrations in commercial real estate (CRE) and wholesale funding. M/CBS management has identified community banks with significant concentrations of CRE lending. The Balance Sheet Management Group within CMR has further stratified this group to identify CRE concentrated banks with an elevated level of liquidity risk. For these institutions, there is a need for robust management by the bank and a thorough understanding of the bank's liquidity position and contingent funding capacity by the OCC. Given the clear linkage between credit quality and liquidity, liquidity risk assessments should be completed in tandem with the credit reviews at the targeted CRE banks.

Attached to this memorandum are reference materials to use during your liquidity risk assessments review at these banks. The attached document includes:

- An overview of sound liquidity risk management practices including:
    - Liquidity implications for banks with asset quality problems
    - Rollover Risk Management
    - Collateral Management
    - Contingency Funding Plans
    - Legal Restrictions (e.g., PCA implications for brokered deposits)
- Liquidity Reference Materials
    - Sample Request Letter
    - Sample Liquidity Procedures
    - CAMELS Liquidity Definition
    - Liquidity Risk Assessment System Definitions

This guidance can also be used for non-CRE banks that are experiencing credit deterioration as funds providers may respond similarly to these institutions.

Attachment

Examiner Guidance on Liquidity Risk Management

Credit & Market Risk

PURPOSE

A revised Comptroller's Handbook on Liquidity is currently in draft form and many of the concepts from that handbook are provided in this document. Due to the current work being done in banks with heavy CRE concentrations, this guidance is being provided as an interim measure to meet examiner needs.

The guidance summarizes the basic principles of a sound liquidity risk management process and outlines issues relevant to community banks with asset quality problems and/or concentrations in commercial real estate loans. It also emphasizes the use of key risk management tools including cash flow projections (i.e., a sources and uses statement) and well-developed contingency funding plans (CFP) that are accompanied by quantitative stress scenario analyses. A bank's assessment of its funding sources compared to its funding needs, and the bank's ability to manage unplanned changes in funding sources made possible by an effective CFP are integral parts of a satisfactory liquidity risk management framework. The OCC expects all banks to manage liquidity risk; the sophistication of the processes and systems used should be commensurate with the bank's complexity, risk profile, and scope of operations.

A compilation of Liquidity Reference Materials, including examination procedures and rating and risk assessment definitions, is included to assist examiners in completing liquidity examinations. Examiners should use these reference materials as necessary depending on their familiarity and experience with liquidity risk assessments and specific knowledge of the bank's liquidity risk management processes. Questions related to the content of these materials should be directed to the Balance Sheet Management Policy Group or to your District Capital Markets Lead Expert.

Liquidity Risk Management

Ensuring adequate liquidity to meet financial obligations is critical to the ongoing operations, profitability, and safety and soundness of all banks. Accordingly, it is a safe and sound practice for bank management to implement and maintain a robust liquidity risk management process that includes:

- ***Liquidity responsibilities and strategy.*** The board of directors has ultimate responsibility to set the bank's liquidity risk limits. Senior management ensures there is an effective risk management process that maintains the bank's liquidity risk position within board approved limits during both normal activity and times of stress. Senior management develops a clear strategy for managing the bank's liquidity position within board approved risk limits. For example, strategies should identify primary sources for meeting daily operating cash outflows, seasonal and cyclical cash flow fluctuations, as well as address alternative responses to various adverse business scenarios.

- ***Policies and procedures.*** Formal policies and procedures establish liquidity risk tolerances and guidelines appropriate for the complexity and liquidity risk profile of the bank. Examiners should expect to see a bank employ both quantitative targets and qualitative guidelines.[1]

- ***Risk measurement and reporting.*** Risk measurement includes an analysis of projected cash flows that includes all material assets, liabilities, off-balance-sheet positions, and other activities of the bank. Cash flow projections can take the form of simple spreadsheets to very detailed reports depending upon the complexity and sophistication of the bank and its liquidity risk profile. Projecting cash flows involves assumptions on the behavior of assets, liabilities and off-balance sheet products under various conditions and rate scenarios over a stated period of time. Typically bank management reviews and approves these assumptions on a periodic basis (i.e., annually).

  A bank must maintain a liquidity risk monitoring process sufficiently robust and flexible to allow for the timely computation of risk metrics. Liquidity risk reports should provide aggregate information in sufficient supporting detail to enable management to assess the sensitivity of the institution to changes in market conditions, its own financial performance, and other important risk factors. Reportable items include, but are not limited to, cash flow gaps, cash flow projections, rollover risk, asset and funding concentrations, key early warning or risk indicators, funding availability, status of contingent funding sources, collateral usage, and the critical assumptions used in cash flow projections.

- ***Contingency Funding Plan (CFP).*** A bank should have a board approved formal CFP. A CFP details strategies for meeting liquidity shortfalls during a crisis. In addition, a CFP: (1) includes early warning triggers; (2) defines a liquidity crisis (or crises) for the bank; (3) details action plans to identify sources of liquidity to meet projected shortfalls; (4) identifies

[1] For example, periodic and cumulative projected cash flow mismatches, minimum level of asset liquidity, liquid asset coverage of volatile liabilities, concentrations in assets and funds providers, and the level of contingent liabilities (e.g., unfunded loan commitments, lines of credit, securitizations).

responsible bank personnel to declare, manage and resolve the crisis; (5) describes an internal and external communication process for disseminating relevant information; and (6) defines a process of regular testing to ensure that the CFP is operationally robust. Examiners should assess, and if necessary challenge, the reasonableness of the bank's stress scenarios and assumptions. The following are examples of liquidity stress events, warning triggers, and possible monitoring reports.

Examples of Liquidity Stress Events.doc

- ***Internal Controls.*** Internal controls address relevant elements of the liquidity risk management process, including adherence to policies and procedures; the adequacy of risk identification, risk measurement, reporting; and compliance with applicable rules and regulations. For many banks, it is appropriate for an independent third party to regularly review and evaluate the various components of the bank's liquidity risk management process. However, less complex institutions may achieve independence by assigning this responsibility to qualified individuals independent of the risk management process. A bank's independent review process should report key issues requiring attention, including instances of non-compliance, to the appropriate level of management for prompt corrective action consistent with approved policy.

Liquidity Implications for Banks with Asset Quality Problems

A bank's risk exposures are most often interconnected. That is, changing risk exposures in one area may materially affect a bank's risk exposure in one or more other risk areas. This is particularly true of credit and liquidity risks. A bank with adequate liquidity during sustained periods of good asset quality, loan performance, and overall sound financial condition may find the maintenance of sufficient liquidity more challenging and costly during times of deteriorating or poor asset quality. In fact, sources of liquidity that a bank typically relies on may significantly decrease or become completely unavailable. Assessing the implications of increased credit risk and asset quality deterioration is an integral part of a bank's liquidity risk management process, particularly for banks experiencing weakening asset quality. An effective liquidity risk management process develops alternative funding strategies prior to loan quality deterioration.

Assessing the sensitivity of significant funds providers and evaluating strategies to reduce liquidity risk posed by asset quality deterioration are critical components of sound liquidity risk management. Many factors lead to the credit sensitivity of a bank's liability base including: (1) availability of desirable collateral or insurance; (2) sophistication and financial savvy of funds providers; (3) availability of information on a bank's financial condition and asset quality performance; and (4) general economic conditions and liquidity of the financial markets. The importance of one factor over another varies from one institution to another and likely depends on the market segments or geographic regions served by the bank. Examiners must consider a bank's own specific circumstances before reaching a conclusion regarding the sensitivity of a particular funding source.

When reviewing a bank's liquidity in the wake of declining asset quality, examiners should consider bank management's willingness, ability and effectiveness in managing the following categories and their associated risks: (1) rollover risk; (2) collateral positions; (3) contingency funding plans; and (4) legal restrictions.

Rollover Risk Management

Rollover risk is the potential that a bank cannot replace funds as they mature. As opposed to a projected cash flow statement, a rollover risk report focuses solely on those funds with contractual maturities (e.g., Fed Funds Purchased, Correspondent Lines, Repos, Certificates of Deposit, FHLB Advances). Rollover risk management is crucial when a bank experiences credit quality deterioration or an overall decline in its financial condition as funds providers become reluctant or disinclined to reinvest. Funds providers may choose to place funds in a less risky counterparty, effectively terminating the funding relationship with the bank. Therefore, management must monitor, on a forward-looking basis, the contractual or effective maturity of each significant funding source. These sources should be aggregated and reported over meaningful time intervals (monthly is most common).

Management should make reasonable assumptions regarding the outflow or potential runoff of funds prior to scheduled maturity (e.g., putable or convertible advances, early redemption or breakage of CDs, and loss of access to Fed Funds and repo lines). Projected time periods should extend far enough into the future to allow for sufficient time to develop replacement funding strategies. Bankers and examiners should pay close attention to those periods in which a significant amount or concentration of funding matures or is redeemed.

A sound method of rollover risk control ensures diversification of funding maturities by establishing maximum limits on the amount of maturing funds within any reported time period. Banks with a material or growing reliance on short maturity funding (less than 1 year) should have more detailed and formalized rollover risk reporting and control.

The following sample of rollover risk reporting is provided as an example and is not intended to represent best practices or regulatory requirements.

Sample Rollover Risk Report

Collateral Management

A bank should manage its collateral position so that it can easily understand which assets are encumbered and unencumbered. Bank management should assess the eligibility of its collateral not only to the FHLB but also to the Federal Reserve or other counterparties to determine available liquidity net of haircuts. A bank's CFP should have different haircuts for each scenario recognizing that haircuts will increase in a deteriorating environment.

Effective management of collateral pledged to secure funding is of heightened importance during periods in which a bank suffers from credit quality deterioration. Often times, banks under credit and financial stress find greater stability in funding secured by highly liquid assets such as U.S. government and agency bonds. In any case, the stability of these funding relationships is dependent on the adequacy and quality of the collateral pledged. This underscores the crucial role of efficient collateral management in maximizing the amount of funding that a bank can realize from these collateralized sources.

Sound collateral management includes the following:

- Policy limits on the minimum market value of unpledged securities available as replacement or supplementary collateral.
- Monitoring and maintenance of collateral in the bank's Federal Reserve account to adequately cover potential daylight overdraft positions.
- Controls over collateral replacement as investments and loans mature or otherwise require substitution.
- Monitoring, by type of collateral, the market value and collateral haircuts (margin) required by secured lenders as well as announced or anticipated changes to their collateral policies.
- Diversification of safekeeping arrangements and pledging so that the collateral required for securing expected and unexpected funding is available to the counterparty when needed.
- In the case where the bank uses loans or other assets as collateral, a thorough understanding of underwriting requirements and other terms, as well as collateral audit policies so that pledged collateral meets all counterparty expectations.
- A sound understanding of all borrowing terms including circumstances that may trigger an event of default or other adverse action by lenders.
- Maintaining periodic communication with secured lenders during times of stress.
- CFP stress scenarios that include only those funding sources where the quantity and quality of available collateral is sufficient to secure required funding needs.

Revisions to Contingency Funding Plans

All banks should have a written CFP that addresses funding needs during periods of financial stress. Banks that begin to experience declining asset quality or overall financial performance should frequently revise CFP stress scenarios to reflect current circumstances. As a bank's financial condition deteriorates, the expected behavior of funds providers becomes clearer, thus, more accurate and meaningful stress scenarios can be developed. For example, if a wholesale funds provider indicates through various means an increasing reluctance to provide funding or alters terms of future funding, CFP scenario analysis should be revised to reflect these changes and the likelihood of further borrowing restrictions from this and other lenders.

If asset quality problems lead to a deteriorating capital position, a bank may find itself restricted or completely shut off from the brokered deposit market or from other high rate deposit sources (see Legal Restrictions section below). In this circumstance, not only are banks restricted from obtaining funds from these sources but they cannot renew or rollover these funds. If brokered or high rate funds have short or indeterminate maturities (e.g., transaction, savings, MMDAs), they constitute a significant and immediate rollover risk to the bank's funding structure. Bank management should revise its CFP stress scenarios to incorporate the implications of a deteriorating capital position as well as other changes in a bank's funds availability. During periods in which a bank's asset quality and loan performance is deteriorating, sound contingency funding planning includes the timely recognition of changing circumstances, the potential decline in funds availability, and the identification of alternative sources.

The following examples illustrate a sample sources and uses report for both "business as usual" as well as stressed scenarios.

Sample Sources and Uses Statement.xls   Sample CFP Scenario Analysis.xls

Legal Restrictions

Deteriorating asset quality, if severe enough, often leads to the erosion of earnings and capital. If regulatory capital declines below the Prompt Corrective Action (PCA) "well capitalized" category, certain statutory restrictions (Law: 12 USC 1831f; Regulation: 12 CFR 337.6) limit a bank's ability to grant, renew or rollover brokered and other high rate deposits. OCC formal actions and capital directives could also restrict funding activities. For bank's experiencing significant loan portfolio deterioration, management must consider these restrictions during the development of funding plans under both normal and stress scenarios. Banks with funding concentrations in brokered or high rate deposits that lose access to this source are particularly exposed to extreme disruptions in funding.[2] The FDIC **cannot** grant a waiver of the statutory restrictions on high rate deposits. In certain circumstances, the FDIC **may** grant a waiver that may allow the granting or renewal of a certain dollar amount of brokered funds. The FDIC expects a comprehensive, documented analysis and justification to support brokered deposit waiver requests. Waiver requests often require multiple submissions before they are accepted. Therefore, management must consider the time commitment often accompanying a waiver request within short-term funding strategies. Based upon recent decisions on waiver requests, the FDIC is more apt to grant waivers for banks that are attempting to preserve funding for their existing asset base rather than efforts to fund new growth. Further, the FDIC does not use a specific formula for determining what dollar amount of brokered funds to allow, in the event that it grants a waiver. Therefore, it is often appropriate for management, during the development of normal and contingent funding plans, to presume the loss of their ability to grant, renew or rollover brokered and high rate funds entirely.

Brokered Deposit Regulation Flowchart

Other Considerations

[2] Refer to the attached flowchart for assistance in determining what types of restrictions this regulation places on banks as well as the statutory definition of high rate funds.

There are other factors that should be considered when managing liquidity risk during periods of credit portfolio deterioration.

- *Rising Funding Costs* – The bank may experience a significant rise in the cost of new and existing sources of funding. As depositors, lenders, public entities, counterparties, and financial markets become aware of a bank's deteriorating asset quality and overall financial condition, they may require a higher rate of interest in order to maintain or expand relationships with the bank. The rising cost of funds may exacerbate the impact of credit quality erosion on earnings and capital levels. Bank management, as well as examiners, should measure the impact of a potential or actual rise in a bank's costs of funds during the assessment of liquidity, earnings, and capital.

- *Retail Deposit Management* – The management and monitoring of a bank's retail deposit base is critical during periods of significant credit quality deterioration. Bank management should closely monitor the information presented in local news and other media sources and assess the impact on both depositor perception and behavior. Management should develop and monitor deposit retention reports to track the trends in depositor behavior and address funding needs in a timely manner. As conditions deteriorate, the frequency of reporting must be accelerated. Also, communication between branch personnel and senior management must be timely and unambiguous.

- *Inaccessibility of Certain Funding Sources* – During periods of financial stress, banks may lose access to certain sensitive funds providers. Funds providers to community bank that may react quickly to real or even perceived financial deterioration include unsecured correspondent banks, municipal public depositors, and sources derived from the financial markets including the issuers of trust preferred securities. The management of liquidity and funding plans should consider and assess the sensitivity of these and other sources and include funding replacement strategies.

- *Cash Flow Disruptions Due to Non-performing Loans* – Loan non-performance will affect anticipated cash flows. As credit quality begins to deteriorate, management should make changes to loan portfolio cash flow assumptions and projections and make plans for alternative funding sources, if needed. These assumption changes should be commensurate with anticipated non-performance in the portfolios experiencing credit quality deterioration.

Conclusion

The implications of asset quality deterioration on liquidity risk can be severe. The timely recognition of this impact as well as the development of meaningful and realistic funding plans is critical. At a minimum, in banks with deteriorating asset quality, the factors discussed in this document should form a basis for the assessment of liquidity risk.

LIQUIDITY REFERENCE MATERIALS

LIQUIDITY REQUEST LIST

Internal OCC Documents

- Supervisory strategy in the OCC's electronic information system
- Examiner-in-charge's (EIC's) scope memorandum
- Previous report of examination and overall summary comments
- Previous examination working papers

OCC Financial Reports

- Canary System
- Uniform Bank Performance Report (UBPR)
- CMR and District outlier reports
- Other applicable reports to identify any material changes or trends since the prior examination

Bank Liquidity Reports

- Organizational charts and liquidity and investment management policies and procedures
- Recent asset/liability committee (ALCO) minutes and report packages
- Sources and uses of funds and liquidity gap analysis reports
- Cash flow projection reports and asset/liability maturity reports
- Detailed schedule (amount and type) of borrowed funds and other wholesale funding providers
- FHLB Customer Profile Report[3] for bank
- Reports detailing the quality, maturity, pledge status, accounting treatment, and market value of the investment portfolio
- Funding cost reports, current deposit rate offering sheets, and local and national market surveys, if available
- Capacity usage reports for assets that may be pledged for borrowings
- Contingency funding plans and associated liquidity crisis planning reports
- Liability concentration reports or large deposit reports
- Assets purchased, sold, or repurchased since the last examination
- Assets available for sale or securitization

[3] This report may be referenced under a different name in the various Federal Home Loan Banks. This report essentially summarizes the bank's credit line, including stock holdings, collateral summary, and borrowing capacity.

SAMPLE PROCEDURES

Background

1. Determine the following during preliminary discussions with management:
   - How management supervises liquidity, including methods to identify, measure, monitor, and control liquidity risk.
   - The relative stability or volatility of funding sources.
   - The degree of reliance on credit-sensitive wholesale funds providers.
   - The impact of the level and trend of funding costs on bank profitability.
   - Trends in the volume, pricing, and success rate of recent asset sales and securitizations.
   - Any significant changes in policies, practices, personnel, or controls.
   - Any internal or external factors that are affecting or could affect liquidity.
   - The bank's Prompt Corrective Action (PCA) capital position and trend. If less than well capitalized, is the bank accepting brokered deposits with or without a waiver from the FDIC?

Wholesale Funding Risk

1. Determine the bank's reliance on wholesale funding. What are the types and volumes of wholesale funding used?
   - FHLB borrowings
   - Fed Funds purchased
   - Repurchase agreements
   - Brokered CDs
   - Other borrowed funds

2. In the case of a growing bank, has the bank's growth largely been funded by wholesale funding? What have been the preferred funding types, considering features such as secured/unsecured, tenor, optionality, etc.

3. Determine the purpose of the bank's wholesale funding activities and the strategy for the current or future use of these funds. (Are they temporary or permanent?). Consider:
   - What assets or activities are being funded.
   - The profitability or spread between these sources and their uses.
   - What types of maturity mismatches exist between wholesale sources and the assets they fund.
   - The structural characteristics of wholesale funding sources (call or put options, complex interest rate rules or calculations, complex prepayment schedules, etc.), the liquidity risks they present and management's understanding and ability to control those risks.
   - Whether there has been any deterioration in the bank's ability to raise or renew wholesale funds by reviewing such items as:
     - Interest rates paid by the bank for these funds that exceed prevailing market rates.
     - The impact of the costs associated with these funds on bank profitability.
     - The bank's credit rating.

- Frequent or recent changes in wholesale lenders.
- Changes in sensitivity to credit risk of the bank's wholesale funding providers.
- Changes in the amount and availability of collateral.
- Requests for, increases in, or changes to the collateral requirements of wholesale funding providers.
- Significant concentrations in these funding sources.
- Changes in the bank's Federal Reserve discount window status (primary or secondary lending program).

4. Using the bank's liquidity gap and asset/liability cash flow reports, evaluate the bank's cash flow projections under the normal course of business:
   - Are the bank's expected sources of funds sufficient to cover the expected use of funds?
   - How does the bank address estimated liquidity gaps?
   - Is loan growth captured in the cash flow forecast? And if not, is the stagnant loan growth assumption supported by history and/or strategies?
   - To what degree is the bank reliant on wholesale funds to bridge funding gaps? And does future reliance on wholesale funds call into question supervisory concerns?
   - Do "regular course of business" cash flows contain adequately stratified time horizons to effectively capture liquidity risk in different time periods?

5. Quantify the bank's ability to meet possible runoff of volatile funds and high cost deposits:
   - Consider the bank's capacity to borrow under the FHLB collateralized loan program or other similar collateralized borrowing facilities.
   - Compare estimated cash flows and capacity to borrow under established lines to short-term liquidity needs, including required collateral availability.
   - Consider the capacity to issue longer-term liabilities and capital to meet medium- and long-term liquidity needs. Options may include deposit programs, Medium-term note programs, Subordinated debt, and Trust preferred securities.
   - Consider the capacity and collateral available to borrow from the Federal Reserve discount window and whether the bank qualifies for the primary or secondary borrowing program.
   - Consider the policies of large wholesale funds depositors, and whether the policies require them to reduce or remove funds on deposit due to a decline in the bank's credit rating or deterioration in the bank's financial condition.

