#369

RESCINDED

Office of Thrift Supervision
Department of the Treasury

Thomas A. Barnes
Deputy Director, Examinations, Supervision, and Consumer Protection

1700 G Street, N.W., Washington, DC 20552 • (202) 906-5650

This document and any attachments are superseded by (Comptroller's Handbook - Community Bank Supervision).

October 8, 2010

MEMORANDUM FOR: **CHIEF EXECUTIVE OFFICERS**

FROM: Thomas A. Barnes, Deputy Director
Examinations, Supervision and Consumer Protection

SUBJECT: Risk Assessment Summary in the Thrift Report of Examination

The Office of Thrift Supervision (OTS) is enhancing the thrift Report of Examination (ROE) by adding a new page summarizing examination conclusions related to an institution's risk management practices.

In 2006, the OTS developed a risk matrix and assessment tool for large and complex institutions in its conglomerate program. This tool provided a consistent reporting method to document the quantity of risk, quality of risk management, aggregate risk and direction of risk. The risk matrix and instructions for its usage were incorporated in the March 2009 revision of the Holding Company Handbook Section 200 Administration Appendix B Continuous Supervision. Utilizing this experience and drawing from best practices, OTS is now extending similar procedures to thrift examinations.

Use of a defined risk assessment matrix and summary provides:

- A consistent means to record examiner judgment in support of the risk-focused examination approach;
- Sharper evaluation of risks through separate assessment of inherent risks and risk management processes;
- A forward looking means to indicate the direction of individual institutions' risk;
- Greater emphasis on early identification of emerging risks and system-wide issues that necessitate horizontal reviews or additional risk analysis and monitoring;
- Standard documentation of risk elements, direction and management techniques; and
- Greater consistency with other banking regulatory agencies.

RESCINDED

Effective November 1, 2010, all OTS comprehensive thrift ROEs will have a new Risk Assessment Summary (RAS) page that will include a risk assessment summary matrix (copy attached).

OTS will continue to assign a CAMELS rating. The RAS and the uniform interagency rating systems are distinct yet closely related evaluation methods used during the supervisory process. Both provide information about an institution's:

- Overall soundness.
- Financial and operational weaknesses or adverse trends.
- Problems or deteriorating conditions.
- Risk management practices.

Because of these commonalities, the RAS and the rating systems tend to affect one another. The use of both methods provides an important verification of supervisory findings and planned activities.

OTS also takes this opportunity to re-emphasize the importance of sound risk management practices for financial institutions' boards of directors and management and to encourage institutions to have a robust risk management and monitoring system.

Risk Assessment Summary

OTS has defined eight risk categories for bank supervision purposes: Credit, Interest Rate, Liquidity, Price, Operational, Compliance, Strategic, and Reputation. OTS assesses the quantity of risk, quality of risk management, aggregate level of risk, and the direction of risk for each risk category. ***Quantity of risk*** *represents the level or volume of risk that currently exists and is assessed as* low, moderate *or* high*.* ***Quality of risk management*** *is how well risks are identified, measured, controlled, and monitored and is assessed as* strong, satisfactory *or* weak*.* ***Aggregate risk*** *is a summary judgment reflecting the level of supervisory concern considering both the quantity of risk and the quality of risk management and is assessed as* high, moderate *or* low*.* ***Direction of risk*** *indicates likely changes to the risk profile of each risk category over the next twelve months and is assessed as* increasing, stable *or* decreasing*.*

RISK PROFILE				
Risk Category	**Quantity of Risk** (Low, Moderate, High)	**Quality of Risk Management** (Weak, Satisfactory, Strong)	**Aggregate Level of Risk** (Low, Moderate, High)	**Direction of Risk** (Increasing, Stable, Decreasing)
Credit				
Interest Rate				
Liquidity				
Price				
Operational				
Compliance				
Strategic				
Reputation				
NOTE: Risk assessments indicated in **bold** or *italic* type reflect a change since the last assessment.				

