NEW OCC GUIDELINES FOR RISK MANAGEMENT RAISE STAKES FOR CEOS AND BOARDS OF LARGE AND MID-SIZED BANKS

CLIENT ALERT

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New guidelines for risk management of large financial institutions, just published by the Office of the Comptroller of the Currency (OCC), raise the stakes for preparedness and warrant the prompt attention of boards and senior management of banks with consolidated assets of $50 billion or more.

In addition to codifying increased supervisory expectations for risk management, which the OCC has been implementing since 2010, the guidelines put new demands on large bank internal audit teams — requiring them each year to independently assess the design and effectiveness of the bank's risk governance framework relative to regulatory mandates and industry leading practices. This assessment may be conducted by internal audit, an external party or internal audit in conjunction with an external party.

Perhaps most significant, however, the OCC has made clear that these "guidelines" are not merely suggestions: they are enforceable. If a national bank or federal savings association fails to meet a prescribed guideline, the OCC has the discretion to require the submission of a plan specifying how it will meet the guideline. If the bank fails to submit an acceptable plan or fails materially to comply with its submitted plan, the OCC may issue an order. Such orders are formal — and public — and may be enforced in district court or through the assessment of monetary penalties.

Combining many elements of the OCC's Satisfactory-to-Strong program with certain risk management aspects of the Federal Reserve Board's 12 C.F.R. 252, parts of which have yet to be finalized, the proposed guidelines are designed to address several risk management program failures observed in the aftermath of the financial crisis. They're also designed to implement heightened supervisory expectations for:

- **Formal Strategic Plans,** which should provide the board, management, and regulators a clear road map of the bank's overall mission and strategic objectives, an assessment of expected risks, and an explanation for how the bank will govern those risks, and any changes thereto, over the plan period.
- **A Risk Appetite Statement,** including risk tolerances, limits and breach protocols relative to earnings, capital, and liquidity, which must formally tie to and define the risk boundaries of firm-wide and business line / unit strategic and business plans, govern concentrations of risk, and assist the board and executive management in the establishment and communication of an appropriate risk culture.

- **Risk Management Roles, Responsibilities, Accountabilities, and Expectations** for bank business lines and units, independent risk management functions and internal audit functions. Additional requirements address the independence, stature, expertise, and reporting requirements for the Chief Risk and Audit Executives and compensation, incentive, and performance and talent management structures to support the bank's desired risk appetite, prohibit excessive risk taking, and provide for the recruitment, development, retention and succession of management and staff needed to manage the bank's risks.
- **Risk Data Aggregation and Reporting,** which must timely and effectively capture, process, aggregate, and report firm-wide and business line / unit risks to enable informed management of risks and risk governance by the board.
- **Board Governance and Oversight,** which must ensure an effective risk governance framework, provide for active board oversight of risks and credible board challenge of management. The guidelines also require the exercise of independent judgment by board members, initial and ongoing training of directors, and annual self-assessment of board effectiveness in meeting its risk governance and oversight responsibilities.

While the proposed guidelines will not be final until the OCC has received and evaluated public comments, large banks should start to prepare to be supervised according to the guidelines, well in advance of their implementation. Additionally, the OCC increasingly expects mid-sized banks to implement heightened risk management consistent with the principles proposed in these guidelines, as demonstrated by the roll out of the S2S program.

Large and mid-sized banks should assess and identify gaps in their current risk management frameworks, board governance and oversight compared to the proposed guidelines. If gaps are identified, remediation plans should be established. And chief audit executives of large banks should begin to implement independent risk governance assessment processes as required by the guidelines.

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