<u>Retail Funding Risk</u>

1. Determine the stability, credit and rate sensitivity, and character of the bank's deposit structure. *Pay particular attention to deposits that may be considered as "core" by definition, but exhibit high rates in relation to competitors (premium money market accounts, CD specials).* Analyze reports generated from the bank's internal MIS, the Canary System, and UBPR data on insured deposits to determine:
   - Changes and trends in deposit volume and product mix.
   - Material shifts between deposit types and reasons for these shifts.

- Offering rates and costs for all major deposit types, including those gathered through the Internet and deposit-splitting arrangements, compared to peer banks and market interest rates.
- The ability and likelihood of renewal or retention of these funds at maturity.
- Management's deposit pricing policies and the success of recent pricing decisions.
- The success of recent branch expansion and marketing efforts to attract and retain deposit relationships.

2. Review a list of deposits greater than $100,000 (i.e., uninsured deposits). In an effort to determine the stability of these accounts, discuss with management:
   - The aggregate number and volume of these accounts and the degree of the bank's reliance on this funding source.
   - The nature of account holders' relationship with the bank (insider, multiple product/service relationships, location of account holder and proximity to the bank's branch network).
   - Rate paid on these accounts relative to local and national market competitors.
   - The aggregate dollar amount of these accounts originated through an intermediary (brokered deposits).
   - Any concentrations of individual depositors or groups of depositors.
   - The ability to retain and replace these funds.
   - The recent success of marketing efforts related to these accounts.
   - Pledging requirements, if any, and management's controls over collateral availability.
   - Any competitive pressures, economic conditions, or other factors that may affect the retention of these deposits.

<u>Asset Liquidity</u>

1. Evaluate the volume and trends of sources of liquidity available to meet liquidity needs:
   - Compare the level of money market assets and other liquid assets (easily convertible into cash) with current and potential short-term liquidity needs.
   - Determine the amount of free (unencumbered) marketable investment securities available for cash conversion and/or collateral for available borrowing lines.
   - Determine the level and impact of asset depreciation.
   - Determine the impact of fair value accounting on asset liquidity, and the distribution of securities designated "held-to-maturity" and "available-for-sale."
   - Determine adequacy of cash flows (payments, prepayments, maturities) from assets such as loans, investments, and off-balance-sheet contracts.
   - Review other potential sources of asset liquidity (securitization, loan sales) and determine trends in pricing and spreads (e.g. market acceptance).

<u>Liquidity Availability in Crisis Scenario</u>

1. Determine whether adequate contingent funds are available to meet the needs required in liquidity stress or crisis scenarios. Through a review of the banks contingency funding plan, determine whether management is properly planning for contingent liquidity in identified crisis scenarios. Consider:

- Management's short- and long-term contingency funding scenarios and the adequacy of cash flows and other sources to meet liquidity needs (this review should consider the assessment of the reasonableness of all material assumptions used in the planning process).
- Any identified market disruptions (nationally, and within the bank's trade area) and the adequacy of bank contingent liquidity to meet both short- and long-term funding needs.

2. Determine the impact of any current or potential deterioration in the bank's credit or reputation on liquidity, and the ability of identified contingent sources to support the related outflows of funds. Determine the impact of a disruption to the bank's operations and financial condition.
   - What is the bank's ability to refund or repurchase a portion or all assets sold that the bank might need to repurchase?
   - Can the bank absorb a considerable loss of available funding due to increases in collateral "haircuts" or withdrawal of all available unsecured lines?

3. Consider the potential effects of destabilization in the market or trade area caused by:
   - Competitor/peer bank failure.
   - General market trends (e.g., net emigration from the bank's market area).
   - Disintermediation (i.e., loss of deposits).
   - Changes in investor preference (e.g., to mutual funds).
   - Stock or real estate market declines resulting in reduced customer wealth.
   - Systemic technology failure.

<u>Quality of Liquidity Risk Management</u>

1. Determine that liquidity policies, procedures, and limits are appropriate for the size, complexity, and sophistication of the bank. Review and discuss with management the liquidity policies, procedures, and risk limits, and determine their appropriateness and comprehensiveness with respect to:
   - Identification of the objectives and strategies of the bank's liquidity management and its expected and preferred reliance on various sources of funds to meet liquidity needs under alternative scenarios.
   - Clear delineation of responsibility and accountability over liquidity risk management and management decision-making.
   - Specification of and rationale for quantitative limits and guidelines that define the acceptable level of risk for the bank. Examples include the use of maximum and targeted amounts of projected cash flow mismatches, liquidity reserves, volatile liabilities, collateral usage, maximum usage of borrowing capacity, and funding concentrations.
   - Specification of the methods used to measure and monitor liquidity risk and their frequency.
   - Definition of specific procedures and approvals necessary for exceptions to policies, limits, and authorizations.

2. Determine whether policies and practices regarding wholesale funding are adequate. Review formal and informal wholesale funding policies and determine whether they:
   - Designate lines of authority and responsibility for decisions.
   - Outline the objectives of bank wholesale funding activities.
   - Describe the bank's wholesale funding philosophy relative to risk considerations (e.g., leverage/growth, liquidity/income).
   - Provide for controls over concentration exposure by diversifying sources and by staggering maturities (or determine whether funding decisions are based largely on cost).
   - Limit wholesale funds by amount outstanding, specific type, individual source, market source, or total interest expense.
   - Provide a system of reporting requirements to monitor wholesale funding activity.
   - Provide controls over wholesale funding cash flow uncertainty by limiting the amount and type of embedded options.
   - Require material strategies and transactions be reviewed and approved by the board, senior management, or a committee thereof (ALCO).
   - Provide for review and revision of established policy at least annually.

3. Assess the adequacy of liquidity contingency funding plans. Review the liquidity contingency funding plan (CFP), the minutes of ALCO meetings and board meetings and discuss with management the adequacy of the institution's contingent planning processes for liquidity. Consider the following:
   - Customization of the CFP to fit the bank's liquidity risk profile.
   - Identification of potential sources of liquidity under stress events.
   - Breadth of potential stress triggers and events and the analyses of various levels of stress to liquidity that can occur under defined scenarios.
   - Quantitative assessment of short-term and intermediate-term funding needs in stress events.
   - The reasonableness of the assumptions used in forecasting potential contingent liquidity needs and the frequency of management's review of these assumptions to ensure they remain valid.
   - For banks that have a material reliance on brokered deposits – consider simulations reflecting the bank's capacity to absorb the potential inability to roll, renew, extend, or obtain brokered CDs under statutory PCA restrictions.
   - Comprehensiveness in forecasting cash flows under stress conditions including the incorporation of off-balance sheet cash flows.
   - Use of contingent liquidity risk triggers to monitor, on an ongoing basis, the potential for contingent liquidity events.
   - The limitations of payment systems and their operational implications to the bank's ability to access contingent funding.
   - Operating policies and procedures to be implemented in stress events, including assignment of responsibilities for communicating with various stakeholders.
   - Prioritization of actions for responding to stress situations.

Conclusions

1. Determine the CAMELS component rating for liquidity (refer to Appendix A in this document). Consider:
   - Whether management is able to properly measure, monitor, and control the institution's liquidity position, including whether funds management strategies, liquidity policies, management information systems, and contingency funding plans are effective.
   - The adequacy of liquidity sources in light of present and future needs and the ability of the institution to remain liquid without compromising its operations or condition. Capital adequacy, asset quality, earnings stability, and management stability are primary considerations.
   - Whether sufficient assets are 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, credit-sensitive 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.

2. Determine assessments of the quantity of liquidity risk, quality of risk management, and the aggregate level and direction of risk (refer to Appendix B in this document).
   - Determine the quantity of liquidity risk (low, moderate, high). Consider:
     - The availability and cost effectiveness of funding sources.
     - The diversification of funding sources.
     - The availability and cost effectiveness of market alternatives for funding.
     - Capacity to augment liquidity through asset sales or securitizations, including market accessibility.
     - Level of and trends in reliance on wholesale funding sources.
     - The volume of wholesale liabilities with embedded options.
     - Vulnerability to funding difficulties arising from material adverse changes to market perception.
     - Support provided by the parent company.
     - Earnings and capital exposure to liquidity risk.

   - Determine the quality of liquidity risk management (strong, satisfactory, weak). Consider:
     - The appropriateness and effectiveness of policies, procedures and limits.
     - The effectiveness of board/ALCO supervision.
     - The effectiveness of the liquidity risk management process in identify, measuring, monitoring and controlling risk.
     - The level of sophistication necessary to effectively manage liquidity.
     - Management's knowledge and understanding of the bank's liquidity risk exposure.

- The adequacy of contingency funding plans, including whether or not it is current, reasonably addresses most relevant issues, and provides an adequate level of detail and breadth for scenario analyses.
- The adequacy, accuracy, and timeliness of MIS, including whether or not its focus is on significant liquidity risk exposures.

• Determine the aggregate level of liquidity risk (low, moderate, high). Consider:
  - The assessment of the quality of risk management in relation to the level of liquidity risk exposure.

• Determine the direction of risk (decreasing, stable, increasing). Consider:
  - The potential for changes in the risk profile due to new or planned activities.
  - Trends in reliance on or changes in wholesale funding.
  - Potential impact of local, regional and national markets on future liquidity levels.
  - Ability of management to effectively and efficiently resolve a potential adverse liquidity scenario.

Appendix A - CAMELS Liquidity Definition[4]

In evaluating the adequacy of a financial institution's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

Liquidity is rated based upon, but not limited to, an assessment of the following evaluation factors:

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

Liquidity Component Rating Definitions

1 A rating of 1 indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

[4] The rating criteria and definitions are extracted directly from OCC 97-1 Uniform Financial Institutions Rating System.

2 A rating of 2 indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.

3 A rating of 3 indicates liquidity levels or funds management practices in need of improvement. Institutions rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds management practices.

4 A rating of 4 indicates deficient liquidity levels or inadequate funds management practices. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs.

5 A rating of 5 indicates liquidity levels or funds management practices so critically deficient that the continued viability of the institution is threatened. Institutions rated 5 require immediate external financial assistance to meet maturing obligations or other liquidity needs.

Appendix B - Liquidity Risk Assessment System

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

Summary Conclusions:

The quantity of liquidity risk is:

☐ Low	☐ Moderate	☐ High

The quality of liquidity risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate liquidity risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of liquidity risk indicators

Examiners should use the following indicators, as appropriate, when assessing the quantity of liquidity risk. It is not necessary to exhibit every characteristic in a column, or a majority of the characteristics, to be accorded the rating at the column's head.

Low	Moderate	High
Funding sources are abundant and provide a competitive cost advantage.	Sufficient funding sources are available which provide cost-effective liquidity.	Funding sources and liability structures suggest current or potential difficulty in maintaining long-term and cost-effective liquidity.
Funding is widely diversified. There is little or no reliance on wholesale funding sources or other credit-sensitive funds providers.	Funding is generally diversified, with a few providers that may share common objectives and economic influences, but no significant concentrations. A modest reliance on wholesale funding may be evident.	Borrowing sources may be concentrated in a few providers or providers with common investment objectives or economic influences. A significant reliance on wholesale funds is evident.
Market alternatives exceed demand for liquidity, with no adverse changes expected.	Market alternatives are available to meet demand for liquidity at reasonable terms, costs, and tenors. The liquidity position is not expected to deteriorate in the near term.	Liquidity needs are increasing, but sources of market alternatives at reasonable terms, costs, and tenors are declining.
Capacity to augment liquidity through asset sales and /or securitization is strong and the bank has an established record in accessing these markets.	Bank has the potential capacity to augment liquidity through asset sales and /or securitization, but has little experience in accessing these markets.	The bank exhibits little capacity or potential to augment liquidity through asset sales or securitization. A lack of experience accessing these markets or unfavorable reputation may make this option questionable.
The volume of wholesale liabilities with embedded options is low.	Some wholesale funds contain embedded options, but potential impact is not significant.	Material volumes of wholesale funds contain embedded options. The potential impact is significant.
The bank is not vulnerable to funding difficulties should a material adverse change occur in market perception.	The bank is not excessively vulnerable to funding difficulties should a material adverse change occur in market perception.	The bank's liquidity profile makes it vulnerable to funding difficulties should a material adverse change occur.
Support provided by the parent company is strong.	Parent company provides adequate support.	Little or unknown support provided by the parent company.
Earnings and capital exposure from the liquidity risk profile is negligible.	Earnings or capital exposure from the liquidity risk profile is manageable.	Potential exposure to loss of earnings or capital due to high liability costs or unplanned asset reduction may be substantial.

Quality of liquidity risk management

Examiners should use the following indicators, as appropriate, when assessing the quality of liquidity risk management.

Strong	Satisfactory	Weak
Board-approved policies effectively communicate guidelines for liquidity risk management and designate responsibility.	Board-approved policies adequately communicate guidance for liquidity risk management and assign responsibility. Minor weaknesses may be present.	Board-approved policies are inadequate or incomplete. Policy is deficient in one or more material respects.
The liquidity risk management process is effective in identifying, measuring, monitoring, and controlling liquidity risk. Reflects a sound culture that has proven effective over time.	The liquidity risk management process is generally effective in identifying, measuring, monitoring, and controlling liquidity. There may be minor weaknesses given the complexity of the risks undertaken, but these are easily corrected.	The liquidity risk management process is ineffective in identifying, measuring, monitoring, and controlling liquidity risk. This may be true in one or more material respects, given the complexity of the risks undertaken.
Management fully understands all aspects of liquidity risk. Management anticipates and responds well to changing market conditions.	Management reasonably understands the key aspects of liquidity risk. Management adequately responds to changes in market conditions.	Management does not fully understand, or chooses to ignore, key aspects of liquidity risk. Management does not anticipate or take timely or appropriate actions in response to changes in market conditions.
The contingency funding plan is well-developed, effective and useful. The plan incorporates reasonable assumptions, scenarios, and crisis management planning, and is tailored to the needs of the institution.	The contingency funding plan is adequate. The plan is current, reasonably addresses most relevant issues, and contains an adequate level of detail including multiple scenario analysis. The plan may require minor refinement.	The contingency funding plan is inadequate or nonexistent. Plan may exist, but is not tailored to the institution, is not realistic, or is not properly implemented. The plan may not consider cost-effectiveness or availability of funds in a non-investment grade or CAMELS "3" environment.
Management information systems focus on significant issues and produce timely, accurate, complete, and meaningful information to enable effective management of liquidity.	Management information systems adequately capture concentrations and rollover risk, and are timely, accurate, and complete. Recommendations are minor and do not impact effectiveness.	Management information systems are deficient. Material information may be lacking or inaccurate, and reports are not meaningful.
Internal audit coverage is comprehensive and effective. The scope and frequency are reasonable.	Internal audit is satisfactory. Any weaknesses are minor and do not impair effectiveness or reliance on audit findings.	Internal audit coverage is nonexistent or ineffective due to one or more material deficiencies.

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

SM 2013-2

Washington, DC 20219

To: All Examining Personnel

From: John C. Lyons Jr., Senior Deputy Comptroller and Chief National Bank Examiner

Date: January 28, 2013

Subject: Rescission of Internal OCC Issuances

As part of our ongoing effort to develop an integrated supervisory policy platform for national banks and federal savings associations and to ensure that OCC issuances are current, we are rescinding the entries in the *Policies & Procedures Manual* (PPMs) and the supervisory memorandums listed in the attachment. These documents transmitted internal guidance and information to OCC employees and were not distributed outside the agency. We are rescinding these documents because they either are outdated or were replaced by subsequent guidance.

Attachment: Rescinded Internal OCC Issuances

Rescinded Internal OCC Issuances

Policies & Procedures Manual	**Title**	**Reason Rescinded**
PPM 3220-24	Retail Credit Program	Outdated
PPM 5000-04	Right to Financial Privacy Act of 1978—Annual Report	Outdated
PPM 5300-01	Bank Information Systems Program	Outdated
PPM 5310-09	Year 2000: Enforcement Actions	Outdated
Supervisory Memorandum	**Title**	**Reason Rescinded**
SM 1997-01	Supplement to PPM 5310-3 (rev) and SMS Technical Bulletin regarding Corrective Actions (published as MM 97-5)	Outdated
SM 1997-02	Letter to National Bank CEOs (published as a letter)	Outdated
SM 1998-01	Examining Guidance—Credit Underwriting (published as MM 98-30)	Outdated
SM 1999-01	UCE PPM (published as MM 99-18)	Outdated—see current PPM 5400-7, revised 11/12/12.
SM 1999-02	Economic and Systemic Issues Affecting the National Banking System (published as MM 99-19)	Outdated
SM 1999-03	Economic and Systemic Risks in the National Banking System (published as MM 99-28)	Outdated
SM 1999-04	Economic and Systemic Issues Affecting the National Banking System (published as MM 99-30)	Outdated
SM 2000-02	Economic and Systemic Risks in the National Banking System (published as MM 2000-2)	Outdated
SM 2000-03	Economic and Systemic Risks in the National Banking System (published as MM 2000-10)	Outdated

Supervisory Memorandum	Title	Reason rescinded
SM 2000-05	Direct Confirmation of Serviced Assets (published as MM 2000-13)	Replaced—no longer a mandatory requirement. See the "Community Bank Supervision" booklet of the *Comptroller's Handbook*.
SM 2000-08	Internal Control Questionnaires and Verification Procedures (published as MM 2000-22)	Replaced—see the "Internal Control Questionnaires and Verification Procedures" booklet, December 2007.
SM 2001-01	Audit Policy Clarification (published as MM 2001-1)	Replaced—see the "Internal and External Audits," "Community Bank Supervision," and "Large Bank Supervision" booklets of the *Comptroller's Handbook*.
SM 2001-03	Streamlined Report of Examination Format (published as MM 2001-3)	Replaced—see the "Bank Supervision Process" and "Community Bank Supervision" booklets of the *Comptroller's Handbook*.
SM 2002-01	Examiner View PPM (published as MM 2002-1)	Outdated—note that PPM 5000-35 remains active until updated.
SM 2009-01	Revised PPM 3220-29 Specialty Skills Program and National Training Initiative (NTI)	Outdated—see current PPM 3220-29, revised 3/28/12.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2013-5

To: All Examining Personnel

From: Martin Pfinsgraff, Senior Deputy Comptroller, Large Bank Supervision
Jennifer Kelly, Senior Deputy Comptroller, Midsize and Community Bank Supervision

Date: November 1, 2013

Subject: Immediate Public Availability of Formal Enforcement Actions and Other Actions

---

Pursuant to OCC practice, the OCC publishes enforcement orders and other written agreements issued to financial institutions and individuals. The agency issues monthly news releases of enforcement actions and posts the documents monthly to the OCC Web site. This practice sometimes results in a delay of several weeks between the execution and issuance of the enforcement actions and written agreements and their publication through OCC news releases and posting on the Web site. Before the OCC publishes signed and issued enforcement orders or written agreements, or before the decision is made to publish these documents, the orders and agreements are considered "non-public OCC information." Pursuant to 12 CFR 4, financial institutions and individuals are required to submit written requests to the OCC and obtain OCC permission before revealing the existence of the enforcement orders or agreements, even though all parties have executed them, and the OCC has issued them to the financial institutions or individuals.

In recent years, many financial institutions have concluded that securities laws require that they publicly disclose the existence of enforcement orders or written agreements as soon as the actions are executed and issued, before their publication by the OCC. As a result, the OCC has received a large and growing number of written requests from financial institutions, pursuant to 12 CFR 4, to disclose non-public OCC information.

Effective the date of this memorandum, the OCC is making available to the public enforcement orders and written agreements that all parties, including the OCC, have executed and that the OCC has issued immediately upon execution by all parties, unless the OCC otherwise notifies the parties. Absent notice by the OCC, such documents no longer are treated as non-public OCC information. Financial institutions and individuals do not have to file 12 CFR 4 requests to reveal the existence of such orders or written agreements, subsequent to their execution and issuance but before their publication by the OCC. The institutions and individuals, however, may believe that they are obligated, pursuant to securities laws or other legal requirements, to reveal that the OCC may issue an enforcement order or enter into a written agreement, before the execution of such a document. In such cases, the institutions and individuals must still obtain prior OCC written permission, pursuant to 12 CFR 4, to reveal non-public OCC information. The OCC also makes public immediately the documents notifying the institutions of the termination of enforcement orders or written agreements described in this paragraph.

The OCC's policy is to make corporate decisions, operating agreements, and Gramm-Leach-Bliley Act agreements pursuant to 12 CFR 5.39(j) available to the public after all parties have executed them unless the OCC specifically provides otherwise. Similarly, a notice of charges filed with the Office of Financial Institutions Adjudication or served upon an institution or institution-affiliated party is considered public when filed unless the OCC specifically provides otherwise. Therefore, institutions or individuals may disclose fully executed documents described in this paragraph without further action by the OCC.

The OCC reserves the right, on a case-by-case basis, not to make fully executed enforcement documents, agreements, corporate decisions, or notices of charges, available to the public, pursuant to 12 USC 1818(u) or its general supervisory authority under the National Bank Act.

Separate procedures govern the disclosure of such informal actions as memorandums of understanding, individual minimum capital requirements, and other non-public OCC information as defined in the OCC's regulations. Non-public OCC information cannot be disclosed without OCC authorization following a request submitted in accordance with 12 CFR 4. Therefore, in order to permit national banks, federal savings associations, and their holding companies, to make timely disclosures that the federal securities laws mandate, Chief Counsel Amy Friend has delegated to the district counsels and the Director of the Securities and Corporate Practices Division the authority to grant requests to disclose certain non-public OCC information in securities filings. This delegation of authority and the procedures for processing requests is contained in an October 2013 memorandum from the Chief Counsel, "Disclosure of Non-public OCC Information for Federal Securities Law Purposes."