Narrative Discussions:

Credit Risk

Interest Rate Risk

Liquidity Risk

Price Risk

Operational Risk

Compliance Risk

Strategic Risk

Reputation Risk

Community Bank RAS

Credit Risk

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

Credit risk is the most recognizable risk associated with banking. This definition, however, encompasses more than the traditional definition associated with lending activities. Credit risk also arises in conjunction with a broad range of bank activities, including selecting investment portfolio products, derivatives trading partners, or foreign exchange counterparties. Credit risk also arises from country or sovereign exposure, as well as indirectly through guarantor performance.

Summary Conclusions

Quantity of credit risk is:

☐ Low	☐ Moderate	☐ High

Quality of credit risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate credit risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of Credit Risk

Quantity of credit risk is derived from the absolute amount of credit exposure and the quality of that exposure. How much credit exposure a bank has is a function of:

- Level of loans and other credit or credit-equivalent exposures relative to total assets and capital.
- Extent to which earnings are dependent on loan or other credit or credit-equivalent income sources.

All else being equal, banks that have higher loans-to-assets and loans-to-equity ratios and that depend heavily on the revenues from credit activities have a higher level of credit risk. The degree of exposure is a function of the risk of default and risk of loss in assets and exposures comprising the credit exposure. However, the risk of default and loss is not always apparent from currently identified problem assets. It also includes potential default and loss that are affected by such factors as bank risk selection and underwriting practices; portfolio composition; concentrations; portfolio performance; and global, national, and local economic and business conditions. All credit activities should be considered, including off-balance sheet, loans held for sale, and credit risk in the investment portfolio.

An assessment of low, moderate, or high credit risk should reflect the bank's standing relative to existing financial risk benchmarks or peer or historical standards and should take into consideration relevant trends in risk direction. When considering the effect of trends on quantity of risk, examiners must consider the rate of change as well as the base level of risk from which the change occurs. (For example, a modest adverse trend in a bank with a moderate quantity of credit risk should weigh more heavily on the examiner's decision to change the quantity of risk rating than a modest adverse trend in a low risk bank.) These factors represent minimum standards, and examiners should consider additional factors.

To determine the quantity of credit risk, examiners must consider an array of quantitative and qualitative risk measurements. These indicators can be leading (rapid growth), lagging (high past-due levels), static (point in time evaluation/gauge), relative (exceeds peer/historical norms), or dynamic (trend or change in portfolio mix). Many of these indicators are readily available from internal MIS as well as call report and UBPR information. Other indicators, such as a bank's risk tolerance or underwriting practices, while more subjective, should also be considered.

It is extremely important to note that banks can exhibit increasing or high levels of credit risk even though many or all traditional lagging indicators or asset quality indicators are low. Although qualitative and quantitative indicators may have opposite effects on credit risk (the one may mitigate the other's effect), the indicators may also work together (the one may add to the other's effect). Although each type of measure can provide valuable insights about risk when viewed individually, they become much more powerful for assessing the quantity of risk when viewed together.

Quantity of Credit Risk Indicators

Examiners should consider the following indicators when assessing quantity of credit risk.

Low	Moderate	High
The level of loans outstanding is low relative to total assets and equity capital.	The level of loans outstanding is moderate relative to total assets and equity capital.	The level of loans outstanding is high relative to total assets and equity capital.
Growth rates are supported by local, regional, and/or national economic and demographic trends and level of competition. Growth (including off-balance-sheet activities) has been planned for and appears consistent with management and staff expertise and/or operational capabilities.	Growth rates exceed local, regional, and/or national economic and demographic trends and level of competition. Some growth (including off-balance-sheet activities) has not been planned or exceeds planned levels and may test management and staff expertise or operational capabilities.	Growth rates significantly exceed local, regional, and/or national economic and demographic trends and level of competition. Growth (including off-balance-sheet activities) was not planned or exceeds planned levels, and stretches management and staff expertise and/or operational capabilities. Growth may be in new products or with out-of-area borrowers.
The bank has well diversified income and dependence on interest and fees from loans and leases is commensurate with asset mix. Loan yields are low and risks/returns are well balanced.	The bank is dependent on interest and fees from loans for the majority of its income, but income sources within the loan portfolio are diversified. Loan yields are moderate. Imbalances between risk and return may exist but are not significant.	The bank is highly dependent on interest and fees from loans and leases. Bank may target higher risk loan products for their earnings potential. Loan income is highly vulnerable to cyclical trends. Loan yields are high and reflect an imbalance between risk and return, and/or risk is disproportionately high relative to return.