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2014-2

To: Examining Personnel

From: John C. Lyons Jr., Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner

Date: March 24, 2014

Subject: Supervision of End-User Derivatives and Trading Activities

---

Purpose

OCC Bulletin 2014-8 contains supplemental procedures that OCC examiners should use to identify new and emerging risks in the end-user derivatives and trading activities of national banks, federal savings associations, and federal branches and agencies (collectively, banks). While the primary purpose of these procedures is to identify and monitor risks, they will also inform examiners' core assessment of the consolidated company, particularly with regard to quantity of price risk and quality of price risk management.[1]

References

Comptroller's Handbook, "Risk Management of Financial Derivatives"
12 CFR 3, appendix B, "Risk-Based Capital Guidelines; Market Risk" (market risk capital rule)
79 Fed. Reg. 5535 (Jan. 31, 2014), "Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (to be codified at 12 CFR 44)
PPM 5310-3 (REV), "Enforcement Action Policy"
PPM 5310-10, "Guidance to Examiners in Securing Access to Bank Books and Records"
Accounting Standards Codification 820, "Fair Value Measurements and Disclosures"

Scope

Examiners of large banks should begin using these procedures immediately. Examiners of midsize banks should consider using these procedures, particularly the procedures related to end-user derivatives, as appropriate for the banks' complexity and risk profiles. These procedures are likely not necessary for examinations of community banks.

[1] Several procedures address areas in which the OCC has established heightened expectations for large banks, particularly the need for strong audit and risk management functions.

Background

The OCC employs risk-based supervision, allocating the greatest resources to the areas of highest risk. Risk-based supervision begins with identifying risk. For risk-based supervision to be effective, it is vital that examiners recognize when the risk profiles of business units are changing.

While trading activity has always received a significant examination focus, examiners must place a high priority on the evaluation of derivatives used for end-user purposes, including asset and liability management. For example, banks commonly use interest rate derivatives to adjust the interest rate sensitivity of their balance sheets, and they use credit derivatives for credit portfolio management. Because of the size of large banks' balance sheets and credit portfolios, end-user derivatives activity may involve very large volumes of derivatives transactions and could create significant risks. Examiners must be aware of banks' end-user derivatives activity and especially material changes in activity that alter banks' risk profiles, because of the potential for derivatives to accumulate risk. Moreover, new regulatory requirements, such as the market risk capital rule, heighten the importance of the distinction between trading and end-user activities. Examiners should verify that banks properly report end-user derivatives in the call reports and the financial statements. Banks should not automatically treat all derivatives as held for trading.

The supplement contains a variety of procedures to assess the risk profile of (1) trading activity (whether in cash or derivative instruments) and (2) end-user derivatives (derivatives held for purposes other than trading). These procedures supplement the existing procedures in the "Risk Management of Financial Derivatives" booklet. The procedures are divided into two groups: minimum scope procedures, to assess the effectiveness and integrity of risk management systems for end-user derivatives and trading activity; and ongoing monitoring procedures, to identify trading activity, end-user derivatives, and trends in risk profile in both trading and non-trading units.

Many of these procedures incorporate existing regulatory requirements, chiefly the market risk capital rule,[2] or update existing procedures.[3]

Effective supervision of trading activity and end-user derivatives requires an interdisciplinary approach. Examiners should not hesitate to seek assistance from other units within the OCC as necessary.[4] In particular, it is important to have examiners with appropriate expertise (for example, capital markets, credit, accounting) review the bank's end-user derivatives activity. The examiner-in-charge should assign these procedures to the most suitable examiners.

[2] 12 CFR 3, appendix B.

[3] *Comptroller's Handbook*, "Risk Management of Financial Derivatives," pp. 87–89.

[4] Staff members from the Financial Markets Group, Capital Policy, the Office of the Chief Accountant, the Risk Analysis Division, and the Securities and Corporate Practices Division may be particularly helpful.

Many of the procedures involve obtaining documents and records from the banks. While examiners should use existing management reports and public disclosures[5] to the extent practical, the OCC's expectations for information necessary to identify risks and document hedging activity may reveal the inadequacies of existing reports. Examiners should work with their banks to obtain regular reporting of information necessary to understand properly the banks' risk profiles.

Examiners must have access to the information they believe is necessary to carry out their responsibilities and must understand clearly the extent of their authority to obtain access to needed information. Examiners encountering uncooperative bank personnel should review PPM 5310-10, "Guidance to Examiners in Securing Access to Bank Books and Records." Delay and screening tactics to hinder the OCC's access to information may be red flags that the bank is attempting to conceal evidence of violations of law or unsafe or unsound practices. PPM 5310-10 lists remedies for these situations, including demand letters, administrative subpoenas, and enforcement actions. Examiners also have the authority to obtain information under oath,[6] which could be useful if an examiner suspects the bank is providing inaccurate information. The Law Department can help examiners understand and use these remedies.

The OCC provides additional procedures in the forthcoming revision to the "Risk Management of Financial Derivatives" booklet.

Please direct questions concerning these procedures to Kurt Wilhelm, Director, Financial Markets Group, at (202) 649-6437; or Roman Goldstein, Senior Attorney, Securities and Corporate Practices Division, at (202) 649-7223.

---

[5] For example, the quarterly disclosure required by the market risk capital rule contains quantitative data and qualitative disclosures for each material trading portfolio.

[6] 12 USC 481.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2018-01

To: All Examining Personnel

From: Toney M. Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision
Grace E. Dailey, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner
Grovetta N. Gardineer, Senior Deputy Comptroller for Compliance and Community Affairs
Morris R. Morgan, Senior Deputy Comptroller for Large Bank Supervision

Date: January 31, 2018

Subject: Using Supervisory Guidance in Communications With Banks

---

Background and Purpose

The Office of the Comptroller of the Currency (OCC) recognizes the important distinction between statutes and regulations that can be enforced according to their terms and supervisory guidance, which does not impose legally binding constraints but rather outlines safe and sound banking or risk management principles. The OCC issues supervisory guidance to clarify the agency's expectations and to promote transparency and consistency in its supervisory approach across banks. Supervisory guidance may include OCC Bulletins[1] and interagency guidance, which are intended for bankers, and booklets of the *Comptroller's Handbook*, which are intended primarily for examiners.[2]

This Supervisory Memorandum explains how examiners must communicate references to supervisory guidance. This memorandum applies to the OCC's supervision of all national banks, federal savings associations, and federal branches and agencies of foreign banks (collectively, banks).

When communicating banks' deficient practices, examiners may find it helpful to refer to relevant supervisory guidance to provide bankers with a better understanding of sound risk management principles. Bankers may also find it helpful when relevant supervisory guidance is referenced in written communications.

[1] The OCC's pre-1994 publications (e.g., Banking Bulletins, Banking Circulars, Examining Circulars, and Examining Bulletins) are other examples of supervisory guidance.

[2] Supervisory guidance also includes internal OCC guidance, such as Supervisory Memorandums and National Risk Committee Supervision Tips. Internal OCC guidance, however, must not be referenced in written communications to banks.

Examinations

Deviation from supervisory guidance does not necessarily mean that a bank's practices are deficient. Although principles for sound governance, internal controls, and risk management may be included in supervisory guidance, examiners should not treat the supervisory guidance as a list of requirements that banks must implement or strictly adhere to. Examiners should assess a bank's practices and determine whether the bank has implemented sound governance, internal controls, and risk management principles. A sound risk management system identifies, measures, monitors, and controls risks. Because market conditions and company structures vary, no single risk management system works for all banks. The sophistication of the risk management system should be proportionate to the risks present and the bank's size and complexity.[3] Examiners must use judgment and consider whether a bank's practices (e.g., policies, processes, procedures, or controls), or lack of practices, constitute a deficient practice. Deficient practices are practices, or lack of practices, that

- deviate from sound governance, internal control, or risk management principles, and have the potential to adversely affect a bank's condition, including its financial performance or risk profile, if not addressed; or
- result in substantive noncompliance with laws and regulations, enforcement actions, or conditions imposed in writing in connection with the approval of any application or other request by the bank.

Deficient practices may be unsafe or unsound. A practice does not, however, need to be unsafe or unsound to meet the definition of a deficient practice. An unsafe or unsound practice is generally any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the Deposit Insurance Fund.

Supervisory Communications

Examiners should focus on the deficient practice and the potential for the deficient practice to adversely affect the bank's condition or result in violations if not addressed. Supervisory communications[4] <u>must not</u> use language such as "comply/compliance" or "required" in reference to supervisory guidance. Although written communications cannot state that a bank must comply with supervisory guidance, matters requiring attention (MRA) should still use the word "must" when requiring management to correct deficient practices. Corrective action(s) in an MRA or enforcement action may require a bank's practices to be "consistent with" safe and sound

[3] Refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook* for more information on sound governance, internal controls, and risk management.

[4] Supervisory communications include reports of examination, supervisory letters, other written correspondence to banks, and enforcement actions.

principles with a separate corresponding reference to supervisory guidance that may assist bankers in addressing a specific supervisory concern.[5]

Example 1 provides examples of correct and incorrect ways to reference supervisory guidance in written communications.

Example 1

Correct	Incorrect
• The bank's third-party risk management program deviates from sound governance and risk management principles. • Management must improve the bank's third-party risk management program to be consistent with sound governance and risk management principles. Refer to OCC Bulletin 2013-29, "Third-Party Risk Management: Sound Risk Management Principles" for sound third-party risk management principles. • The bank's compliance risk management program deviates from sound risk management principles. Management did not conduct a review of applicable consumer protection laws and regulations before approving new products or services. • The bank's concentration risk management program is satisfactory. [Additional text would include support for conclusion.]	• The bank's third-party risk management program does not comply with OCC Bulletin 2013-29. • Management failed to implement a satisfactory loan review program as required by OCC Bulletin 2006-47, attachment I, "Loan Review Systems." • Management must ensure compliance with OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products or Services: Risk Management Principles." • The bank must implement an effective compliance risk management program that ensures compliance with all applicable laws, regulations, and supervisory guidance. • The bank's concentration risk management program complies with OCC Bulletin 2006-46, "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices: Interagency Guidance on CRE Concentration Risk Management."

Example 2 shows examples of correct and incorrect wording of the 5Cs in an MRA.

Example 2

5Cs	Correct	Incorrect
Concern	The bank's third-party risk management program is less than satisfactory. Management does not conduct appropriate due diligence on critical third-party vendors. Due diligence lacks analysis of the third party's financial condition, legal and regulatory compliance program, and information security program.	The bank's third-party risk management program does not comply with OCC Bulletin 2013-29, as management failed to conduct appropriate due diligence on third-party vendors as required.
Cause	Management did not consider the assessment of critical third parties' financial condition, compliance program, and information security program to be necessary elements of due diligence and overemphasized the cost of the contract when conducting due diligence.	Management did not understand the requirements of OCC Bulletin 2013-29.
Consequence of inaction	Failure to conduct appropriate due diligence on third-party vendors exposes the bank to heightened operational, compliance, reputation, and strategic risks.	Failure to conduct appropriate due diligence on third-party vendors can result in further noncompliance with OCC Bulletin 2013-29 and exposes the bank to heightened operational, compliance, reputation, and strategic risks.

[5] Refer to PPM 5400-11, "Matters Requiring Attention," and PPM 5310-3, "Bank Enforcement Actions and Related Matters," for more information regarding MRAs and enforcement actions.

5Cs	Correct	Incorrect
Corrective action	Management must improve the bank's third-party risk management program and conduct appropriate due diligence on third-party vendors, including • analyzing the third party's financial condition. • assessing the third party's compliance and information security programs. Refer to OCC Bulletin 2013-29 for more information on sound third-party risk management principles.	Management must improve the bank's third-party risk management program to comply with OCC Bulletin 2013-29, including • analyzing the third party's financial condition. • assessing the third party's compliance and information security programs.
Commitment	Management committed to providing the OCC with an action plan to improve the bank's third-party risk management program within 30 days of this letter.	Management committed to providing the OCC with an action plan to improve the bank's third-party risk management program to include compliance with OCC Bulletin 2013-29 within 30 days of this letter.

Example 3 shows correct and incorrect wording for enforcement actions.

Example 3

Correct	Incorrect
Management shall ensure that model development practices are consistent with safe and sound standards for model risk management. Refer to OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management" for guidance.	Management shall ensure that model development practices are consistent with prudent standards for model risk management, and with OCC Bulletin 2011-12.

Violations of Statutes or Regulations

A violation of law or regulation is an act (or failure to act) that deviates from, or fails to comply with, a statutory or regulatory requirement. Examiners may refer to the sound governance, internal control, or risk management principles addressed in supervisory guidance when supporting a violation of a law or regulation, provided that the guidance relates directly to the law or regulation. Examiners must refrain, however, from stating that management's failure to follow supervisory guidance is the basis for the violation because supervisory guidance does not impose legally binding requirements. As indicated in PPM 5400-14, "Violations of Laws and Regulations," examiners must document uncorrected deficient practices that caused a violation as a concern in an MRA.

Appendixes to Regulations

Some regulations contain appendixes that may raise different considerations. For example, appendixes A, B, C, D, and E to 12 CFR 30 are different from other appendixes because 12 CFR 30 contains a specialized enforcement scheme. Examiners can cite noncompliance with a requirement in 12 CFR 30 appendixes. Noncompliance with appendixes to 12 CFR 30 should be included under a separate sub-heading, "Noncompliance with Guidelines," on the violations page of written communications.[6] Appendix A of this memorandum includes a sample violations page and write-up for noncompliance with guidelines.

Examiners can treat appendixes of other regulations (i.e., not 12 CFR 30) like supervisory guidance. In some cases, examiners may be able to cite noncompliance with the appendix, but should first consult with assigned legal counsel. The OCC's authority to cite noncompliance with appendixes other than those in 12 CFR 30 generally depends on whether the appendix has a specialized enforcement scheme or a consequence for a bank's failure to comply. Other considerations may include the following:

- Whether the appendix was issued through the public notice and comment process
- The language used in the appendix (e.g., whether the appendix uses the term "shall" or "should")
- How the intended effect of the appendix was characterized at the time the appendix was issued

Table 1 summarizes how statutes, regulations, and their appendixes should be communicated in supervisory communications.

Table 1: Summary of Treatment of Statutes, Regulations, and Appendixes Thereof

Type	Treatment and Terminology
Statute (e.g., 12 USC 161)	Violation
Regulation (e.g., 12 CFR 34.43(a))	Violation
Appendix to 12 CFR 30	Noncompliance[a, b]
Appendix to other regulations	Treat as supervisory guidance, and consult with the Chief Counsel's Office to determine whether the OCC can cite noncompliance

[a] Noncompliance with an appendix to 12 CFR 30 may be considered the functional equivalent of a violation of a law in the context of an enforcement action under 12 USC 1818. Consult with the appropriate OCC District Counsel or the Enforcement and Compliance Division in cases where enforcement action is contemplated.

[b] Examiners may not cite noncompliance with the supplement to 12 CFR 30, appendix B.

Example 4 shows how examiners could reference supervisory guidance when citing a violation.

Example 4

A bank originates a $225,000 loan secured by an owner-occupied single family residence. Pursuant to 12 CFR 34.43(b), "Evaluations Required," an evaluation rather than an appraisal is required because the loan amount is less than $250,000. The examiner determines that the evaluation should have included an assessment of the property's condition, which is a sound practice for evaluations in OCC Bulletin 2010-42, "Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines." The violation write-up should indicate that the bank failed to perform an appropriate evaluation as required by 12 CFR 34.43(b) because the evaluation did not include a current assessment of the property's condition. The examiner may refer the banker to OCC Bulletin 2010-42, but must not state that OCC Bulletin 2010-42 requires an assessment of the property's condition.

[6] The "violations page of written communications" includes a report of examination, supervisory letter, or a separate document as defined in PPM 5400-14.

Matters Requiring Attention Issued Before Issuance of This Supervisory Memorandum

Some MRAs written before the issuance of this Supervisory Memorandum may include terminology that is inconsistent with this policy. Examiners cannot rewrite existing MRAs, but should use appropriate terminology when writing MRA status updates. Example 5 shows an MRA written using incorrect terminology, and a corresponding status update.

Example 5

Original MRA	**Status Update**
Third-Party Risk Management **Concern:** The OCC identified a new enterprise governance concern. • *Third-Party Management:* The bank's third-party risk management does not comply with the requirements of OCC Bulletin 2013-29. Specifically, – management does not perform an assessment of the third party's compliance program as part of due diligence. – management does not perform ongoing monitoring of critical third-party service providers.	Third-Party Risk Management **Concern:** The OCC originally reported this concern in the 20XX ROE. Status Update • *Third-Party Management (past due):* Examiners reviewed a sample of due diligence documentation, which continues to lack an assessment of the third party's compliance program. Management has implemented ongoing monitoring of critical third-party vendors, but monitoring lacks an assessment of the third party's financial condition.
Cause: Management was not aware of the requirements of OCC Bulletin 2013-29.	**Cause:** Management focused efforts on implementing the program for ongoing monitoring and did not devote sufficient time to improving due diligence.
Consequence of inaction: The failure to comply with OCC Bulletin 2013-29 could result in increased operational, compliance, reputation, and strategic risks.	**Consequence of inaction:** The failure to perform appropriate due diligence and ongoing monitoring on third-party service providers exposes the bank to increased operational, compliance, reputation, and strategic risks.
Corrective action: Management must improve the bank's third-party risk management program in a manner consistent with the requirements of OCC Bulletin 2013-29, including • an assessment of the third party's compliance program as part of due diligence. • performing ongoing monitoring of critical third-party vendors that meets the standards of OCC Bulletin 2013-29.	**Corrective action:** Management must perform an assessment of the third party's compliance program during due diligence. Ongoing monitoring of critical vendors must include an assessment of the third party's financial condition. Refer to OCC Bulletin 2013-29 for sound third-party risk management principles.
Commitment: President Smith committed to improving the bank's third-party risk management program by December 31, 20XX.	**Commitment:** President Smith committed to improving the bank's third-party risk management program to include the above-noted items by June 30, 20X1.

References

"Corporate and Risk Governance" booklet of the *Comptroller's Handbook*
PPM 5310-3, "Bank Enforcement Actions and Related Matters"
PPM 5400-11, "Matters Requiring Attention"
PPM 5400-14, "Violations of Laws and Regulations"

Appendix A: Sample Violations Page and Write-Up for Noncompliance with Guidelines

Violations of Laws and Regulations

The comments in this section of the report describe violations of laws and regulations. The board and management are responsible for ensuring timely correction of the violations where indicated in the corrective actions section. Failure to timely correct violations may result in enforcement actions, including assessment of civil money penalties against the bank and institution-affiliated parties.

NONCOMPLIANCE WITH GUIDELINES

12 CFR 30, appendix B(II)(A) – Interagency Guidelines for Establishing Information Security Standards: Information Security Program
Each bank shall implement a comprehensive information security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the bank and the nature and scope of its activities.

Noncompliance: The bank is in noncompliance with appendix B of 12 CFR 30. Management continues to use improper storage facilities for backup media, and has not implemented a satisfactory patch management program. These are deficient practices that expose customer information to an increased risk of unauthorized disclosure, misuse, alteration, or destruction of data. Failure to correct these deficiencies may lead to an inaccurate privacy notice. Lax oversight of this program may expose the bank to increased operational, reputation, and strategic risks.

Corrective action: Management must implement a satisfactory information security program consistent with the guidelines in 12 CFR 30, appendix B, to include appropriate and secure storage of backup media and a satisfactory patch management program.

Commitment: President Smith committed to moving the bank's backup media storage to an appropriately secure location and implementing a satisfactory patch management program by December 31, 20XX.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2018-03

To: All Examining Personnel

From: Committee on Bank Supervision

Date: April 4, 2018

Subject: Examiner Guidance on the Volcker Rule

This supervisory memorandum addresses the proprietary trading and rebuttable presumption provisions of the Volcker rule.[1] Implementation of these provisions has presented numerous interpretive issues for regulators as well as national banks, federal savings associations, and federal branches and agencies of foreign banks (collectively, banks). Complexity regarding the definition of proprietary trading and lack of clarity regarding standards for banks' ability to rebut the presumption of proprietary trading have caused compliance uncertainty. This uncertainty has implicated traditional banking activities that generally do not present the types of risks the Volcker rule was intended to address.

This memorandum clarifies examiners' responsibilities regarding the Volcker rule's presumption of proprietary trading.[2] It also provides guidance on how the rule applies to several traditional banking activities. In particular, this memorandum

- lists activities that ordinarily are not proprietary trading.
- explains how examiners should evaluate a bank's attempt to rebut the presumption for certain other activities.[3]

The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, U.S. Commodity Futures Trading Commission, and U.S. Securities and Exchange Commission are working to revise the Volcker rule with the aim of reducing complexity and providing greater clarity. This supervisory memorandum provides interim guidance pending revisions to the rule. While the approaches in the proposed revised rule may be different, the effect of this internal guidance is expected to be directionally consistent with the outcome of the interagency process.

---

[1] 12 CFR 44, "Proprietary Trading and Certain Interests in and Relationships with Covered Funds."

[2] 12 CFR 44.3(b)(2), "Prohibition on Proprietary Trading; Rebuttable Presumption for Certain Purchases and Sales."

[3] The Committee on Bank Supervision may amend these lists based on supervisory experience. Absence from these lists does not imply that an activity is proprietary trading.

How the Rebuttable Presumption Works

The Volcker rule presumes that a purchase or sale of a financial instrument is proprietary trading if the bank holds the instrument for fewer than 60 days or substantially transfers the risk of the instrument within 60 days. The rule allows the bank to rebut this presumption by demonstrating that the principal purpose of the transaction was not short-term trading—namely, benefiting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging short-term trading.

The burden is on the bank to rebut the presumption of short-term trading. A bank with a standard or enhanced Volcker compliance program[4] must (1) have internal controls reasonably designed to monitor compliance with the rule and prevent prohibited activities, and (2) keep records demonstrating compliance with the rule for at least five years.[5] Therefore, the bank must identify and document presumptive proprietary trading and document the bank's rebuttal.[6] Examiners who determine that a bank has not met its burden should take appropriate supervisory action.

The rule does not require a bank to file an application or make a formal request to rebut the presumption. Rather, examiners assess rebuttal attempts in the course of regular supervision.

Regardless of how the Volcker rule treats an activity, examiners should take appropriate supervisory action when they identify activities they determine not to be safe, sound, prudent, or appropriate for a particular bank.

Activities That Ordinarily Are Not Proprietary Trading

The following activities' principal purpose ordinarily is not short-term trading. Therefore, these activities ordinarily are not proprietary trading. Examiners should, however, take appropriate supervisory action when they identify facts and circumstances indicating that a bank is structuring one of these activities in an attempt to evade the Volcker rule.

- **Synthetic floating-rate debt:** Issuing a fixed-rate debt security and contemporaneously entering into an interest rate swap in which the bank (1) makes floating-rate payments and (2) receives fixed-rate payments that substantially offset the payments that the bank owes on the debt security.
- **Synthetic fixed-rate debt:** Issuing a floating-rate debt security and contemporaneously entering into an interest rate swap in which the bank (1) makes fixed-rate payments and

[4] Under 12 CFR 44.20, "Program for Compliance; Reporting," a bank must have at least a standard compliance program unless the bank

- has total consolidated assets of $10 billion or less on December 31 of the prior two calendar years, or
- limits its proprietary trading to domestic government obligations and engages in no covered fund activities or investments.

[5] 12 CFR 44.20(b)(2) and (6).

[6] 12 CFR 44.20(b)(6).

(2) receives floating-rate payments that substantially offset the payments that the bank owes on the debt security.

- **Asset swap:** Buying a fixed-rate (floating-rate) debt security and contemporaneously entering into an interest rate swap in which the bank (1) receives floating-rate (fixed-rate) payments and (2) makes fixed-rate (floating-rate) payments that substantially offset the coupons from the debt security.
- **Error correction trades:** Correcting an erroneous trade using a segregated error account.

Activities That Can Be Rebutted

Examiners should review the following activities and determine whether the bank has demonstrated that the principal purpose of the activities is not short-term trading. To evaluate the bank's rebuttal, examiners should consider all relevant facts and circumstances. Examiners should consult the appendix in this supervisory memorandum for more information on evaluating an activity's principal purpose.

- **Money market fund sweeps:** Buying and selling money market mutual fund shares as part of a deposit sweep program. Banks buy shares and sell them, typically on the same day, to manage client cash flow expectations while insulating clients from wrong-way risk.
- **Liquidity management swaps:** Entering into foreign exchange or cross-currency swaps for active funding or liquidity management. Managing liquidity at branches and subsidiaries is an expected activity to promote safety and soundness.
- **Instruments that mature within 60 days:** Buying a financial instrument that matures within 60 days of purchase.
- **Perfectly matched swaps:** Contemporaneously entering into two perfectly matched swaps in which the bank retains minimal price risk.[7] If the bank retains more than minimal price risk from the two swaps, then the bank cannot rebut the presumption and must conduct the activity under the market-making exemption.[8]
- **Sale of acquired bank's investments:** Selling one or more financial instruments from an acquired bank's investment portfolio to comply with the acquiring bank's written policies—including standards on risk appetite, investment liquidity, issuer creditworthiness, credit concentrations, interest rate risk, and operational issues.

For more information, contact Roman Goldstein, Risk Specialist, Treasury and Market Risk Group, at (202) 649-7223; Michael Killick, Technical Expert, Treasury and Market Risk Group, at (202) 649-6413; or Christopher McBride, Director for Treasury and Market Risk, at (202) 649-6402.

[7] Even perfectly matched swaps will create some price risk because of, for example, differences in each swap's credit valuation adjustment.

[8] 12 CFR 44.4(b), "Permitted Underwriting and Market Making-Related Activities."

Appendix: Identifying an Activity's Principal Purpose

To identify an activity's principal purpose, consider all the relevant facts and circumstances, including the following:

- The bank's process for identifying and reviewing presumptive proprietary trading and its related policies, procedures, and internal controls.
- The bank's stated purpose for the activity.
- A list of relevant transactions.
- Responsible business lines, business units, desks, and personnel.
- The nature of the activity and how it fits into the relevant unit's or desk's mandate.
- Any limit breach that the activity caused and the authorization for the breach.
- Any limit increase to accommodate the activity and the authorization for the increase.
- The activity's incremental contribution to the relevant unit's or desk's risk position.
- The activity's incremental contribution to the relevant unit's or desk's risk measures (e.g., value-at-risk and stress value-at-risk).
- Context for the relevant transactions (e.g., market conditions).
- Compensation policies, procedures, and practices of bank personnel conducting the activity.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2018-05

To: All Examining Personnel

From: Grace E. Dailey, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner

Date: June 20, 2018

Subject: Examiner Guidance to Supplement OCC Bulletin 2018-14, "Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending"

Background

OCC Bulletin 2018-14, "Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending," encourages banks[1] to develop responsible, short-term, small-dollar (STSD) installment loans, typically two to 12 months in duration with equal amortizing payments, to help meet the credit needs of consumers.

U.S. consumers borrow nearly $90 billion every year in STSD loans ranging from $300 to $5,000.[2] Banks have largely withdrawn from this market for various reasons, focusing instead on meeting STSD loan demand through overdraft activities and credit card lending. Because overdraft activities and credit card lending do not always meet consumers' emergency or short-term credit needs, some consumers have turned to non-bank lenders.

Before 2013, a small number of banks offered deposit advance products (DAP) to meet consumer STSD credit needs. DAPs were often structured in a similar manner to higher-cost products available from nonbank lenders. These products had the potential for adverse consumer outcomes, including recurring cycles of debt and costs exceeding the principal amount borrowed. Because of these concerns, the OCC issued guidance in 2013 regarding DAPs that detailed supervisory expectations to address potential safety and soundness and consumer protection issues, including specific underwriting guidelines. Banks believed the underwriting expectations were burdensome and discontinued offering DAPs.

---

[1] The term "banks" refers collectively to national banks, federal savings associations, and federal branches and agencies of foreign banks.

[2] Refer to Center for Financial Services Innovation, "2017 Financially Underserved Market Size Study," pp. 44–47, for revenue and volume data on pawn loans, online payday loans, storefront payday loans, installment loans, title loans, and marketplace personal loans.

In October 2017, the Bureau of Consumer Financial Protection (BCFP) issued a final rule titled "Payday, Vehicle Title, and Certain High-Cost Installment Loans" (Payday Rule), which covers DAPs. The OCC rescinded its DAP guidance shortly after the BCFP issued its Payday Rule.[3] Continuing the guidance would have subjected banks to potentially inconsistent regulatory direction and undue burden. As noted in OCC Bulletin 2018-14, the Payday Rule's underwriting requirements generally apply to consumer loans with maturities of 45 days or less or longer-term loans that involve balloon payments. The rule has very few restrictions for STSD installment loans with maturities greater than 45 days and equal amortizing payments.

The OCC believes that many banks are well-positioned to provide affordable STSD installment loans that are fair, inclusive, and consistent with safe and sound lending practices. Banks can also provide products with reasonable pricing and repayment structures while continuing to provide customers with other financial services, such as financial education and credit bureau reporting. In doing so, banks can avoid the more concerning product terms and conditions that were evident in some previous DAPs.

When the OCC rescinded its DAP guidance, the agency identified three core lending principles that should govern banks' STSD lending activities. OCC Bulletin 2018-14 provides further clarification of the three core principles and encourages banks to discuss STSD lending plans with their portfolio manager, examiner-in-charge, or supervisory office.

Examiner Guidance

This supervisory memorandum provides supplemental guidance for examiners regarding STSD installment loans. Examiners should consider the information in this guidance consistent with each bank's risks and individual circumstances.

Banks have offered unsecured consumer installment lending for many years. The OCC has a number of reference documents that examiners can use when reviewing STSD lending. These documents include various booklets of the *Comptroller's Handbook* and several OCC bulletins and advisory letters. Some of the documents are specific to STSD installment lending, while others pertain to retail lending activities that may be similar to STSD installment lending. While STSD lending activity may be new or specialized for a bank, it is fundamentally still a lending activity that OCC examiners are well-suited to evaluate. If examiners have questions about a particular bank's product design, applicable state usury laws, or evaluating program profitability, they should contact their Lead Retail Credit Expert or the Retail Credit Risk staff within the Office of the Chief National Bank Examiner. Examiner questions about the consumer compliance aspects of a program, including disclosures or fair lending issues, should be directed to the appropriate Compliance Officer in Compliance Supervision Management or Consumer Compliance Policy staff within Compliance and Community Affairs.

---

[3] Refer to OCC news release 2017-118, "Acting Comptroller of the Currency Rescinds Deposit Advance Product Guidance," October 5, 2017, announcing the rescission of OCC Bulletin 2013-40, "Deposit Advance Products: Final Supervisory Guidance."

Banks may design STSD installment lending programs in different ways, which may include developing them in-house or in partnership with third parties. In some cases, banks may look to diversify current product structures or expand eligibility and underwriting parameters to attract new borrowers. Banks may also develop marketing or products to reach specific segments of consumers. These approaches may result in potential applicants from unbanked or underbanked populations, which can pose unique risks that need to be understood and managed.

If STSD installment lending represents a new, modified, or expanded product or program for a bank, examiners should refer to OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles." Examiners should determine whether the STSD installment lending program was developed and implemented consistent with sound risk management practices and is aligned with the bank's overall business plan and strategy. Examiners should assess whether appropriate stakeholders within the bank were involved in STSD installment lending product development. These stakeholders can include bank staff in the areas of credit risk, credit administration, legal, compliance risk, compliance operations, audit, information technology, and operational risk. Bank management should ensure that products are evaluated by appropriate and knowledgeable bank staff for potential fair lending issues, product inclusiveness, and compliance with applicable federal and state standards for consumer lending activities.

Depending on the nature and extent of a bank's STSD installment lending, examiners may need to hold several discussions with bank management before and after a bank's implementation of STSD installment lending to thoroughly understand the program.

Banks may investigate relationships with financial technology (fintech) companies and other third parties offering STSD installment lending solutions. Examiners should refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," and OCC Bulletin 2017-21, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29," for guidance in reviewing or discussing third-party relationships with bank management. Examiners may also refer to Supervision Tip 2016-01, "Identifying Risks Associated With Marketplace Lending." The OCC's Office of Innovation is also a resource for examiners or banks that are evaluating prospective fintech companies. The Office of Innovation maintains information about fintech companies that have sought consultation with the office, including information on their product offerings.

Loan Structures, Amounts, and Underwriting

OCC Bulletin 2018-14 states that STSD installment lending programs should support affordability and successful repayment by establishing loan amounts and repayment terms that align with eligibility and underwriting criteria. In reviewing whether a bank's program is consistent with this principle, examiners should evaluate how thoroughly banks analyze the needs of potential consumer populations. A bank's analysis should effectively demonstrate how the bank has balanced consumers' overall creditworthiness with offered loan amounts and repayment requirements. The "Installment Lending" booklet of the *Comptroller's Handbook* provides guidance on how lenders generally make underwriting determinations of product eligibility and applicant creditworthiness for installment loans. Techniques may include the analysis of applicants' debt-to-income ratios, disposable income, and credit scores, or other means of assessing ability to pay. The booklet also provides information on how banks price for risk. Examiners should also refer to the "Retail Lending" booklet of the *Comptroller's Handbook*, which contains guidance on sound approaches for credit approvals and choosing product types, target markets, and product testing. The booklet further discusses underwriting criteria, loan pricing considerations, loan acquisition sources, and automated scoring and model-driven loan approval processes.

Loan Pricing and Profitability

The OCC believes that banks can responsibly and profitably offer STSD installment loans. Pursuant to federal law, state laws establish the rate of interest that may be charged on consumer installment loans. There can be wide variability in the maximum rates established by states. To the extent permitted by law, lenders may offer simple-interest loans or loans with other structures. Federal law also establishes disclosure requirements, and to the extent not preempted, state law may do the same. From the OCC's perspective, STSD installment loan pricing should reflect a reasonable risk/return relationship at the transaction and portfolio level. Riskier consumer lending typically has higher rates and revenues to support the higher origination costs, greater credit losses, and more robust risk management systems.

The overall rate of return for a bank's STSD installment loan product should reflect the product's risk profile and costs. Determining whether the rate of return is reasonable may require an examiner to perform a thorough profitability analysis. Such an analysis is common when evaluating retail lending activities. Examiners should refer to the "Installment Lending" and "Retail Lending" booklets, which provide information on analyzing profitability.

Expected and actual loss rates on STSD portfolios can vary widely depending on the creditworthiness of consumers targeted by the bank. For example, banks' net loss rates for other consumer loans[4] ranged from less than 1 percent to over 9 percent in 2017 because of different risks in each bank's consumer products and programs.

Examiners should consider STSD lending when reviewing the quality and composition of bank earnings and the appropriateness of the allowance for loan and lease losses (ALLL). Specifically, examiners should assess the risk to earnings from any concentration of revenue resulting from significant STSD lending programs. For example, banks with higher-risk consumer loans may

---

[4] Other consumer loans may take the form of

1. installment loans, demand loans, single payment time loans, and hire purchase contracts (for purposes other than retail sales of passenger cars and other vehicles such as minivans, vans, sport-utility vehicles, pickup trucks, and similar light trucks for personal use),
2. retail installment sales paper purchased by the bank from merchants, finance companies, other parties or dealers (other than dealers of passenger cars and other vehicles such as minivans, vans, sport-utility vehicles, pickup trucks, and similar light trucks), or
3. other revolving credit plans that are extensions of credit to individuals for household, family, and other personal expenditures arising from prearranged overdraft plans and other revolving credit plans not accessed by credit cards.

exhibit a high or disproportionate contribution to earnings from their consumer loan business. In addition, if STSD lending represents a material exposure, examiners should determine whether the bank's ALLL methodology specifically segments this portfolio when estimating potential credit losses.

If a bank's STSD installment lending targets subprime consumers, examiners should refer to the guidance in OCC Bulletin 1999-15, "Subprime Lending: Risks and Rewards" (national banks), and OCC Bulletin 2001-6, "Subprime Lending: Expanded Guidance for Subprime Lending Programs" (national banks and federal savings associations). Certain STSD installment loans made to military personnel must comply with the Military Lending Act and its implementing regulation.[5]

Alternative Analysis of Creditworthiness

Banks may use innovative technology products to lower underwriting costs, including in the assessment of creditworthiness. These products are typically offered by third parties and are designed to interface with banks' servicing systems in a highly automated manner. Using these software solutions may allow banks to expand their underwriting capabilities beyond the traditional standards of credit scores or repayment ratios. For example, some product solutions allow banks to quickly analyze the inflows and outflows of an applicant's primary deposit account at any depository institution. Some alternatives may expose banks to elevated levels of model risk that did not previously exist. Bank management should review the conceptual soundness and empirical performance of any alternative creditworthiness models before adoption. Examiners should refer to OCC Bulletin 2011-12, "Sound Practices for Model Risk Management." The OCC's Credit Risk Analysis Division can be a resource for examiners and banks in this area.

Fair Treatment and Access, Marketing, and Disclosures

OCC Bulletin 2018-14 states that STSD installment lending programs should promote fair treatment of and access for consumers. All aspects of a bank's STSD program should be objective and fairly applied, including the setting of prices, fees, and other terms and conditions. Bank marketing and consumer disclosures must also comply with applicable consumer protection laws and regulations, such as the Truth in Lending Act as implemented by Regulation Z and section 5 of the Federal Trade Commission Act. Examiners should assess the quality of the bank's compliance risk or internal audit review of STSD installment lending.

Examiners should refer to the following OCC documents on unfair or abusive marketing and account management practices: Advisory Letter 2000-7, "Abusive Lending Practices" (for national banks and federal savings associations); Advisory Letter 2000-10, "Payday Lending" (for national banks and federal savings associations); Advisory Letter 2000-11, "Title Loan Programs" (for national banks); Office of Thrift Supervision CEO Memo 131, "Title Loan Programs" (for federal savings associations); Advisory Letter 2002-3, "Guidance on Unfair or

[5] Refer to 10 USC 987, 32 CFR 232, and the "Military Lending Act" booklet of the *Comptroller's Handbook*.

Deceptive Acts or Practices" (for national banks and federal savings associations); and OCC Bulletin 2014-42, "Credit Practices Rules: Interagency Guidance Regarding Unfair or Deceptive Credit Practices (for national banks and federal savings associations). Examiners should also refer to SM 2018-04, "Discussion Points on UDAP and UDAAP Compliance," for more information about potential unfair, deceptive, or abusive acts or practices.

Loan Servicing, Account Management, and Workouts

Examiners should evaluate whether banks' servicing processes are designed to support successful repayment. This means maintaining processes that identify and take timely action with borrowers who show signs of financial distress. The use of timely and reasonable workout strategies can increase the potential for successful repayment.

Effective management information systems not only monitor key performance indicators but also identify potential adverse outcomes such as interest or fee costs that exceed the amount of principal borrowed. Such outcomes could indicate poor repayment structures or liberal renewal and refinancing practices. One such example could be a situation in which a consumer effectively pays $120 in interest or fees to borrow $100 in principal (total of $220 paid) as a result of several consecutive renewals of a loan with a new fee assessed each time. Outcomes like this exemplify how lending practices may contribute to borrowers continuing in a cycle of debt versus improving borrowers' opportunities to transition to more mainstream financial products.

Banks should engage in prudent classification and account management practices for STSD installment lending and may use accelerated loss recognition as appropriate. Examiners should refer to OCC Bulletin 2000-20, "Uniform Retail Credit Classification and Account Management Policy: Policy Implementation."

Credit Bureau Reporting

Well-developed STSD loan programs accurately report credit information to the credit bureaus. Few nonbank lenders report payment performance to the credit bureaus. Banks can provide this important service, which can assist consumers who repay in a timely manner to build or rebuild their credit profiles, and potentially achieve better financial standing by transitioning to more mainstream financial products.

More Information

For more information on OCC Bulletin 2018-14 or this supervisory memorandum, contact the Retail Credit Risk organization at (202) 649-6220 in the Office of the Chief National Bank Examiner.

News media queries about OCC Bulletin 2018-14 should be referred to OCC Public Affairs at (202) 649-6870.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2019-01

To: All Examining Personnel

From: Grovetta N. Gardineer, Senior Deputy Comptroller for Bank Supervision Policy

Date: March 7, 2019

Subject: Discussion Points Related to the Flood Disaster Protection Act Requirement for Flood Insurance Coverage on Commercial Building Contents

---

Background

Under the Flood Disaster Protection Act of 1973 (FDPA) and its implementing regulations, if a bank takes a security interest in a building and its contents located in a Special Flood Hazard Area (SFHA), then flood insurance coverage is required for both the building and the contents.[1] This requirement is commonly referred to as the FDPA "mandatory purchase requirement" and is required regardless of whether the bank perfects its security interest in the contents.

In connection with the review of several banks' commercial loan portfolios, the OCC identified instances of lack of contents coverage when banks took broadly defined security interests in the buildings and contents, securing the loans through mortgage or deed of trust agreements. In these cases, the flood insurance policies in place covered the buildings, but not their contents. Weaknesses in a bank's policies and procedures were a common root cause of these FDPA issues, which resulted in bank management neglecting to ensure that the security agreements used at loan closing fully matched the underlying loan transaction.

Banks should have processes to effectively identify, measure, monitor, and control the risks associated with the FDPA mandatory purchase requirement, including when taking both a building and its contents located in an SFHA as security for a loan.

Discussion Points for FDPA Compliance Risk Reviews

Following is supplemental information and examples of questions examiners may consider and appropriately tailor for discussions with bank management and staff regarding compliance with flood insurance coverage requirements, including the bank's compliance management system, and the bank's monitoring of third parties that generate its loan documents. The section is intended to help examiners

[1] 42 USC 4012a(b); 12 CFR 22.3(a).

- raise awareness of this issue with bank management.
- assist bank management in identifying areas of risk.
- give bank management the opportunity to implement any necessary risk mitigation measures.
- evaluate whether bank management has taken appropriate action to (1) implement policies and procedures; (2) verify that loan security agreements are consistent with the secured collateral; and (3) train staff and applicable third parties.