Quantity of Credit Risk Indicators - continued

Low	Moderate	High
The bank's portfolio is well diversified with no single large concentrations and/or a few moderate concentrations. Concentrations are well within internal limits. Change in portfolio mix is neutral or reduces overall risk profile.	The bank has one or two material concentrations. Concentrations are in compliance with internal guidelines but may be approaching the limits. Change in portfolio mix may increase overall risk profile.	The bank has one or more large concentrations. Concentrations may have exceeded internal limits. Change in portfolio mix significantly increases overall risk profile.
Existing and/or new extensions of credit reflect conservative underwriting and risk-selection standards. Policies are conservative and exceptions are nominal.	Existing and/or new extensions of credit generally reflect conservative to moderate underwriting and risk-selection standards. Policies and exceptions are moderate.	Existing and/or new extensions of credit reflect liberal underwriting and risk-selection standards. Policies either allow such practices or practices have resulted in a large number of exceptions.
Underwriting policies are reasonable. Underwriting standards for loans held for sale or originated to distribute are reasonable and consistent with loans made with the intention of being held for the bank's portfolio. The bank has only occasional loans with structural weaknesses and/or underwriting exceptions. Those loans are well mitigated and do not constitute an undue risk.	Underwriting policies are satisfactory. Underwriting standards for loans held for sale or originated to distribute are reasonable but are inconsistent with loans made with the intention of being held for the bank's portfolio. The bank has an average level of loans with structural weaknesses and/or exceptions to sound underwriting standards consistent with balancing competitive pressures and reasonable growth objectives.	Underwriting policies are inadequate. Underwriting standards for loans held for sale or originated to distribute are inconsistent with loans made with the intention of being held for the bank's portfolio. The bank has a high level of loans with structural weaknesses and/or underwriting exceptions that expose the bank to heightened loss in the event of default.
Collateral requirements are conservative. Collateral valuations are timely and well supported.	Collateral requirements are acceptable. Bank practices result in moderate deviations from policy. A moderate number of collateral valuations are not well supported or reflect inadequate protection. Soft (intangible) collateral is sometimes used in lieu of hard (tangible) collateral.	Collateral requirements are liberal, or if policies incorporate conservative requirements, there are substantial deviations. Collateral valuations are not always obtained, frequently unsupported and/or reflect inadequate protection. Soft (intangible) collateral is frequently used rather than hard (tangible) collateral.
Loan documentation and/or collateral exceptions are low and have minimal impact on risk of loss.	The level of loan documentation and/or collateral exceptions is moderate, but exceptions are corrected in a timely manner and generally do not expose the bank to risk of loss.	The level of loan documentation and/or collateral exceptions is high. Exceptions are outstanding for inordinate periods and the bank may be exposed to heightened risk of loss.

Quantity of Credit Risk Indicators - continued

Low	Moderate	High
Distribution across pass categories is consistent with a conservative risk appetite. Migration trends within the pass category are balanced or favor the higher or less risky ratings. Lagging indicators, such as past dues and nonaccruals, are low and the trend is stable.	Distribution across pass categories is consistent with a moderate risk appetite. Migration trends within the pass category are starting to favor the lower or riskier pass ratings. Lagging indicators, such as past dues and nonaccruals, are moderate and the trend is stable or rising slightly.	Distribution across pass categories is heavily skewed toward the lower or riskier pass ratings. Downgrades dominate rating changes within the pass category. Lagging indicators, such as past dues and nonaccruals, are moderate or high and the trend is rising.
Classified and special-mention loans represent a low percentage of loans and capital and are not skewed to the more severe categories (doubtful or loss).	Classified and special-mention loans represent a moderate percentage of loans and capital and are not skewed to the more severe categories (doubtful or loss).	Classified and special-mention loans represent a high percentage of loans and capital or a moderate percentage of loans and capital and are growing or are skewed to the more severe categories (doubtful or loss).
Bank re-aging, extension, renewal, and refinancing practices raise little or no concern about the accuracy/transparency of reported problem loan, past due, nonperforming and loss numbers.	Bank re-aging, extension, renewal, and refinancing practices raise some concern about the accuracy/transparency of reported problem loan, past due, nonperforming and loss numbers.	Bank re-aging, extension, renewal, and refinancing practices raise substantial concern about the accuracy/transparency of reported problem loan, past due, nonperforming and loss numbers.
Loan losses to total loans are low. ALLL coverage of problem and non-current loans and loan losses is high. Provision expense is stable.	Loan losses to total loans are moderate. ALLL coverage of problem and non-current loans is moderate, but provision expense may need to be increased.	Loan losses to total loans are high. ALLL coverage of problem and non-current loans is low. Special provisions may be needed to maintain acceptable coverage.