Policies and Procedures

Supplemental Supervisory Information

While the FDPA mandatory purchase requirement applies to residential and commercial loans, associated risk may be higher in the commercial loan portfolio. For commercial loans, banks typically take a security interest in both the building and the building contents, while residential loans are often collaterialized by only the building. Bank management should have language in a security agreement to take a security interest in building contents only when they secure that loan with building contents. Bank management should also consider whether there are legal limitations associated with a security interest in building contents when, for example, the building is tenant-occupied. If the bank management does not secure a loan with building contents, the loan agreement should not include language to this effect, and language regarding taking contents as collateral should not be included out of an "abundance of caution."

When bank management takes building contents as security for a loan, and the security agreement includes language to do so, they should ensure appropriate flood insurance coverage is in place for both the building and the building contents.[2] Both the building and the contents are considered to have a sufficient amount of flood insurance for regulatory purposes if some reasonable amount of insurance is allocated to the building as well as to the contents.[3]

If examiners identify a potential FDPA issue related to insurance coverage for building contents, then the next step would be to determine the root cause of the issue. For example, examiners should review the bank's policies and procedures to determine if the bank has processes in place to use loan security agreements that match the underlying loan transaction (i.e., the bank takes a security interest in building contents only when it secures the loan with building contents and requires a reasonable amount of flood insurance coverage for those building contents); and that

---

[2] See Q/A 39, "Interagency Questions and Answers Regarding Flood Insurance," 74 Fed. Reg. 35914, 35941 (July 21, 2009).

[3] For example, assume a bank makes a loan for $200,000 that is secured by a commercial building with an insurable value of $200,000 and contents with an insurable value of $100,000. Under the National Flood Insurance Program, the maximum amount of insurance that is available for the building and contents is $500,000 for each. In this situation, the flood insurance requirement could be met by requiring $150,000 of coverage on the building and $50,000 of coverage on the contents, thus providing total coverage in the amount of the $200,000 outstanding principal loan balance.

such security-taking language is excluded from security agreements in transactions in which the bank does not take contents as security for the loan. Subsequent FDPA examinations could include appropriate transaction testing to validate adherence to applicable policies and procedures, consistent with an appropriate 3-cycle strategy approach.[4]

The bank's underwriting and loan closing policies and procedures, including transactions executed on behalf of the bank by third-parties, should direct bank staff to use loan security agreements that are consistent with the underlying transaction, only take collateral the bank relies on as security for the loan, and put appropriate flood insurance coverage in place.

Questions

1. What processes does the bank have to ensure the following:

    a) Language used in the security agreements and other loan documents for its commercial loans accurately reflects its interest in the collateral property relied on as security for the loan?
    b) Security agreements and other loan documents fully match the structure of the underlying transaction?
    c) Appropriate flood insurance coverage is in place when the bank takes the building and contents located in an SFHA as collateral?

Monitoring and Audit

Supplemental Supervisory Information

The bank's loan origination staff, internal audit, or designated review teams should review loan documents and security agreements to verify the bank's security agreements include language that take a security interest in building contents only when the bank secures that loan with contents.

Many banks rely on third-party generated forms as part of the loan application and closing processes. Bank management should review and determine, as part of its ongoing monitoring of third-party relationships,[5] that the forms generated appropriately reflect the collateral the bank relies on to secure the loan.

[4] Refer to SM 2018-08, "Frequency and Scope of Compliance Activities," for information regarding transaction testing during a three-cycle strategy planning period.

[5] Refer to OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."

Questions

2. Which parties within the bank are responsible for assessing loan documentation to verify, prior to loan closing, that the security agreement is consistent with the bank's underwriting of the loan with respect to taking an interest in the building and its contents in an SFHA?

3. How does bank management work with third parties (for example, document generators used for loan application, processing, and closing functions) to verify that documentation properly reflects the collateral bank management relies on to secure the loan?

Training

Supplementary Supervisory Information

Loan officers, processors, underwriters, compliance teams, other staff, and any third parties involved in the bank's pipeline for underwriting, closing, increasing, extending, renewing, or servicing a mortgage loan, should all receive training on the FDPA mandatory purchase requirement when a building and its contents are taken as security for a loan.

Question

4. How does the bank management ensure staff or third parties performing functions on behalf of the bank are appropriately trained on the FDPA requirements for flood insurance when a building and its contents in an SFHA are taken as security for a loan?

Additional Resources

The Bank Supervision Policy and Community and Consumer Law staffs are available to address questions and to ensure consistent application of the law and OCC policy.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2020-03

To: All Examining Personnel

From: Grovetta N. Gardineer, Senior Deputy Comptroller for Bank Supervision Policy

Date: May 12, 2020

Subject: Frequently Asked Questions About Financial Services for Marijuana-Related Businesses

---

An increasing number of states have permitted the use of marijuana in limited ways. Under the federal Controlled Substances Act (21 USC 801, et seq.), however, it is illegal to manufacture, import, possess, use, and distribute marijuana. The difference between state initiatives and federal law has raised questions about potential Bank Secrecy Act (BSA) compliance risk exposure and other issues for banks[1] that may be doing business with marijuana-related businesses.

This supervisory memorandum provides answers for examiners to frequently asked questions about the provision of financial services to marijuana-related businesses in states that have enacted laws relating to the legal status of the manufacture, importation, possession, use and distribution of marijuana or marijuana derivatives. The answers are adapted from existing information and do not provide new guidance for examiners.

1. What is the current legality of marijuana under federal law?

The Controlled Substances Act makes it illegal under federal law to manufacture, import, possess, use, and distribute marijuana. Although many states impose and enforce similar provisions, an increasing number of states and localities have taken steps in recent years to permit the use of marijuana in limited ways.

2. Is there guidance on whether banks can provide financial services to marijuana-related businesses?

In February 2014, the Financial Crimes Enforcement Network (FinCEN) issued FIN-2014-G001, "BSA Expectations Regarding Marijuana-Related Businesses" (2014 FinCEN guidance), which

---

[1] "Banks" refers collectively to national banks, federal savings associations, and federal branches and agencies of foreign banking organizations. Note that the Financial Crimes Enforcement Network's 2014 guidance, FIN-2014-G001, refers to "financial institutions." For purposes of this supervisory memorandum (except when used in quotation marks), "financial institutions" is replaced with "banks."

clarified BSA expectations for banks seeking to provide services to marijuana-related businesses. The 2014 FinCEN guidance also clarifies how banks can provide services to marijuana-related businesses consistent with their BSA obligations. The decision to provide financial services to customers directly or indirectly involved with a marijuana-related business generally lies with bank management. According to the 2014 FinCEN guidance, "in general, the decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution" (see FAQ 4 for more information).

3. Has the Office of the Comptroller of the Currency (OCC) set expectations for a bank that chooses to provide financial services to a marijuana-related business?

For banks that choose to provide financial services to customers engaged in marijuana-related businesses, the OCC will review compliance with applicable banking laws and regulations, including compliance with BSA-related requirements for detecting and reporting transactions that are suspicious or violate federal law. These requirements include conducting the required customer due diligence on marijuana-related businesses consistent with the 2014 FinCEN guidance; assessing the money laundering and terrorist financing risks posed by these businesses; and implementing appropriate controls to assure ongoing compliance with BSA-related requirements, including appropriate suspicious activity monitoring and reporting.

4. Is there guidance on what type of due diligence banks should conduct when assessing the risk of providing services to marijuana-related businesses?

The 2014 FinCEN guidance states that customer due diligence is a critical aspect of a bank's assessment of whether the bank has the capacity to effectively manage the risks associated with providing financial services for any customer engaged in marijuana-related businesses. Specifically, the 2014 FinCEN guidance states that due diligence should include

- verifying that a business is licensed and registered with state authorities.
- reviewing the license application and related documentation.
- requesting information about the business and related parties from state licensing and enforcement authorities.
- developing an understanding of normal and expected business activities, including the types of products sold and customers served.
- monitoring public sources on an ongoing basis for adverse news about the business or related parties.
- monitoring suspicious activity on an ongoing basis.
- updating information collected during due diligence on a periodic basis based on the customer's risk.

These due diligence items are consistent with FinCEN's general customer due diligence rule. Under the rule, banks are required to implement appropriate procedures for conducting ongoing customer due diligence. Such due diligence must include (1) understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and

(2) conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information. Refer to 31 CFR 1020.210.

5. Is there a requirement for banks to file Suspicious Activity Reports (SAR) if they provide financial services to a marijuana-related business?

In general, banks are required to file SARs if they detect known or suspected violations of federal law or suspicious transactions related to money laundering activities or BSA violations. Given the Controlled Substances Act's prohibitions, financial transactions involving marijuana-related businesses would generally involve funds derived from illegal activity. The 2014 FinCEN guidance states that banks should file specific types of SARs on activities that involve marijuana-related businesses. The obligation to file SARs is not affected by any state law that decriminalizes or otherwise permits marijuana-related activity.

6. What does the 2014 FinCEN guidance say that banks should consider when preparing to file SARs on transactions related to marijuana-related businesses?

The 2014 FinCEN guidance is intended to help banks determine how to file SARs that will be highly useful in criminal investigations and proceedings. With that in mind, the guidance clarifies how financial institutions can comply with their SAR filing obligations and facilitate law enforcement's access to information pertinent to a priority. These types of SARs are (1) "Marijuana Limited" SARs, (2) "Marijuana Priority" SARs, and (3) "Marijuana Termination" SARs.

In determining which type of SAR is appropriate, the guidance states that banks should take into account the following important priorities (also referred to as "Cole Memo[2] priorities"):

- Preventing the distribution of marijuana to minors.
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels.
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states.
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity.
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana.
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use.
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands.
- Preventing marijuana possession or use on federal property.

[2] In 2013, then Deputy Attorney General, U.S. Department of Justice, James M. Cole issued a memorandum providing guidance to federal prosecutors concerning marijuana enforcement. Known as the Cole Memo, this guidance was rescinded in 2018 by then Attorney General Jefferson B. Sessions. Notwithstanding this rescission, the 2014 FinCEN guidance remains in effect and references to the Cole Memo remain in the 2014 FinCEN guidance.

7. Under what circumstances should a bank file a "Marijuana Limited" SAR, a "Marijuana Priority" SAR, or a "Marijuana Termination" SAR?

A "Marijuana Limited" SAR should be filed if a bank providing services to a marijuana-related business reasonably believes, based on customer due diligence, that the customer does not violate state law or implicate one of the Cole Memo priorities. The bank should follow FinCEN's existing guidance on the timing of filing continuing activity reports for the same activity initially reported on a "Marijuana Limited" SAR. The 2014 FinCEN guidance states that this type of continuing activity report may contain the same limited content as the initial SAR, plus details about the amount of deposits, withdrawals, and transfers in the account since the last SAR.

A "Marijuana Priority" SAR should be filed if the bank believes that its marijuana-related business customer's activity violates state law or runs counter to any of the Cole Memo priorities. The 2014 FinCEN guidance provides several red flags that banks can look for when determining the priority of a SAR filing. (The 2014 FinCEN guidance does not provide an exhaustive list of red flags.) The bank should determine whether red flags are present in account activity or whether the customer exhibits behavior that violates state law or runs counter to the Cole Memo priorities.

A "Marijuana Termination" SAR should be filed if the bank deems it necessary to terminate a relationship with a marijuana-related business.

For more information about each SAR type, refer to the 2014 FinCEN guidance.

8. Are banks required to file Currency Transaction Reports (CTR) on marijuana-related business transactions if the banks are already filing continuing activity Marijuana Limited SARs?

The 2014 FinCEN guidance states that banks are required to report currency transactions for marijuana-related businesses in the same way that banks would report any other transaction with the same reporting threshold and requirements.

9. Are marijuana-related businesses eligible for exemptions from CTR filing?

No. The 2014 FinCEN guidance provides that a business engaged in marijuana-related activity may not be treated as a non-listed business under 31 CFR 1020.315(e)(8) and is therefore not eligible for consideration for an exemption with respect to a bank's CTR obligations under 31 CFR 1020.315(b)(6).

10. Does the 2014 FinCEN guidance apply to a bank providing indirect services to marijuana-related business?

The 2014 FinCEN guidance is unclear on this point. The guidance states that, when services are provided indirectly, the bank may file SARs based on existing regulations and guidance without distinguishing between Marijuana Limited and Marijuana Priority. The guidance lists two examples of services being provided indirectly: (1) a financial institution providing services to another domestic financial institution that, in turn, provides financial services to a marijuana-related business; and (2) a financial institution providing services to a non-financial customer that provides goods or services to a marijuana-related business (e.g., a commercial landlord that leases property to a marijuana-related business). The guidance does not, however, indicate whether SARs should be filed in either example. Specific questions regarding the applicability of the FinCEN guidance to indirect relationships should be directed to FinCEN's Resource Center at (800) 767-2825.

The risk of these relationships varies depending on the circumstances and should be assessed based on the bank's risk appetite and controls. Also, while existing OCC guidance does not specifically reference marijuana-related businesses, banks may consider the risk management principles communicated in existing guidance focusing on certain customer segments, i.e., OCC Bulletin 2016-32, "Risk Management Guidance on Foreign Correspondent Banking: Risk Management Guidance on Periodic Risk Reevaluation of Foreign Correspondent Banking," and OCC Bulletin 2014-58, "Banking Money Services Businesses: Statement on Risk Management."

11. Is there guidance on whether a bank is required to terminate a marijuana-related business relationship or what constitutes a reasonable time frame for exiting such a relationship once the bank files a marijuana-related SAR?

The OCC has not issued specific guidance on this point; however, the decision to provide financial services to customers directly or indirectly involved with a marijuana-related business, or to exit an existing relationship, is a bank management decision and can be made on a risk basis. If bank board and management decide to do business with a marijuana-related business, the bank should have adequate policies and procedures in place that demonstrate how it will assess and manage the money laundering and terrorist financing risks associated with these customers and how the bank will comply with BSA/AML laws and regulations. Such procedures should include the bank's processes for considering whether to exit marijuana-related business relationships. Banks are expected to follow their policies and procedures when determining whether to terminate a customer relationship.

12. Are banks allowed to provide financial services to hemp growers? Do banks need to file SARs on these customers?

The Agricultural Improvement Act of 2018 (2018 Farm Bill) removed hemp as a controlled substance. Hemp is defined as the plant Cannabis sativa L. and any part of that plant containing no more than 0.3 percent delta-9-tetrahydrocannabinol (THC).[3] Banks can provide services to hemp growers and customers engaging in hemp-related business activities. Banks are not required to file SARs on customers solely because they are growing or cultivating hemp, but banks are expected to follow SAR procedures if a customer's activity appears suspicious.

[3] Refer to 7 USC 1639o(4) (defining hemp) and 21 USC 802(16) (defining marijuana).

The OCC, the other federal banking agencies, and FinCEN recently issued interagency guidance on providing financial services to customers engaged in hemp-related businesses.[4] Refer to OCC News Release 2019-141, "Agencies Clarify Requirements for Providing Financial Services to Hemp-Related Businesses."

13. How did the 2018 Farm Bill affect the production of hemp under the Federal Food, Drug, and Cosmetic Act or the Public Health Service Act?

The 2018 Farm Bill that legalized hemp growth and cultivation did not affect the production of hemp under the Federal Food, Drug, and Cosmetic Act or the Public Health Service Act. For example, the U.S. Food and Drug Administration (FDA) must approve cannabis-derived products that are sold with a claim of having health benefits. This may include such products as cannabidiol (CBD) oils, creams, lotions, or food products. Compliance with the FDA requirements would fall on bank customers engaged in businesses involving these products.[5]

14. Has the OCC brought an enforcement action against a bank based solely on the fact that the bank provided financial services to marijuana-related business customers?

No, the OCC has not brought an enforcement action against a bank based solely on the fact that the bank provided financial services to one or more marijuana-related business customers. Nonetheless, the OCC expects banks to assess the specific money laundering and terrorist financing risks posed by customers and to implement appropriate controls to manage their relationships in accordance with applicable laws and regulations. Banks that choose to provide services to customers engaged in marijuana-related businesses must also comply with all applicable BSA-related requirements, including appropriate suspicious activity monitoring and reporting, and should consider the 2014 FinCEN guidance.

15. Should marijuana-related businesses be included in an examination scope? What examination procedures should be used when reviewing marijuana related businesses?

The decision to include marijuana-related businesses in an examination scope should be risk-based and determined in the same way as with any other type of bank product or service that poses money laundering or terrorist financing risk.

There are no BSA/AML examination procedures specific to reviewing marijuana-related businesses. If marijuana-related businesses are included in the BSA/AML examination scope, examiners should use the appropriate sections of the *Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering Examination Manual*. An examination covering marijuana-related business activities may include a comprehensive assessment of a bank's marijuana-related business banking program or transaction testing of individual

[4] Visit the FinCEN website for updated guidance. FinCEN has stated that they will be issuing additional guidance concerning the specific due diligence requirements under the BSA for hemp-related business customers.

[5] Refer to the "FDA Regulation of Cannabis and Cannabis-Derived Products, Including Cannabidiol (CBD)" web page.

marijuana-related business relationships. Marijuana-related business relationships may be included in transaction testing under core or expanded procedures such as Customer Due Diligence, Beneficial Ownership, or Suspicious Activity Reporting. The extent of transaction testing and activities conducted is based on various factors, including the examiner's judgment of risks, controls, governance, and the adequacy of independent testing. Examiners should consider OCC and FinCEN guidance during supervisory activities. Examiners may assess the adequacy of controls for developing and implementing new products or services for those banks with newly implemented marijuana-related business programs or programs still in development.

16. If my bank has additional questions on marijuana-related businesses, where should I direct the bank?

For questions pertaining to marijuana-related businesses, banks should continue following the 2014 FinCEN guidance and are encouraged to contact FinCEN's Resource Center at (800) 767-2825 for more information.

For questions pertaining to hemp, banks should contact the U.S. Department of Agriculture or visit the agency's website at www.usda.gov.

For questions pertaining to cannabis-derived products, banks should contact the U.S. Food and Drug Administration or visit the agency's website at www.fda.gov.

17. If I have additional examiner questions on marijuana-related businesses, who should they be directed to?

For policy-related questions, examiners should contact Bank Supervision Policy's BSA/AML Policy group at (202) 649-5470. For examination and supervision-related questions, examiners should contact the appropriate lead experts for their supervision unit.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2020-04

To: All Examining Personnel

From: Grovetta N. Gardineer, Senior Deputy Comptroller for Bank Supervision Policy

Date: May 12, 2020

Subject: Fulfilling the Full-Scope, On-Site Examination Requirement in Light of COVID-19

National banks, federal savings associations, and federal branches and agencies of foreign banking organizations (collectively, banks) must receive a full-scope, on-site examination every 12 or 18 months.[1] Most examination work during the coronavirus (also known as COVID-19) national emergency is not, however, being conducted on-site. Through December 31, 2020,[2] even if examination work does not occur on site, the OCC considers the required full-scope, on-site examination requirement to be fulfilled if the examination work meets the requirements described in this supervisory memo. All other full-scope examination requirements remain unchanged.

The full-scope, on-site examination requirement may be fulfilled by conducting one examination (most common in community banks) or by aggregating several supervisory activities (most common in midsize and large banks). Consistent with the "Bank Supervision Process" booklet of the *Comptroller's Handbook*, a full-scope, on-site examination must consist of examination activities performed during the supervisory cycle that

- satisfy the core assessment[3] and are sufficient in scope to assign the bank's regulatory ratings, except Community Reinvestment Act ratings.[4]

---

[1] 12 USC 1820(d) requires the OCC to conduct a full-scope, on-site examination of each insured depository institution every 12 or 18 months. The OCC applies this statutory examination requirement to all types of banks (federal branches and agencies excepted), regardless of insured status, in 12 CFR 4.6. The frequency of on-site examinations for federal branches and agencies is prescribed by 12 USC 3105(c) and 12 CFR 4.7. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for a summary of a bank's eligibility for an 18-month supervisory cycle.

[2] The OCC may extend this time frame.

[3] For specific core assessment information, refer to the "Community Bank Supervision," "Federal Branches and Agencies Supervision," and "Large Bank Supervision" booklets of the *Comptroller's Handbook*.

[4] Regulatory ratings include a bank's composite and component CAMELS or ROCA ratings as well as information technology, trust, and consumer compliance component ratings, as applicable. Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more information regarding the regulatory rating systems.

- result in conclusions about the bank's risk profile.
- review the bank's Bank Secrecy Act compliance program.[5]
- assess the bank's compliance with the national flood insurance program, if the bank is an insured depository institution.[6]
- include on-site supervisory activities.[7]
- conclude with the issuance of a report of examination.

Examiners should continue to engage in discussions with bank management, as needed. Examiners must conduct exit meetings with bank management for supervisory activities that occur off-site. Discussions and exit meetings may be by phone or OCC-approved video conferencing systems.

[5] For more information, refer to the *Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering Examination Manual.*

[6] Refer to 12 USC 1820(i), "Flood Insurance Compliance by Insured Depository Institutions."

[7] The "Bank Supervision Process" booklet of the *Comptroller's Handbook* indicates that the extent of on-site examination work is flexible.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2020-05

To: All Examining Personnel

From: Grovetta Gardineer, Senior Deputy Comptroller for Bank Supervision Policy

Date: May 21, 2020

Subject: Artificial Intelligence

Purpose

This supervisory memorandum (SM) addresses banks'[1] use of artificial intelligence (AI), including machine learning (ML), and provides examiners with an overview of effective risk management for using AI. This SM also addresses how existing supervisory guidance relates to AI. The SM gives examiners insight on how to conduct reviews and speak with bankers on

- the importance of banks developing, managing, documenting, and validating AI and its use, similar to guidance communicated in OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management."
- appropriate due diligence and risk assessments as communicated in OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles."
- sound third-party risk management, when third parties are part of a bank's AI use.
- the importance of effective data management practices, including data quality, data completeness, and understanding potential biases, including consumer compliance implications.

Overview

AI is broadly defined as the application of computational tools to address tasks traditionally requiring human analysis. AI can be used to identify risks, develop predictions, or make decisions based on advanced analytics operating on extensive data sets. ML, a subcategory of AI, is a method of designing a sequence of actions to solve a problem that optimizes automatically

---

[1] "Banks" refers collectively to national banks, federal savings associations, and federal branches and agencies of foreign banking organizations.

through experience and with limited or no human intervention.[2] ML algorithms[3] give computers the ability to identify patterns without requiring a human to specify all of the pattern elements.

The field of AI is rapidly evolving. ML is the most common approach for AI that banks are using. Advances in computing capacity combined with greater availability of data and improvements in analytical techniques provide opportunities for banks to leverage AI[4] for risk management and ongoing operations. These trends reflect a progression of banks' use of advanced analytics, including automation, to support business decisions.

Risks

It is important for banks to identify, measure, monitor, and control risks arising from AI. The most common risk is operational risk, which includes the risk from failed or inadequate internal processes or systems, human errors or misconduct, information technology weaknesses, cybersecurity, risk from third parties, and model risk management issues. Depending on the bank's specific use of AI, credit risk, market risk, reputation risk, compliance risk, and other risks may need to be addressed.

Examples of AI Uses in Banking

Banks use AI to automate repetitive tasks or to develop insights that supplement human analysis to make decisions. For example, banks may use AI to automate repetitive tasks that can be completed faster or more accurately than by humans. Banks also use AI to assist with sophisticated decision making and pattern recognition. The level of "intelligence," or ability to automate or augment human analysis, ranges from basic to complex. The following are examples of AI use cases being piloted or in production in banking:

- **Fraud detection and prevention:** AI can be used to detect and support reduction of various types of fraud, including fraudulent payment transactions (e.g., debit cards, credit cards, and automated clearing houses) and insider fraud. Given the vast quantity and availability of transaction data, one of the first areas in banking to use pattern recognition and ML techniques was credit card fraud detection.

---

[2] AI and ML definitions are from the Financial Stability Board's November 2017 report titled "Artificial Intelligence and Machine Learning in Financial Services: Market Developments and Financial Stability Implications."

[3] An algorithm is a set of computational rules to be followed to solve a mathematical problem. More recently, the term has been adopted to refer to a process to be followed, often by a computer.

[4] The varying levels of complexity and use of AI in banks continue to evolve. This SM does not classify AI as specifically being a model, although some uses of AI may meet the definition of a model in OCC Bulletin 2011-12. Whether AI is classified as a model can depend on how AI is being used. Regardless of how AI is classified, the associated risk management should be commensurate with the level of risk of the function that the AI supports. Additionally, while the outputs of AI are not always quantitative in nature, AI is typically based on complex mathematical techniques, which necessitates effective risk management for prudent use.

- **Marketing:** Banks can improve marketing precision by using large data sets and insights produced by AI. AI can help banks deepen customer relationships by providing financial wellness checks, offering personalized insights and recommendations, and reducing customer friction in account opening and maintenance. AI can help reduce customer acquisition costs.

- **Chatbots:** Client-facing chatbots are designed to automate routine customer interactions, such as account-opening activities and general customer inquiries, and limit the level of customer interaction with human customer service representatives. This can result in reduced costs and more efficient allocation of resources.

- **Credit risk management:** Underwriting retail loans dominated many early AI uses. Today, AI is often used to underwrite small and medium commercial loans, for portfolio monitoring, to support commercial real estate valuations, and in syndicated corporate lending and trade settlement. Banks can use AI in credit risk management to
  - enhance decision making and loss forecasting.
  - simplify and speed customer experiences while enhancing credit scoring and decisioning.
  - enhance credit monitoring (including through early warning systems), collections, restructuring, and recovery.

- **Robo-advising:** AI can use client data and preferences to automate the development of investment strategies and ongoing management of portfolios with limited human input.[5]

- **Trading algorithms and automation:** AI can create trading strategies by searching traditional and nontraditional data sets for correlations.

- **Financial and market analysis:** Banks can use text recognition, voice recognition, and natural language processing to analyze the content of earnings calls, company reporting, investor presentations, financial statements, market or industry research, media reporting, and social media activity. AI can identify insights that can augment human analysis and enhance decision making and risk mitigation in underwriting, portfolio monitoring and management, and trading.

- **Cybersecurity:** AI can help banks detect threats and malicious activity, reveal attackers, identify compromised systems, and support threat mitigation.

- **Bank Secrecy Act/anti-money laundering (BSA/AML) suspicious activity monitoring:**[6] In a departure from the traditional rule-based and intelligence system approach, banks can use AI to mine large volumes of transactions to detect potential suspicious activities across different products, business lines, and customers. Using AI has the potential to help banks comply with BSA regulations more efficiently and at a lower cost by reducing false positives

[5] Refer to the OCC Awareness Paper titled "Robo-Automated Digital Investment Advisory Services."

[6] For more information, refer to OCC Bulletin 2018-44, "Bank Secrecy Act/Anti-Money Laundering: Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing."

and focusing human analysis on reviewing transactions that are more likely to constitute reportable suspicious activity.

- **BSA/AML customer due diligence:** AI can enhance customer due diligence and quickly help build customer profiles by using data extraction from documents, visual recognition of identification, biometrics, and fast querying across large databases. Customer due diligence processes can benefit from the use of AI to enhance accuracy and reliability of documentation, automatically contact customers for outstanding documentation, and reduce labor-intensive processes.

- **Robotic process automation (RPA):** Banks can use RPA for simple, repetitive tasks normally handled by humans. Tasks include using pattern recognition algorithms to look for anomalies. For example, funds-transfer bots can correct inaccuracies in funds transfers, reconcile trades, and validate account closures.

- **Audit and independent risk management:** Banks can use AI to assist internal audit and credit risk review to increase sample size, evaluate risk, and refer higher-risk issues to human analysts.

OCC Guidance Applicable to AI

The use of AI should be managed in a safe and sound manner, consistent with applicable laws and regulations, including those related to consumer protection. In many instances, the OCC has existing supervisory guidance that addresses fundamental risk management principles applicable to banks' use of AI. The principles described in OCC guidance are intended to be risk-based and technology-neutral. Risk management and control oversight of AI should be commensurate with the risk of the business processes supported by AI.

Key examples of applicable OCC guidance are

- OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management."
- OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."
- OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles."
- OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29."

While existing OCC guidance does not explicitly mention use of AI, the guidance provides fundamental risk management principles that may apply to AI.

Supervisory Approach and Examiner Discussions With Bankers

This section provides information for examiners to use in discussions with bankers regarding current and potential uses of AI. Risk-based discussions should cover

- risk management of AI.
- transparency and controls for using AI.
- data quality and data governance.
- third-party risk management.

Risk Management of AI

AI can serve any number of functions and controls for a bank's operations. Risk management of AI should be commensurate with the risk of the activity or business process that the AI is supporting. Examiners can leverage OCC and Federal Financial Institutions Examination Council (FFIEC) guidance mentioned in this SM to help assess AI risk management. Examinations of AI risk management should generally consider whether

- the bank is performing appropriate due diligence and risk assessments as it implements AI. This assessment should include determining whether the AI is appropriate for the intended business purpose (e.g., fitness for purpose[7]). Examiners can refer to OCC Bulletin 2017-43 when assessing due diligence and change management processes for implementing AI. The level of due diligence and assessment should be commensurate with the risk of the business function or activity that the AI supports.
- the bank has enough qualified staff to implement, operate, and control the risks associated with AI. For example, the bank should have enough personnel, or access to third-party resources, with the requisite knowledge to sufficiently manage the risks associated with AI.
- the bank keeps an inventory of AI uses; identifies the level of risk associated with each use of AI;[8] establishes clear and defined parameters governing the use of AI; and has effective processes to validate that AI use provides sound, unbiased results.
- the bank has in place effective technology controls, such as system and data access, identity and authorization, system integration, separation of duties, configuration management, vulnerability management, encryption, malware controls, business resilience, system change control, monitoring and logging, data management, and other similar controls. Examiners should refer to the *FFIEC Information Technology Examination Handbook* for more information on information technology controls for banks.

For help with assessing the risk of AI, examiners should reach out to appropriate subject matter experts in their business unit, Bank Supervision Policy, Systemic Risk Identification Support and Specialty Supervision, the Risk Analysis Division in the Economics Department, and other OCC resources. These groups can help examiners maintain a consistent supervisory approach across banks as the use of AI continues to evolve.

---

[7] The AI is fit for purpose if it does what the bank (or third party) designed it to do without material unintended consequences.

[8] Risk factors may include ensuring compliance with laws, protecting customer information, or performing critical operational functions.

Transparency and Controls for Using AI

AI is typically based on complex mathematical techniques, which necessitates effective risk management for prudent use. OCC Bulletin 2011-12 addresses effective model risk management, including sound development, implementation, and use; validation; and governance, policies, and controls. The principles in OCC Bulletin 2011-12 provide a foundation for the risk management of quantitative decision-making methods and are relevant for many uses of AI. Individual attributes and characteristics of the AI drive the level and depth of risk management and governance. The bank is expected to have controls, governance, and documentation commensurate with the risk associated with the use of AI.

When reviewing AI controls, governance, and documentation, examiners should determine whether bank management has

- developed controls, such as ongoing performance monitoring,[9] to review the outcomes that the AI is producing.
- established governance and controls commensurate with risks of the bank's use of AI, considering the business purpose, materiality, and potential impact to consumers.
- adequately documented the support for key assumptions and decisions used to develop, implement, and validate the AI and confirm the effectiveness of the use of AI.

As described in OCC Bulletin 2011-12, validation is a fundamental component of model risk management. Examiners should consider validation when evaluating AI's use. Failure to adequately validate the effectiveness of AI uses may result in deficient practices, including unsafe or unsound practices, that could adversely affect the bank and its customers. In general, validation should be performed by qualified staff who are independent of AI development, who are independent of AI use, and who do not have a stake in whether the AI is determined to be valid. While there is no single standard for the type of validation expected for AI, the rigor of the process should be commensurate with the AI's use, risk, and operations being supported. Some of the techniques that can be used include back testing and other checks for accuracy and performance over time, and impact assessments if the AI does not perform as expected. Banks that lack qualified staff for validation may need to rely on third-party resources or independent audit for validation. The rigor of validation still depends on such factors as the criticality of the business processes using AI or the potential impact on consumers.

Per OCC Bulletin 2011-12, conceptual soundness is an important component of validation. One challenge in evaluating the conceptual soundness of AI is that, due to complexity, the workings of the AI are often not transparent. Transparency and "explainability" are key considerations that should be evaluated as part of effective risk management regarding the use of AI. Within the AI community, "explainability" is the extent to which AI decisioning processes and outcomes are reasonably understood by bank personnel.

[9] Ongoing performance monitoring is one of many techniques that banks can use to check that the results of the AI are within the bounds of what was expected or considered reasonable for the specific business use or purpose.

The appropriate level of explainability of an AI outcome depends on the specific use and level of risk associated with that use. AI applied to significant operations or decisions (e.g., credit underwriting decisions) should be supported by thorough understanding of how the AI arrived at its conclusions and validation that it is operating as intended. There may be challenges with explaining some AI based on complexity or, in some cases, limited documentation provided for third-party solutions. Examiners should discuss with bank management the bank's process for exploring various approaches to determine whether bank personnel have an understanding of how AI functions and makes decisions, including identifying any limitations and use of compensating controls.

Data Quality and Data Governance

Data quality and governance are critical to the effective use of AI, because many uses heavily depend on large volumes of data. Understanding data sources, quality, and limitations is a key aspect of sound data governance. Examiners should discuss data management programs with bank management. Risk management is expected to be commensurate with the data complexity and use. Bank management and staff are expected to fully understand and control risks associated with the data involved.

Proper data governance is important for identifying possible biases in the data, particularly if the AI is using nontraditional (or alternative) data sources.[10] While no individual variable may itself be inherently biased, the complex interactions that are typical of AI use could lead to unintended impacts or outcomes, with the source of the bias being obscured by the model's complexity. Bank management should be aware of risks associated with potential biases, such as potential reputation and compliance risks, and consider whether data biases could result in disparate impact on a prohibited basis. The bank should have processes to monitor data and mitigate potential adverse outcomes from data quality issues.

Third-Party Risk Management

Banks might rely on AI solutions provided by a third party. As with other third-party relationships, examiners should determine whether the bank includes third-party AI in its third-party risk management process. OCC Bulletin 2013-29 provides approaches for assessing and managing risks associated with third-party relationships. The fundamental concepts of due diligence, contract management, and ongoing monitoring apply to a bank's use of third-party AI; there are, however, specific considerations for using third-party AI solutions that examiners should assess, including the following:

- Whether due diligence processes include a thorough assessment and understanding of documentation for AI product components, design, and suitability for intended use.
- Whether contract provisions address ownership of the AI and data used, documentation provided, testing and validation expectations, update and maintenance of models,

[10] For more information on alternative data, refer to OCC Bulletin 2019-62, "Consumer Compliance: Interagency Statement on the Use of Alternative Data in Credit Underwriting."

communication of changes to the model or data inputs, relationship termination, and other key controls for AI use.
- Whether bank management has sufficient expertise to evaluate and understand data sources and outputs, especially if the third party is leveraging nontraditional data.
- Whether bank management properly assesses ongoing performance monitoring and outcomes analysis for use of the AI. This should include an assessment of information on updates and modifications to the AI products.

Examiners should determine whether bank management appropriately validates third-party AI. When banks do not have the ability to independently validate AI, examiners should determine whether the banks have evaluated independent testing results documenting that the AI products work as expected (for the specific use at each specific bank). This documentation should include any identified limitations or assumptions.

Examiners should verify that customization choices and configurations for AI uses are documented and adequately supported as part of validation. If a third party supplies input data or assumptions, or uses them to build models, bank management should obtain information regarding the data used to develop or train the AI and assess the extent to which those data are representative of the bank's situation.

OCC Ongoing Oversight of Banks' Use of AI

As adoption of AI increases in the federal banking system, the OCC continues to adjust supervisory approaches to effectively monitor banks' risk management. The OCC actively engages with other regulators and the industry to better understand the evolving nature of banks' use of AI. Examiners should continue to focus on identifying banks' use of AI and determine whether risk management practices are commensurate with the activities being supported by AI.

Resources for Examiners

For more information about the use of AI by banks or specific AI companies working with banks, examiners should reach out to the Office of Innovation or the Operational Risk Policy Division. Further, the OCC, along with other federal financial regulatory agencies, has issued various guidance and supervisory materials to help banks apply sound risk management principles. These principles may apply to assessing risk to banks and the banking system from the use of AI.

- OCC Bulletin 2011-12, "Sound Practices for Model Risk Management: Supervisory Guidance on Model Risk Management"
- OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"
- OCC Bulletin 2017-7, "Third-Party Relationships: Supplemental Examination Procedures"
- OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles"
- OCC Bulletin 2018-44, "Bank Secrecy Act/Anti-Money Laundering: Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing"

- OCC Bulletin 2019-62, "Consumer Compliance: Interagency Statement on the Use of Alternative Data in Credit Underwriting"
- OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29"
- OCC Innovation Brief, "Artificial Intelligence"
- OCC Office of Innovation Awareness Paper, "Robo-Automated Digital Investment Advisory Services"
- *FFIEC Information Technology Examination Handbook*
- Financial Stability Board, "Artificial Intelligence and Machine Learning in Financial Services: Market Developments and Financial Stability Implications" (November 2017)

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2020-06

To: All Examining Personnel

From: Grovetta N. Gardineer, Senior Deputy Comptroller for Bank Supervision Policy

Date: June 1, 2020

Subject: Temporary Guidance for Compliance-Related Supervisory Activities During the COVID-19 Emergency

---

Purpose

This supervisory memorandum (SM) provides examiners with temporary guidance for conducting compliance-related supervisory activities at national banks, federal savings associations, and federal branches and agencies of foreign banking organizations (collectively, banks) in light of the coronavirus (also known as COVID-19) national emergency.[1]

This SM addresses a range of compliance issues and provides references to related guidance and other information. Examiners are encouraged to use the parts of the SM that are relevant and useful for their supervisory activities and as directed by their supervisory office. Examiners may use this guidance for compliance-related supervisory activities through December 31, 2020.[2] Specifically, examiners can use the guidance and information in this SM to

- hold discussions with bank management regarding banks' COVID-19-related actions pertaining to Bank Secrecy Act/anti-money laundering (BSA/AML), the Community Reinvestment Act (CRA), fair lending, and consumer compliance (refer to appendix A of this SM). The outcome of discussions with bank management could result in adjustments to the supervisory strategy, as explained in appendix B of this SM.
- conduct required compliance supervisory activities[3] during the COVID-19 emergency, including conducting activities off-site (refer to appendix B of this SM).

---

[1] The President declared a national emergency on March 13, 2020.

[2] This date may change depending on the length of the COVID-19 national emergency.

[3] Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* and SM 2018-08, "Frequency and Scope of Compliance Activities."

Examiners should continue to use the Office of the Comptroller of the Currency's (OCC) risk-based approach to supervision.[4]

Background

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act[5] was signed into law to provide emergency assistance and health care response to individuals, families, and businesses affected by COVID-19. The federal banking agencies provided temporary regulatory relief to assist banks in their efforts to operate during the national emergency and meet the financial service needs of bank customers. Refer to the COVID-19-related guidance issued by the OCC and other agencies on OCCnet.

The OCC encourages banks to take steps to meet the financial service needs of customers adversely affected by COVID-19. For example, banks may be able to help affected customers by waiving fees, offering repayment accommodations, extending payment due dates, or increasing daily withdrawal limits at ATMs.[6]

The CARES Act includes several requirements that may apply to banks and their customers, including

- funding for emergency small-business-related loan programs (i.e., Paycheck Protection Program [PPP] loans).
- issuance of stimulus payments to certain individuals (i.e., economic impact payments).
- suspension of principal and interest payments for certain federal student loans.
- credit reporting protections for borrowers who receive a COVID-19-related payment deferral, loan forbearance, or loan modification of all types of loans.
- requirements for creditors to provide certain forbearance and foreclosure protections with respect to federally backed mortgage loans and COVID-19-affected borrowers.
- temporary waiver of required minimum distribution amounts in 2020 for certain defined contribution plans and individual retirement accounts.

[4] Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for more information.

[5] Refer to Pub. L. 116-136.

[6] Refer to OCC Bulletin 2020-15, "Pandemic Planning: Working With Customers Affected by Coronavirus and Regulatory Assistance," for more information.

Appendix A: Discussions With Bankers

Examiners can use the information in this appendix to hold discussions with bankers regarding COVID-19-related activities. The information obtained from these discussions may inform future supervisory activities or identify risks that warrant revising the supervisory strategy, as explained in appendix B of this SM.

Banks' COVID-19 Change Management

Examiners are encouraged to discuss possible COVID-19-related change management actions with bank management. Examiners can focus on the following as key takeaways:

- How are banks identifying and implementing COVID-19-related changes and requirements (e.g., applicable CARES Act or other legislative requirements)?
- Are banks assisting COVID-19-affected customers beyond legislative requirements (e.g., providing loan modifications outside of CARES Act requirements or temporarily waiving certain fees)?
- Are banks working with applicable third parties (e.g., third-party mortgage servicers) to ensure timely and adequate actions?
- Have banks assessed whether staffing is adequate to manage potential increases in customer requests for assistance (e.g., COVID-19-related loan modifications or forbearance)?

Banks' change management processes generally include input from subject matter experts in specific bank units (e.g., lending, deposits, compliance, audit, and legal) to help respond to regulatory changes or during implementation of new, modified, or expanded products or services (collectively, new activities).[7] Similarly, subject matter experts may help bank management identify applicable requirements related to the CARES Act and other legislative actions or help with implementing banks' efforts to meet customers' COVID-19-related needs.

Many banks rely on third parties to manage some or all of the operational aspects associated with the banks' products or services, for example, the banks' residential mortgage loan portfolios.

[7] For more information, refer to OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles."