Quality of Credit Risk Management Indicators

Examiners should use the following indicators when assessing quality of credit risk management. (For comprehensive guidelines on portfolio management, refer to the "Loan Portfolio Management" booklet of the *Comptroller's Handbook*.)

Strong	Satisfactory	Weak
There is a clear, sound credit culture. Board and management tolerance for risk is well communicated and fully understood.	The intent of the credit culture is generally understood, but the culture and risk tolerances may not be clearly communicated or uniformly implemented throughout the institution.	Credit culture is absent or is materially flawed. Risk tolerances may not be well understood.
Strategic and/or business plans are consistent with a conservative risk appetite and promote an appropriate balance between risk-taking and growth and earnings objectives. New loan products/initiatives are well researched, tested, and approved before implementation.	Strategic and/or business plans are consistent with a moderate risk appetite. Anxiety for income may lead to some higher-risk transactions. Generally, there is an appropriate balance between risk-taking and growth and earnings objectives. New loan products/initiatives may be launched without sufficient testing, but risks are usually understood.	Strategic and/or business plans encourage taking on liberal levels of risk. Anxiety for income dominates planning activities. The bank engages in new loan products/initiatives without conducting sufficient due diligence testing.
Management is effective. Loan management and personnel possess sufficient expertise to effectively administer the risk assumed. Responsibilities and accountability are clear, and appropriate remedial or corrective action is taken when they are breached.	Management is adequate to administer assumed risk, but improvements may be needed in one or more areas. Loan management and personnel generally possess the expertise required to effectively administer assumed risks, but additional expertise may be required in one or more areas. Responsibilities and accountability may require some clarification. Generally, appropriate remedial or corrective action is taken when they are breached.	Management is deficient. Loan management and personnel may not possess sufficient expertise and/or experience, or otherwise may demonstrate an unwillingness to effectively administer the risk assumed. Responsibilities and accountability may not be clear. Remedial or corrective actions are insufficient to address root causes of problems.
Diversification management is active and effective. Concentration limits are set at reasonable levels. The bank identifies and reports concentrated exposures and initiates actions to limit, reduce or otherwise mitigate their risk. Management identifies and understands correlated exposure risks.	Diversification management may need improvement but is adequate. Concentrated exposures are identified and reported, but limits or other action/exception triggers may be absent. Management may initiate actions to limit or mitigate concentrations at the individual loan level, but portfolio level actions may be inadequate. Correlated exposures may not be identified.	Diversification management is passive or otherwise deficient. The bank may not identify concentrated exposures, and/or identifies them but takes little or no actions to limit, reduce, or mitigate risk. Management does not understand exposure correlations. Concentration limits, if any, may be exceeded or are raised frequently.