Examiners are also encouraged to discuss with bank management

- CARES Act requirements related to federally backed one- to four-family mortgage loans,[8] including forbearance requirements, foreclosure protections, and the bank's reliance on any third parties to manage these or other COVID-19-related provisions.[9]
- CARES Act forbearance requirements related to federally backed multifamily mortgage loans.[10]
- the process to determine borrower eligibility for CARES Act-required forbearance and the method for communicating forbearance terms to borrowers.
- whether the bank provides forbearance for loans not covered under the CARES Act and, if so, the bank's process to determine eligibility and the method for communicating forbearance terms to borrowers.
- the bank's communication of temporary account modifications to customers, including time frames for modifications (e.g., temporary waiver of overdraft or ATM fees) and communication plans when temporary modifications end and when normal business operations resume.
- processes for paying any items escrowed on behalf of borrowers (e.g., property taxes or hazard, flood, or private mortgage insurance premiums) when COVID-19 mortgage loan forbearance agreements defer borrowers' payments that include escrow.
- participation in the PPP and the process for providing PPP loans. For example, is the bank only accepting applications from existing small business customers or is the bank also accepting applications from non-customers? Discussions may include
  - the OCC's recommendations that banks prudently document their implementation and lending decisions.[11]
  - processes for identifying and tracking PPP loans to small business borrowers for potential CRA consideration.
  - adjustments to applicable BSA/AML processes, using a risk-based approach, to address reliance on PPP application forms.

[8] A "federally backed one- to four-family mortgage loan" is any loan secured by a one- to four-family residential real property that is originated, insured, or guaranteed by certain government agencies or purchased or securitized by Freddie Mac or Fannie Mae.

[9] For federally backed one- to four-family mortgage loans, the CARES Act requires that forbearance be granted without penalty, fees, or interest for an initial period of up to 180 days and is subject to an additional 180-day extension at the request of the borrower. The CARES Act also prohibited foreclosure actions for the 60-day period beginning March 18, 2020. Refer to OCC Bulletin 2020-32, "Mortgage Servicing: Joint Statement on Supervisory and Enforcement Practices Related to Provisions of the CARES Act."

[10] A "federally backed multifamily mortgage loan" is any loan secured by a property comprising five or more dwelling units that is originated, insured, or guaranteed by certain government agencies or purchased or securitized by Freddie Mac or Fannie Mae. For federally backed multifamily mortgages loans, section 4023 of the CARES Act requires, with certain limitations, that forbearance be granted for up to 30 days and can be extended for up to two additional 30-day forbearance periods at the request of the borrower.

[11] Refer to OCC Bulletin 2020-45, "Credit Administration: Documentation of SBA Paycheck Protection Program Loans," for more information.

  - processes to collect and verify beneficial ownership information, when applicable,[12] within a reasonable period of time after extending PPP loans to new and existing customers.
- measures that the bank has taken to ensure fair treatment of individuals and small businesses covered by fair lending laws and regulations while implementing provisions of the CARES Act, including the PPP, and what banks are doing to monitor fair treatment (e.g., conducting fair lending or complaints analysis).
- processes to implement CARES Act credit reporting obligations.[13]
- processes for allowing customers to make more than six "convenient transfers" (e.g., electronic transfers via the bank's website) from "savings deposits" (e.g., savings accounts) per month or statement period, as permitted under the Regulation D interim final rule.[14]
- whether the bank has implemented other applicable protections or flexibilities afforded to the bank's customers not already discussed with examiners.
- staffing needs if compliance or operational activities performed by the bank or its third parties have been disrupted or delayed due to COVID-19 (e.g., processes to report accurate information to credit bureaus or to correct previously reported inaccurate information).
- communications and training to applicable bank staff, which could include
  - training for staff transitioned into new roles or responsibilities due to current circumstances in relation to COVID-19-related provisions (e.g., applicable CARES Act provisions).
  - communications and training regarding any bank actions to address customers' needs (e.g., providing loan modifications or waiving fees, and processing customer inquiries or complaints).
  - communications and training for bank staff or third parties for certain areas, based on risk. For example, a bank that experiences an increase in Servicemember Civil Relief Act (SCRA) benefit requests (e.g., interest rate protections) due to increased National Guard active duty call-ups may identify a need to provide applicable staff refresher training or information regarding the bank's procedures for determining SCRA eligibility and processing SCRA benefits.

[12] Refer to the Financial Crimes Enforcement Network's Paycheck Protection Program Frequently Asked Questions, published on April 13, 2020, for more information.

[13] Refer to section 4021 of Pub. L. 116-136 (codified as 15 USC 1681s–2(a)(1)). Refer also to the Consumer Financial Protection Bureau's (CFPB) "Statement on Supervisory and Enforcement Practices Regarding the Fair Credit Reporting Act and Regulation V in Light of the CARES Act" (April 1, 2020).

[14] Refer to the Board of Governors of the Federal Reserve System's press release "Federal Reserve Board Announces Interim Final Rule to Delete the Six-Per-Month Limit on Convenient Transfers From the 'Savings Deposit' Definition in Regulation D" (April 24, 2020).

Banks' COVID-19 Challenges

In discussions with bank management, examiners can focus on the challenges that banks face as they respond to customers' COVID-19-related financial service needs. For example:

- Is the bank experiencing challenges with software or systems that may not easily accommodate certain forbearance or loan modification terms?
- Are third parties responsive to the bank's efforts to meet customers' financial service needs?
- Is the bank receiving higher than usual volumes of customer complaints or other communications? If so, examiners should determine the types of complaints that are increasing. Has the bank been able to resolve complaints in a timely manner?[15]
- How are important functions, such as compliance monitoring or audit, operating? Is the bank completing reviews and audits as originally scheduled?
- Is the bank experiencing any challenges with managing its BSA/AML or Office of Foreign Assets Control (OFAC) programs due to COVID-19?
- How is the bank maintaining records and documentation for PPP decisions?
- Is the bank experiencing delays or challenges issuing necessary customer disclosures within required time frames (e.g., due to staffing shortages)?

Banks may face challenges with making settings or parameter changes in processing or loan systems to accommodate modifications to deposit or loan accounts (e.g., automatically waiving overdraft fees for deposit accounts or deferring payments for loan accounts). Additionally, systems may not be able to accommodate certain CARES Act requirements, such as Fair Credit Reporting Act requirements.

In their discussions with bank management, examiners are encouraged to inquire about these challenges and ask what steps banks are taking to resolve such challenges. For example, some banks may need to contact their service providers to understand how to properly establish temporary settings or parameter changes and how to properly reset those settings and parameters, as circumstances change. In some instances, system limitations may require banks (or their third-party servicers) to make manual adjustments to loan accounts to accommodate modification or forbearance agreements (e.g., differences between forbearance agreements and how systems actually handle items such as interest accrual).

Banks participating in the PPP may encounter challenges from a potentially high volume of small business applicants requesting PPP loans. Examiners are encouraged to discuss PPP challenges with bank management and inquire whether management has considered how to

- document supporting rationale for PPP business decisions and communicate business decisions to applicable staff for consistent application.

[15] For more information on analyzing complaint data during the supervisory process, refer to NRC Supervision Tip 2018-02, "Customer Complaint Data Review." Refer to the "Compliance Management Systems" booklet of the *Comptroller's Handbook* for information regarding supervisory review of the bank's complaint resolution processes.

- obtain and document information for SBA compliance purposes.
- document supporting rationale for individual PPP loan application decisions (e.g., originations or denials) for fair lending purposes.

Banks may see higher volumes of customer inquiries, complaints, or other concerns as a result of COVID-19. For example, customers may communicate concerns regarding delays or other issues with the bank or the bank's servicer processing COVID-19-related forbearance or modification requests. In processing these requests, the bank needs to consider the information it furnishes to credit reporting agencies[16] and should consider how the same information is recorded on the bank's own books and records.[17] Examiners are encouraged to ask bank management about steps the bank is taking to identify, manage, and analyze COVID-19-related customer inquiries, complaints, or concerns, including those received by or regarding applicable third parties (e.g., the bank's third-party mortgage servicer). Like with other customer communications, banks are encouraged to analyze customers' COVID-19-related communications to determine their severity and whether any concern should be escalated due to higher risk. For example, a COVID-19-related customer communication that alleges unfair treatment of a borrower's forbearance request may need to be escalated within the bank to address potential fair lending risks.

Banks may be experiencing challenges with maintaining their BSA/AML or OFAC programs due to COVID-19 issues (e.g., challenges with obtaining beneficial ownership information from PPP borrowers, delays in obtaining information from COVID-19-affected customers, delays in reviewing customers' banking activities, or delays in filing certain BSA- or OFAC-required reports). Examiners are encouraged to discuss any such challenges with bank management and to inquire whether management has considered

- prioritizing, based on risk, BSA/AML and OFAC compliance responsibilities during the COVID-19 emergency.
- how the bank will address any COVID-19-related delays within a reasonable time frame once normal operations resume.

[16] Refer to section 4021 of Pub. L. 116-136 (codified as 15 USC 1681s–2(a)(1)). Refer also to the CFPB's "Statement on Supervisory and Enforcement Practices Regarding the Fair Credit Reporting Act and Regulation V in Light of the CARES Act" (April 1, 2020).

[17] Refer to OCC Bulletin 2020-35, "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working With Customers Affected by COVID-19 (Revised)."

- communicating any such challenges or delays to the OCC, the Financial Crimes Enforcement Network (FinCEN), or OFAC.[18]

Banks may need to adjust or postpone compliance monitoring or audit schedules due to COVID-19-related requirements for staff (including relied-upon third-party audit staff). For example, compliance monitoring or audit subject matter experts may need to telework for an extended period or may be allocated to address COVID-19 change management needs. Additionally, banks may need to assess appropriateness of actions taken in response to COVID-19 once the national emergency ends. Examiners are encouraged to ask bank management whether COVID-19 is affecting the bank's monitoring or audit of high-risk compliance areas and whether the bank has identified how it will address compliance monitoring and audit schedules once normal operations resume.

[18] Refer to OCC Bulletin 2020-34, "OCC Supports FinCEN's Regulatory Relief and Risk-Based Approach for Financial Institution Compliance in Response to COVID-19," and U.S. Department of the Treasury, OFAC, "Fact Sheet: Provision of Humanitarian Assistance and Trade to Combat Covid-19" (April 16, 2020). The FinCEN COVID-19 notice referenced in OCC Bulletin 2020-34 announces the creation of a COVID-19-specific contact mechanism, via a specific drop-down category, for financial institutions to communicate with FinCEN regarding COVID-19-related concerns while adhering to their BSA obligations. Such COVID-19-related communications are strongly encouraged by FinCEN but are not required. Banks are also encouraged to keep FinCEN and the OCC informed as their circumstances change. In addition, the OFAC COVID-19 notice similarly encourages financial institutions affected by COVID-19 to contact OFAC as soon as practicable if the financial institution believes it may experience delays in its ability to meet deadlines associated with regulatory requirements administered by OFAC.

Appendix B: Scoping and Planning Compliance Activity Considerations in Light of the COVID-19 National Emergency

Examiners can use the following information when determining how to meet the supervisory requirements communicated in SM 2018-08, "Frequency and Scope of Compliance Activities," during COVID-19 and as the OCC and banks transition out of the emergency.

SM 2018-08 contains the OCC's policy for conducting compliance supervisory activities during each supervisory cycle.[19] As discussed in SM 2018-08, some compliance examination activities are required by statute, whereas others are required based on OCC minimum standards or interagency commitments. In general, SM 2018-08 requires completion of the following compliance activities during each supervisory cycle:

- BSA/AML examinations, including risk-based testing and review of the bank's OFAC risk assessment and independent OFAC testing to determine the extent to which a review of the bank's OFAC compliance program should be conducted.
- Flood Disaster Protection Act (FDPA) examinations with risk-based transaction testing required at least once during each three-cycle strategy planning period.[20]
- Fair lending risk assessment activities.
- SCRA risk assessment activities with SCRA examination activities (including transaction testing) conducted at least once during each three-cycle strategy planning period.
- Assignment of the consumer compliance component rating[21] and assessment of the bank's compliance risk using the OCC's Risk Assessment System.[22]

CRA evaluations are not conducted during each supervisory cycle but have an established frequency. CRA evaluation timing and requirements are set by statute and regulation and specified by OCC policy, based mainly on the bank's asset size and previous CRA performance.[23]

[19] A supervisory cycle is either a 12-month or an 18-month period and is dependent on a bank's size and performance. Refer to 12 USC 1820(d) and 3105(c), and 12 CFR 4.6 and 4.7.

[20] For banks on a 12-month supervisory cycle, the three-cycle strategy spans a 36-month period. For banks on an 18-month supervisory cycle, the three-cycle strategy spans a 54-month period.

[21] Refer to the "Bank Supervision Process" booklet of the *Comptroller's Handbook* for information regarding the Uniform Interagency Consumer Compliance Rating System.

[22] Refer to the "Bank Supervision Process," "Community Bank Supervision," "Federal Branches and Agencies Supervision," or "Large Bank Supervision" booklets of the *Comptroller's Handbook* for more information.

[23] Refer to SM 2019-03, "Supervisory Policies and Procedures for Community Reinvestment Act Performance Evaluations," for more information.

Supervisory Activities During the COVID-19 Emergency

Examiners may be able to leverage information gathered from their COVID-19-related discussions with bank management to scope, plan, and complete compliance supervisory activities, including those required by SM 2018-08. Additionally, examiners should consider banks' good faith efforts to comply with applicable laws and regulations during the COVID-19 emergency. The OCC supports and generally will not criticize banks' efforts to accommodate COVID-19-affected customers in a safe, sound, and fair manner.[24]

Examiners are encouraged to consider the following factors when making adjustments to compliance strategies as a result of COVID-19:

- Bank-specific circumstances, such as emergency actions taken by the bank (e.g., bank closures) and the availability of bank resources and information.
- Whether the activity's scope can be reduced, or if the activity can be postponed. While certain procedures and testing may be required, examiners may have flexibility, based on risk, on how to complete these procedures and areas of testing.[25]
- Whether supervisory activities can leverage work done by the bank's first, second, or third lines of defense, especially if the OCC has determined those control systems[26] to be adequate in relation to the bank's size, complexity, and risk profile.
- Whether supervisory activities can leverage work performed by other examiners or other agencies (e.g., OCC examinations focusing on the bank's audit program or the bank's third-party risk management processes, or compliance management systems examinations conducted by the Consumer Financial Protection Bureau).
- Whether testing can leverage data obtained from sources other than the bank (e.g., FinCEN).
- Whether limiting or omitting testing from data integrity examinations is appropriate. Factors to consider include the following:
  - Evaluate the adequacy of internal audit testing of Home Mortgage Disclosure Act (HMDA) data and determine the extent to which the OCC can rely on the audit work.
  - Combine years to select samples, such as
    - a single sample for 2018 and 2019 HMDA data (2017 HMDA data requires a different sampling approach than 2018-future), or
    - a single sample for all years of CRA loan data.
  - If the OCC concluded in previous work that bank policies, processes, personnel, and control systems around data collection, testing, and reporting are adequate; and if there

[24] Refer to OCC Bulletin 2020-15.

[25] Refer to appendix A of this SM for more information.

[26] Control systems are the functions (such as internal and external audits, risk review, quality control, and quality assurance) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes and personnel. Refer to the "Corporate and Risk Governance" booklet of the *Comptroller's Handbook* for more information.

have not been any significant changes to policies, processes, personnel, or control systems.

- Whether strategy adjustments require supervisory office or Compliance Risk Policy (CRP) consultation and approval.
- The effect of off-site work, scope reductions, and related bank challenges on examination staffing, workdays, and completion time frames.
- The effect of examination scope adjustments on examiner developmental needs.

If examiners adjust compliance strategies, examiners should also review and adjust request letters so only needed bank information or records are requested (i.e., eliminate any requests for information that are no longer required as a result of adjusted strategies).

BSA/AML and OFAC Activities

Examiners are required to review a bank's BSA compliance program during each supervisory cycle.[27] The scope of the examination activities must include the minimum procedures applicable to each bank (including conducting risk-based testing), plus any additional procedures based on BSA/AML risk.

When determining the scope of the examination, examiners are encouraged to consider any challenges the bank may have experienced with maintaining its BSA/AML or OFAC programs due to COVID-19 issues (e.g., challenges with obtaining beneficial ownership information from PPP borrowers, delays in reviewing COVID-19-affected customers' banking activities, or delays in filing certain BSA- or OFAC-required reports).[28] For example:

- If the bank experienced delays in gathering and verifying all necessary beneficial ownership information for PPP borrowers due to COVID-19, has the bank taken appropriate action to complete required beneficial ownership verification responsibilities within a reasonable period of time?
- Did the bank experience delays in reviewing customers' banking activities or in filing certain BSA- or OFAC-required reports (e.g., due to challenges with setting up off-site working capabilities or off-site records access for staff)? If so, did the bank implement appropriate risk-based procedures during the COVID-19 emergency for continuity of higher-risk functions and responsibilities? If the bank delayed lower-risk functions or responsibilities, what was bank management's rationale for the decision to delay these functions or responsibilities, and what is management's plan to address them within a reasonable period of time?

[27] Refer to 12 USC 1818(s)(2).

[28] Refer to OCC Bulletin 2020-34 and to U.S. Department of the Treasury, OFAC, "Fact Sheet: Provision of Humanitarian Assistance and Trade to Combat COVID-19" (April 16, 2020). Both FinCEN and OFAC have acknowledged that there may be delays in filing required reports in response to COVID-19. Also refer to "The Office of Foreign Assets Control (OFAC) Encourages Persons to Communicate OFAC Compliance Concerns Related to the Coronavirus Disease 2019 (COVID-19)" (April 20, 2020).

- If the bank uses third parties for BSA/AML or OFAC functions, are any of these third parties located in areas and countries that were severely affected by COVID-19? If so, did the bank implement existing contingency plans and processes to shift these processes and resources and did shifted functions (e.g., monitoring or reporting functions) adequately continue?

Flood Disaster Protection Act Activities

Examiners are required to determine a bank's compliance with FDPA requirements each supervisory cycle.[29] Examiners should consider any effects COVID-19 may have on consumers and on the operations of banks. Accordingly, examiners should generally not take supervisory or enforcement action against a bank for reasonable delays in complying with the flood determination, notice to borrowers, and escrow requirements of the FDPA, provided that the bank made good faith efforts to support borrowers and comply with these requirements. Examiners should also consider the effectiveness of bank management's response and corrective action to previous or existing violations, matters requiring attention, or enforcement actions when assessing FDPA compliance. OCC policy requires examiners to complete risk-based FDPA testing at least once during each three-cycle strategy planning period. Examiners are encouraged to consider FDPA-related actions the bank took during the COVID-19 emergency and the OCC's three-cycle strategy planning when assessing the bank's FDPA compliance or when determining testing needs. For example:

- When processing borrowers' COVID-19-related forbearance or loan modification requests, did the bank
  - identify whether the applicable loan was covered by the FDPA?
  - determine whether the forbearance or modification triggered FDPA requirements (i.e., did the bank make, increase, renew, or extend an FDPA-applicable loan as a result of the forbearance or modification)?
  - determine, as applicable, whether appropriate flood insurance coverage was in place before completing the forbearance or modification request?
- Is FDPA transaction testing necessary during the current supervisory cycle?
  - Has transaction testing been performed in at least one of the previous two supervisory cycles?
  - Is the bank's FDPA-related risk low in relation to the low risk attributes listed in SM 2018-08?
  - Can the bank provide documentation for examiners to review in determining the bank's compliance with the FDPA in lieu of transaction testing (e.g., formal policies and procedures, training materials and records, or compliance monitoring or audit reports)?

Community Reinvestment Act Activities

Examiners are encouraged to review any scheduled CRA activities with the supervisory office and CRP, as applicable, to determine any potential COVID-19-related challenges with

[29] Refer to 12 USC 1820(i).

completing a scheduled activity (e.g., inability to be on-site at the bank, bank or OCC staffing issues, or the bank's inability to transmit requested records remotely). The supervisory office is encouraged to consider a bank's specific CRA circumstances (including past performance) as well as any available scheduling windows or deferral periods[30] when determining whether CRA assessment activities are needed at a bank during the current supervisory cycle.

If the supervisory office determines a CRA evaluation must be completed during the current supervisory cycle (based on the bank's CRA risks or as a result of scheduling windows and deferrals being exhausted), examiners are encouraged to consider, as part of that evaluation, retail banking services and retail lending activities in the bank's assessment areas that are particularly responsive to the needs of low- and moderate-income individuals, small businesses, and small farms affected by COVID-19 and that are consistent with safe and sound banking practices.[31]

Servicemember Civil Relief Act Activities

OCC policy requires examiners to assess a bank's SCRA risk each supervisory cycle and to conduct SCRA examinations (including transaction testing) at banks at least once during a three-cycle strategy planning period. When assessing a bank's SCRA risk or when determining SCRA transaction testing needs, examiners may consider the bank's SCRA-related activities conducted during the COVID-19 emergency as well as the OCC's three-cycle strategy planning. For instance:

- Did the bank receive requests for the SCRA's 6 percent interest rate protections?
- Has the bank experienced an increase in foreclosure or repossession activity associated with loans that did not require or did not qualify for COVID-19-related forbearance or modification?
- Is an SCRA examination (including transaction testing) necessary during the current supervisory cycle?
  - Has an SCRA examination (including transaction testing) been conducted in at least one of the previous two supervisory cycles?
  - Is the bank's SCRA-related risk low in relation to the low-risk attributes listed in SM 2018-08?
  - Can the bank provide documentation for examiners to review in determining the bank's compliance with the SCRA in lieu of transaction testing (e.g., formal policies and procedures, training materials and records, or compliance monitoring or audit reports)?

[30] Refer to SM 2019-03. If additional scheduling flexibility is needed beyond the general policy limitations, examiners should consult their supervisory office and their Compliance Lead Expert, who will consult with CRP if the deferral raises policy concerns.

[31] Refer to OCC Bulletin 2020-19, "Joint Statement on Community Reinvestment Act Consideration for Activities in Response to COVID-19," for more information.

Fair Lending Activities

OCC policy requires examiners to identify and assess fair lending risks during each supervisory cycle.[32] Examiners may incorporate relevant information obtained while reviewing the bank's internal fair lending risk assessment when completing the OCC fair lending risk assessment. Examiners may need to consider the bank's response to the financial service needs of COVID-19-affected customers when assessing the bank's fair lending risk. For example:

- If the bank extended PPP loans to small business borrowers, did the bank develop policies and procedures to adequately document and communicate business decisions, including the bank's decisions regarding whether to accept applications from all applicants or only from existing customers?
- Did the bank document implementation decisions—such as the bank's business justifications and any alternatives considered—when setting eligibility criteria, establishing processes for considering applications, and approving or denying PPP applications?[33]
- Has the bank updated its compliance monitoring or audit, including fair lending monitoring, to include review of borrowers' COVID-19-related requests or applications (including requests or applications submitted to applicable third parties, such as a bank's third-party mortgage servicer) for
  - forbearance or loan modifications?
  - COVID-19-related loans or services (e.g., COVID-19-related small dollar lending)?

Examiners are encouraged to review any scheduled or potential fair lending examinations with the supervisory office and CRP, as applicable, to determine

- potential COVID-19-related challenges with completing a scheduled examination (e.g., inability to be on-site at the bank, bank or OCC staffing issues, or the bank's inability to transmit requested records remotely).
- whether, based on the bank's fair lending risks, a fair lending examination is needed during the scheduled time frame and, if so, the appropriate scope and focal points.

Other Compliance Activities

Examiners are encouraged to consider how COVID-19 has affected a bank's compliance risk when considering other compliance activities, including other risk-based activities scheduled in

[32] Examiners are required to use the OCC's Fair Lending Risk Assessment Tool (FL RAS Tool) when assessing fair lending risk in banks with total assets of $500 million to less than $10 billion. For all other banks, examiners are permitted and encouraged to use the FL RAS Tool at banks with total assets less than $500 million or $10 billion or more.

[33] Refer to OCC Bulletin 2020-45 and to the CFPB's Equal Credit Opportunity Act and Regulation B FAQs related to the COVID-19 emergency (May 6, 2020).

the three-cycle planning period.[34] A low-risk activity that is minimally affected by COVID-19 may need to be delayed or substituted with an area with increased compliance risks due to COVID-19. For example, if the bank experiences a high volume of COVID-19-related mortgage forbearance or modification requests, a mortgage servicing-related activity may need to be scheduled. Examiners should consult the supervisory office to determine whether planned risk-based activities should be modified based on the bank's risks, as well as any COVID-19-related challenges (e.g., inability to be on-site at the bank, bank or OCC staffing issues, or the bank's inability to transmit requested records remotely).

Considerations for Off-Site Supervisory Activities

Examiners are encouraged to consider the unique challenges banks may be facing as a result of COVID-19 when requesting information to conduct work off-site and when assessing banks' efforts to operate in a safe and sound manner.[35] Banks may not have easy or quick access to systems or documents, or the necessary people readily available to respond timely to examiners' information requests.

Examiners are encouraged to consider the following best practices to ensure clear communication channels and sufficient remote-access capability between examiners and the bank throughout any off-site activities:

- Speak with bank management about implementing secure remote access to bank systems where possible and test such access to the bank's systems before the start of any supervisory activity.[36]
- At the start of the examination, collect and share all contact information for the examination team and appropriate bank management (e.g., mobile phone numbers and email addresses).
- Establish regular conference calls (e.g., daily or weekly) with the examination team to share examination findings and track progress throughout the examination.
- Conduct a virtual kick-off meeting with the examination team and bank management during the first week of the examination to
  - establish rapport with bank management.
  - discuss examination expectations and any changes to the scope.
  - clarify logistics for performing the off-site examination.
- Discuss communication protocols and preferences with bank management (e.g., email, telephone, or video conference).

[34] Refer to the COVID-19-related guidance issued by the OCC and other agencies on OCCnet. The guidance may provide, for example, additional information with respect to remittances, credit cards, mortgages, fair credit reporting, and other products as applicable to the scope of the examination.

[35] Refer to OCC Bulletin 2020-15.

[36] Refer to PPM 4000-4-4, "Accessing and Managing Financial Supervision Information," for the OCC's policies regarding remote access to banks' systems.

- Establish regular calls or virtual meetings (e.g., weekly or biweekly) with bank management to provide examination updates.
- Establish agreed-upon core work hours for the bank and the examination team; consider any flexibilities that might be offered for working outside of these hours (e.g., for examination staff whose personal circumstances require scheduling flexibilities).
- Update the applicable OCC information systems (i.e., Examiner View or eDocs) daily, including attaching or uploading work papers or support documentation so lead examiners may track status of assignments, findings, and conclusions.
- Use efficiency tools, such as OneNote, to assist with examination organization and document sharing among examination team members, and to track examination concerns or observations.[37]

[37] Refer to PPM 4000-4-4 for the OCC's policies regarding retention and deletion of financial supervision information.

Office of the
Comptroller of the Currency
Washington, DC 20219

SUPERVISORY MEMORANDUM

SM 2020-08

To: All CBS Personnel

From: Committee on Bank Supervision

Date: October 1, 2020

Subject: Fiscal Year 2022 Bank Supervision Strategy Planning Guidance

---

Attached is the Committee on Bank Supervision's (CBS) strategy planning guidance for fiscal year (FY) 2022. The guidance sets forth strategic priorities and objectives for FY 2022, which commences October 1, 2021, and concludes September 30, 2022. Supervision managers and staff should review and use this guidance to benchmark their supervisory priorities, planning, and resource allocations for FY 2022.

This strategy planning guidance aligns with "The Office of the Comptroller of the Currency's (OCC) Strategic Plan, Fiscal Years 2019–2023" Goal 1 (*The OCC fosters a safe, sound, and fair federal banking system that is a source of economic strength and opportunity that meets the evolving needs of consumers, businesses, and communities*), as well as the National Risk Committee's risk priorities. The OCC will maintain risk-based coverage of key risks at individual banks and service providers, but the risk issues in this FY 2022 strategy planning guidance will be supervisory priorities in all operating units. Throughout this guidance and in all risk areas, examiners should consider the residual impacts of the pandemic, particularly in credit portfolios.

When developing individual strategies, examiners should first consider the minimum work necessary to meet statutory mandates. This includes issuing reports of examination; maintaining accurate CAMELS/ITCC,[1] URSIT,[2] and risk assessment system ratings; and conducting statutorily required compliance assessments. Examiners should allocate resources to perform enforcement action assessments and follow-up work on matters requiring attention (MRA) and concerns, as applicable. Examiners should then consider work required to meet agency priorities, such as National Risk Committee-identified risk areas or work necessary to support agency

---

[1] CAMELS integrates ratings from six component areas: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. ITCC refers to ratings on information technology, trust, consumer compliance, and the Community Reinvestment Act.

[2] URSIT stands for the Federal Financial Institutions Examination Council's Uniform Rating System for Information Technology.

strategic priorities. Consideration should then be given to priorities established by individual operating units and work across geographic groups. In this uncertain economic environment, examiners should update strategies as necessary when bank conditions and risk levels change.

Consistent with broad agency goals of enhancing our efficiency and effectiveness, examiners should implement supervisory practices that optimize operational efficiency. To this end, CBS encourages creativity in executing supervisory strategies that consider examiner knowledge of individual banks and service providers and OCC policies and procedures. Examiners should also leverage technology to perform supervision activities off-site, when appropriate, while considering PPM 4000-4, Supplement 4, "Accessing and Managing Financial Supervision Information" and lessons learned from the OCC expanded telework practices in 2020.

Using the OCC's risk-based approach, examiners should consider to what extent they can leverage internal audit, loan review, compliance management systems, and other risk and control functions in planning and performing their supervisory work. Examiners should test, assess, and conclude on the quality of these functions before determining to what extent, if any, these functions can be leveraged.

CBS expects supervision units to be aware of and implement the principles outlined in the Geographic Resource Allocation Process document to align strategies and resources with CBS expectations. Supervision unit managers will continue to prioritize and coordinate resources across units, specifically by analyzing and assigning OCC resources within various geographies to achieve common OCC goals. The attachment to this supervisory memorandum covers specific efforts that will continue into FY 2022, including supervision units working with Systemic Risk Identification Support & Specialty Supervision and the National Risk Committee to assess systemic supervision risk and emerging risks and to conduct various horizontal risk assessments during the fiscal year to facilitate an agency-wide view of risk on selected topics.

Communication and collaboration across supervision units are essential for successfully executing CBS objectives. The committee appreciates the contributions that OCC staff makes to the agency's mission.

Fiscal Year 2022 Bank Supervision Strategy Planning Guidance
Office of the Comptroller of the Currency
Committee on Bank Supervision

The Office of the Comptroller of the Currency's (OCC) Committee on Bank Supervision (CBS) strategy planning guidance sets forth the agency's supervision priorities and objectives. The agency's fiscal year (FY) for 2022 begins October 1, 2021, and ends September 30, 2022. The strategy planning guidance outlines the OCC's supervision priorities and aligns with "The OCC's Strategic Plan, Fiscal Years 2019–2023" and the National Risk Committee's (NRC) priorities. The strategy planning guidance facilitates the development of supervisory strategies for individual national banks, federal savings associations, national trust banks, federal branches and agencies of foreign banking organizations (collectively, banks), as well as identified service providers. Managers and staff of the OCC supervision units—Bank Supervision Policy, Economics, Large Bank Supervision, Midsize and Community Bank Supervision, and Specialty Supervision in Systemic Risk Identification Support & Specialty Supervision (collectively, supervision units)—will use this plan to guide their supervisory priorities, planning, and resource allocations for FY 2022.

Priority Objectives for Supervision Units

The FY 2022 strategy planning guidance and the follow-on bank supervision operating plan identify priority objectives across the supervision units. Supervision units and managers should use these objectives when developing and executing individual operating unit plans and risk-focused bank supervisory strategies. While the objectives are similar for the Large Bank Supervision, Midsize and Community Bank Supervision, and Specialty Supervision departments, managers will consider differences in bank size, complexity, and risk profile when developing individual bank supervisory strategies. Operating plans include resources and support for risk-focused examinations of technology and significant service providers that provide critical processing and services to banks. As appropriate, supervisory strategies should be adjusted during the fiscal year in response to emerging risks and supervisory priorities.

For FY 2022, in addition to the baseline supervision to assign ratings, the development of supervisory strategies will focus on the following risk areas:

- **Credit:** Examiners should evaluate banks' actions to manage credit risk given projected weaker economic conditions and legacy portfolio issues. Supervisory focus should include commercial and retail credit risk control functions, including portfolio administration and risk management, timely risk identification, independent loan review, risk rating accuracy, concentration risk management, policy exception tracking, collateral valuation, stress testing, collections/workout management, and resource adequacy. Additionally, examiners should assess the appropriateness of allowance for loan and lease losses/allowance for credit losses and forecasting the cumulative impact from a lengthy period of eased underwriting standards and potential risk of higher probability of default and loss given default.

- **Concentrations of credit:** For banks with concentrations, particularly in residential or commercial real estate, examiners should assess the quality of risk management processes and practices and verify that risk assessment and management practices adequately account for concentration risks. Supervisory focus should include portfolios with material concentrations, especially in sectors hard hit by the pandemic, that may experience amplified impacts from changes in market conditions. These impacts may include new office work expectations and shopping habits. They may also suffer increased volumes of specialized other real estate owned (OREO) properties.
- **Allowance for loan and lease losses (ALLL)/allowance for credit losses (ACL):** For all banks, examiners should focus on ALLL and ACL adequacy considering continuing stress on portfolios. U.S. Securities and Exchange Commission (SEC) filers, except small reporting companies as defined by the SEC, were required to adopt the current expected credit losses (CECL) accounting standard in 2020.[3] All other banks are required to implement CECL by 2023. For banks that have not yet adopted CECL, examiners should evaluate preparedness, including bank implementation plans and use of third parties to assist in the development of the loss estimation methodology, modeling techniques, and management information systems. For banks that have adopted CECL, examiners should evaluate the effectiveness of the methodology at estimating lifetime expected credit losses.
- **Cybersecurity:** Cybersecurity resilience, incident response, and data recovery and business resumption should be supervisory focal points. Examiners should use results from the Risk-Based Cybersecurity Assessment Tool to help identify control weaknesses and areas of supervisory follow-up. Examinations should emphasize threat vulnerability and detection, authentication and access controls, network management, data management, managing third-party access, and back-up and recovery processes. Examinations should also focus on incident response programs and cyber resilience capabilities to recover from destructive malware attacks. Examiners should include assessments where internal controls and operational processes changed during the pandemic.
- **Third parties and concentrations:** Examiners should determine whether banks are providing proper oversight of their significant third-party relationships, including partnerships. Examiners should identify where those relationships represent significant concentrations in operations, resiliency, or other risks. Examiners should be aware of the risk posed by the third party's own management of cybersecurity and resilience risks.
- **Bank Secrecy Act, consumer compliance, Community Reinvestment Act (CRA), and Fair Lending:** Supervisory Memorandum (SM) 2018-08, "Frequency and Scope of Compliance Activities." applies to Consumer Compliance, Bank Secrecy Act/Anti-Money

[3] Ten institutions supervised by the OCC elected to defer the adoption of CECL until December 31, 2020, under Section 4014 of the CARES Act.

Laundering (BSA/AML), and CRA. Planning for these activities at all banks should refer to this supervisory memorandum.

- **BSA/AML and Office of Foreign Assets Control:** Strategies should continue to focus on BSA/AML compliance, with emphasis on evaluating the effectiveness of BSA/AML risk management systems relative to the complexity of business models, products and services offered, and customers and geographies served; evaluating technology and modeling solutions to perform or enhance BSA/AML oversight functions; and determining the adequacy of suspicious activity monitoring and reporting systems and processes in providing meaningful information to law enforcement.
- **Consumer compliance:** The focus of consumer compliance activities should also refer to SM 2020-06, "Temporary Guidance for Compliance-Related Supervisory Activities During the COVID-19 Emergency" as appropriate. This SM provided examiners with temporary guidance for conducting compliance-related supervisory activities during the pandemic. Examiners should focus compliance change management efforts given the litany of pandemic-related legislation initiatives and assessing collection programs.
- **CRA:** SM 2019-03, "Supervisory Policies and Processes for Community Reinvestment Act Performance Evaluations," updated the CRA examination process. Examiners should be familiar with these updated procedures and plan accordingly. Examiners should also plan to accommodate training and incorporate new guidance and tools that will be issued during FY 2021 to implement the CRA rule issued on June 5, 2020.
- **Fair Lending:** Strategies should focus on assessing fair lending risk, particularly as banks implement new technology in underwriting processes, and planning for appropriate supervisory activities for banks identified as high-risk during the regular fair lending risk assessments and the annual Home Mortgage Disclosure Act data screening process.

- **Interest rate risk:** Examiners should assess the impact of a low-rate environment on banks' business models, strategies, asset and liability risk exposures, net interest margin, funding stability, and modeling capabilities.
- **London Interbank Offered Rate:** Examiners should evaluate each bank's implementation and execution of alternative reference rates given the 2021 phaseout of the London Interbank Offered Rate (LIBOR). Banks should fully understand all their exposures and be nearly complete with remediation efforts. Examiners should consider operational, reputation, and consumer impact assessments and change management related to an alternative index for pricing loans, deposits, and other products and services.
- **Change management:** Examiners should identify banks that are implementing significant changes in their operations. Mergers and acquisitions, emergency programs in response to the pandemic including the CARES Act, pandemic-related cost control measures, new technological innovation and implementation, including use of cloud computing, artificial intelligence, digitalization in risk management processes, new products and services, and notable changes in strategic plans, may increase risk in an institution if not evaluated, planned, and integrated effectively. Examiners should evaluate the appropriateness of governance processes when banks undertake significant change.
- **Payments risk:** Examiners should evaluate payment systems products and services, currently offered or planned, with additional focus on new or novel products, services or channels for wholesale and retail customer relationships. Examiners should consider

potential risks including operational, compliance, strategic, and reputation and how these risks are incorporated into institution-wide risk assessments and new product review processes, if applicable.

Supervision units should pay particular attention to the efficient use of resources and should leverage technology wherever possible. Strategies should focus on control functions and, as appropriate, leverage the institutions' internal audit, loan review, and risk management processes and assess their ability to identify and elevate risk issues. Examiners should evaluate the effectiveness of these control functions before placing significant reliance on their findings.

Examinations should integrate multiple risk disciplines when feasible. Operational, compliance, technology, and capital risks are present in almost all bank functions. EICs should work to include specialty examiners in activities to help provide a complete assessment of risks in the function being reviewed.

The supervision units will prioritize and coordinate resources and conduct various horizontal risk assessments during the fiscal year. This will help facilitate an agency-wide view of risk on selected topics. No CBS horizontals have been identified at this time. As operating units identify and plan horizontal activities, they should reallocate resources or amend 2022 strategies as necessary.

Supervision units should consider training and development opportunities to build examiner expertise in four priority areas: (1) commercial credit, particularly risk management and credit classification, (2) information technology and cybersecurity, (3) payments charter operations and supervision (4) wholesale and retail payment systems and relevant operational risks. Business units should assess training needs to best tailor development within their respective business units, in coordination with the Examiner Development Committee.

The OCC will provide periodic updates about supervisory priorities, emerging risks, and horizontal risk assessments in the *Semiannual Risk Perspective* report and internal NRC issuances, such as the Message to Examiners. Each supervision unit may provide further detailed strategy planning guidance as appropriate.

INTERNAL GUIDANCE ONLY
NOT FOR EXTERNAL DISTRIBUTION

SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

SM 2012-3

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 1, 2012

Subject: Consideration of Bank Secrecy Act/Anti-Money Laundering Examination Findings in the ***Uniform Interagency Rating Systems*** and ***OCC's Risk Assessment System***

This memorandum provides interim guidance for incorporating Bank Secrecy Act/Anti-Money Laundering (BSA/AML) examination findings into the CAMELS ratings and the OCC's risk assessment system (RAS) assigned to national banks and federal savings associations (collectively, banks).[1] This guidance also applies to federal branches and agencies of foreign banking organizations.

Consumer Compliance Rating

Effective July 18, 2012, the results of a BSA/AML examination are no longer to be considered when assigning a rating under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System.

Management Component Rating

In keeping with current policy, examiners must consider BSA/AML examination findings in a safety and soundness context as a part of the management component of a bank's FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). For federal branches and agencies, BSA/AML examination findings must be considered as part of the risk management component of the ROCA rating system.[2] Examination procedures used to evaluate the adequacy of a bank's BSA/AML compliance remain unchanged.

---

[1] This supervisory memorandum (SM) rescinds SM 2006-2 (issued as MM 2006-2), "Incorporating BSA, AML, OFAC, and USA PATRIOT Act Compliance Into Supervisory Ratings," as well as SM 2004-1 (issued as MM 2004-1), "BSA Examinations."

[2] ROCA stands for Risk management, Operational controls, Compliance, and Asset quality.

In addition, serious deficiencies in a bank's BSA/AML compliance area will create a presumption that the bank's management component rating will be adversely affected. For example, significant deficiencies in a bank's compliance with BSA/AML that result in an overall BSA compliance program violation[3] would reflect risk management practices that are less than satisfactory and would generally warrant a management rating of "3." Other adverse BSA/AML findings, such as those resulting in "Matters Requiring Attention" (MRA) or less severe enforcement actions, may also negatively affect a bank's management component rating, depending on the circumstances. This may be the case, for example, when a bank has BSA/AML-related MRAs across several lines of business. If, however, management is already deemed in need of improvement and risk management practices are deemed less than satisfactory as reflected in a "3" management rating, a further downgrade in the rating as a result of BSA/AML deficiencies may not be warranted. On the other hand, for those situations that raise greater supervisory concerns, a downgrade of the management component beyond a "3" may be appropriate. Notwithstanding the circumstances, the support for the management rating should be fully documented in the appropriate supervisory system. In addition, examiners should be alert to situations in which management weaknesses identified in other areas of a bank reveal potential deficiencies in BSA/AML program oversight.

Risk Assessment System

While examiners will no longer consider BSA/AML examination findings as a part of the interagency consumer compliance rating, BSA/AML findings are still considered as a part of compliance risk under the OCC's RAS. Compliance risk considers a bank's compliance with all applicable laws and regulations. The overall quantity of risk and quality of risk management related to BSA/AML compliance as well as the four pillars of a bank's BSA/AML program are considered in assessments of compliance risk. BSA/AML examination findings should also continue to be reflected in the OCC's assessments of reputation, strategic, and operational risks, as applicable.

The Committee on Bank Supervision expects to incorporate this guidance into revisions of the "Bank Supervision Process," "Large Bank Supervision," and "Community Bank Supervision" booklets of the *Comptroller's Handbook*—and other guidance and systems, as needed—by September 2012.

[3] Overall BSA compliance program violations are citations of 12 CFR 21.21 for national banks or 12 CFR 163.177 for federal savings associations. These violations are cited for deficiencies that render the BSA compliance program ineffective when viewed as a whole and result in the issuance of a cease and desist order.