Quality of Credit Risk Management Indicators - continued

Strong	Satisfactory	Weak
Loan management and personnel compensation structures provide appropriate balance between loan/revenue production, loan quality, and portfolio administration, including risk identification.	Loan management and personnel compensation structures provide reasonable balance between loan/revenue production, loan quality, and portfolio administration.	Loan management and personnel compensation structures are skewed to loan/revenue production. There is little evidence of substantive incentives and/or accountability for loan quality and portfolio administration.
Staffing levels and expertise are appropriate for the size and complexity of the loan portfolio. Staff turnover is reasonable and allows for the orderly transfer of responsibilities. Training programs facilitate ongoing staff development.	Staffing levels and expertise are generally adequate for the size and complexity of the loan portfolio. Staff turnover is moderate and may create some gaps in portfolio management. Training initiatives may be inconsistent.	Staffing levels are inadequate in numbers or skill level. Turnover is high. Bank does not provide sufficient resources for staff training.
Lending policies effectively establish and communicate portfolio objectives, risk tolerances, and loan-underwriting and risk-selection standards.	Policies are fundamentally adequate. Enhancements can be achieved in one or more areas but are generally not critical. Specificity of risk tolerance or underwriting and risk-selection standards may need improvement to fully communicate policy requirements.	Policies are deficient in one or more ways and require significant improvement in one or more areas. They may not be sufficiently clear or are too general to adequately communicate portfolio objectives, risk tolerances, and loan underwriting and risk-selection standards.
Bank effectively identifies, approves, tracks, and reports significant policy, underwriting, and risk-selection exceptions individually and in aggregate, including risk exposures associated with off-balance-sheet activities.	Bank identifies, approves, and reports significant policy, underwriting, and risk selection exceptions on a loan-by-loan basis, including risk exposures associated with off-balance-sheet activities. However, little aggregation or trend analysis is conducted to determine the affect on portfolio quality.	Bank approves significant policy exceptions but does not report them individually or in aggregate and/or does not analyze their effect on portfolio quality. Risk exposures associated with off-balance-sheet activities may not be considered. Policy exceptions may not receive appropriate approval.
Credit analysis is thorough and timely both at underwriting and periodically thereafter.	Credit analysis appropriately identifies key risks and is conducted within reasonable timeframes. Analysis after underwriting may need some strengthening.	Credit analysis is deficient. Analysis is superficial and key risks are overlooked. Credit data are not reviewed in a timely manner.
Internal or outsourced risk rating and problem loan review/identification systems are accurate and timely. They effectively stratify credit risk in both problem and pass-rated credits. They serve as an effective early warning tool and support risk-based pricing, ALLL, and capital allocation processes.	Internal or outsourced risk rating and problem loan review/identification systems are adequate. Though improvement can be achieved in one or more areas, they adequately identify problem and emerging problem credits. The graduation of pass ratings may need to be expanded to facilitate early warning, risk-based pricing, or capital allocation.	Internal or outsourced risk rating and problem loan review/identification systems are deficient and require improvement. Problem credits may not be identified accurately or in a timely manner; as a result, portfolio risk is likely misstated. The graduation of pass ratings is insufficient to stratify risk in pass credits for early warning or other purposes (loan pricing, ALLL, capital allocation).

Quality of Credit Risk Management Indicators - continued

Strong	Satisfactory	Weak
Special mention ratings do not indicate any management problems administering the loan portfolio.	Special mention ratings generally do not indicate management problems administering the loan portfolio.	Special mention ratings indicate management is not properly administering the loan portfolio.
MIS provide accurate, timely, and complete portfolio information. Management and the board receive appropriate reports to analyze and understand the bank's credit risk profile, including off-balance-sheet activities. MIS facilitates exception reporting, and MIS infrastructure can support *ad hoc* queries in a timely manner.	MIS may require modest improvement in one or more areas, but management and the board generally receive appropriate reports to analyze and understand the bank's credit risk profile. MIS facilitates exception reporting, and MIS infrastructure can support *ad hoc* queries in a timely manner.	MIS have deficiencies requiring attention. The accuracy and/or timeliness of information may be affected in a material way. Portfolio risk information may be incomplete. As a result, management and the board may not be receiving appropriate or sufficient information to analyze and understand the bank's credit risk profile. Exception reporting requires improvement, and MIS infrastructure may not support *ad hoc* queries in a timely manner.

Interest Rate Risk

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

The assessment of IRR should consider risk from both an accounting perspective (i.e., the effect on the bank's accrual earnings) and the economic perspective (i.e., the effect on the market value of the bank's portfolio equity). In some banks, IRR is captured under a broader category of market risk. In contrast to price risk, which focuses on the mark-to-market portfolios (e.g., trading accounts), IRR focuses on the value implications for accrual portfolios (e.g., held-to-maturity and available-for-sale accounts).

Summary Conclusions

Quantity of IRR is:

☐ Low	☐ Moderate	☐ High

Quality of IRR management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate IRR is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of IRR Indicators

Examiners should use the following indicators when assessing quantity of interest rate risk.

Low	Moderate	High
No significant mismatches on longer-term positions exist. Shorter- term exposures are simple and easily adjusted to control risk.	Mismatches on longer-term positions exist but are manageable and could be effectively hedged.	Re-pricing mismatches are longer-term and may be significant, complex, or difficult to hedge.
Potential exposure to earnings and capital is negligible under a +/-200 basis point rate change over a 12-month horizon.	Potential exposure to earnings and capital is not material under a +/-200 basis point rate change over a 12-month time horizon.	Potential exposure to earnings and capital is significant under a +/-200 basis point rate change over a 12-month time horizon.
There is little or no exposure to multiple indexes that price assets and liabilities, such as prime, London Interbank Offered Rate (LIBOR), Constant Maturity Treasury (CMT), and Cost of Funds Index (COFI).	Potential exposure to multiple indexes that price assets and liabilities, such as prime, London Interbank Offered Rate (LIBOR), Constant Maturity Treasury (CMT), and Cost of Funds Index (COFI), is reasonable and manageable.	Potential exposure to multiple indexes that price assets and liabilities, such as prime, London Interbank Offered Rate (LIBOR), Constant Maturity Treasury (CMT), and Cost of Funds Index (COFI), is significant. Positions may be complex.
Potential exposure to changes in the level and shape of the yield curve is absent or negligible.	Potential exposure to changes in the level and shape of the yield curve is not material and is considered manageable.	Potential exposure to changes in the level and shape of the yield curve is significant. Positions may be complex.
Potential exposure to assets and/or liabilities with embedded options is low. Positions are neither material nor complex.	Potential exposure to assets and/or liabilities with embedded options is not material. The impact of exercising options is not projected to adversely affect earnings or capital.	Potential exposure to assets and/or liabilities with embedded options is material. Positions may be complex and the impact of exercising options may adversely affect earnings or capital.
Volume and complexity of servicing assets is either insignificant or nonexistent, presenting virtually no exposure to changes in interest rates.	Volume and complexity of servicing assets is relatively modest and does not present material exposure to earnings and capital due to changes in interest rates.	Volume and complexity of servicing assets is material and potentially exposes earnings and capital to significant exposure from changes in interest rates.
Support provided by low-cost, stable non-maturity deposits is significant and absorbs or offsets exposure arising from longer-term re-pricing mismatches or options risk.	Support provided by low-cost, stable non-maturity deposits absorbs some, but not all, of the exposure associated with longer-term re-pricing mismatches or options risk.	Support provided by low-cost, stable non-maturity deposits is not significant or sufficient to offset risk from longer-term re-pricing mismatches or options risk.

Quality of IRR Management Indicators

Examiners should use the following indicators when assessing quality of IRR management.

Strong	Satisfactory	Weak
Board-approved policies are sound and effectively communicate guidelines for management of IRR, functional responsibilities, and risk tolerance.	Board-approved policies adequately communicate guidelines for management of IRR, functional responsibilities, and risk tolerance. Minor weaknesses may be evident.	Board-approved policies are inadequate in communicating guidelines for management of IRR, functional responsibilities, and risk tolerance.
Risk-limit structures provide clear risk parameters for risk to earnings and economic value consistent with risk tolerance of the board. Limits reflect sound understanding of risk under adverse rate scenarios.	Risk-limit structures for earnings and economic value are reasonable and consistent with risk tolerance of the board.	Risk-limit structures to control risk to earnings and economic value may be absent, ineffective, unreasonable, or inconsistent with risk tolerance of the board.
Management demonstrates a thorough understanding of IRR. Management anticipates and responds appropriately to adverse conditions or changes in economic conditions. Management identifies and manages risks involved in new products, services, and systems.	Management demonstrates an adequate understanding of IRR and generally responds appropriately to adverse conditions or changes in economic conditions. Management adequately identifies and manages the risks involved in new products, services, and systems.	Management either does not demonstrate an understanding of IRR or does not anticipate or respond appropriately to adverse conditions or changes in economic conditions. Management does not identify or inadequately identifies and manages the risks involved in new products, services, and systems.
Risk measurement processes are appropriate given the size and complexity of the bank's on- and off-balance-sheet exposures. Data input processes are effective and ensure the accuracy and integrity of management information. Assumptions are reasonable and well documented. IRR is measured over a wide range of rate movements to identify vulnerabilities and stress points.	Risk measurement processes are appropriate given the size and complexity of the bank's on- and off-balance-sheet exposures. Data input processes are adequate and ensure the accuracy and integrity of management information. Assumptions are reasonable. IRR is measured over an adequate range of rate movements to identify vulnerabilities and stress points. Minor enhancements may be needed.	Risk measurement processes are deficient given the size and complexity of the bank's on- and off-balance-sheet exposures. Material weaknesses may exist in data input and interest rate scenario measurement processes. Assumptions may not be realistic or supported. Deficiencies may be material.
Earnings-at-risk is measured as well as economic value-at-risk when significant longer-term or options risk exposure exists. No weaknesses are evident.	Earnings-at-risk is measured as well as economic value-at-risk when significant longer-term or options risk exposure exists. Minor enhancements may be needed.	Earnings-at-risk may not be appropriately measured. Economic value-at-risk may not be considered despite significant exposure to longer-term or options risk.

Quality of IRR Management Indicators - continued

Strong	Satisfactory	Weak
MIS provide timely, accurate, and complete information on IRR to appropriate levels in the bank. No weaknesses are evident.	MIS are adequate, and provide complete information on IRR to appropriate levels of management. Minor weaknesses may be evident.	MIS are inadequate or incomplete. Remedial actions are necessary, as material weaknesses in MIS are evident.
A well designed, independent, and competent review function has been implemented to periodically validate and test the effectiveness of risk measurement systems. The process assesses the reasonableness and validity of scenarios and assumptions. The system is effective and no corrective actions are required.	An acceptable review function is in place. The review periodically validates and tests the effectiveness of risk measurement systems including the reasonableness and validity of scenarios and assumptions. The review is independent and competent. Minor weaknesses may exist but can be easily corrected.	A review function to periodically validate and test the effectiveness of risk measurement systems either does not exist or is inadequate in one or more material respects. The review may not be independent or completed by competent staff. Processes to evaluate the reasonableness and validity of rate scenarios and assumptions used may be absent or deficient.

Liquidity Risk

Liquidity risk is the risk to current or anticipated 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.

As with interest rate risk, many banks capture liquidity risk under a broader category—market risk. Liquidity risk, like credit risk, is a recognizable risk associated with banking. The nature of liquidity risk, however, has changed in recent years. Increased investment alternatives for retail depositors, sophisticated off-balance-sheet products with complicated cash-flow implications, and a general increase in the credit sensitivity of banking customers are all examples of factors that complicate liquidity risk.

Summary Conclusions

Quantity of liquidity risk is:

☐ Low	☐ Moderate	☐ High

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

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of Liquidity Risk Indicators

Examiners should use the following indicators when assessing quantity of liquidity risk.

Low	Moderate	High
Funding sources are abundant and provide a competitive cost advantage.	Funding sources are sufficient and 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. Modest reliance on wholesale funding may be evident.	Borrowing sources may be concentrated among a few providers or providers with common investment objectives or economic influences. 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. 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, even in distressed conditions.	Bank has the potential capacity to augment liquidity through asset sales and/or securitization but has little experience in accessing these markets. Distressed conditions could make this more problematic.	Bank exhibits little capacity or potential to augment liquidity through asset sales or securitization. Lack of experience accessing these markets or unfavorable reputation may make this option questionable, particularly in distressed conditions.
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.
Bank is not vulnerable to funding difficulties should a material adverse change occur in market perception, even in distressed conditions.	Bank is not excessively vulnerable to funding difficulties should a material adverse change occur in market perception. Distressed conditions could make this more problematic.	Bank's liquidity profile makes it vulnerable to funding difficulties should a material adverse change occur, particularly in distressed conditions.
Support provided by the parent company is strong.	Parent company provides adequate support.	Little or unknown support provided by the parent company.

Quality of Liquidity Risk Management Indicators

Examiners should use the following indicators when assessing 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.
Liquidity risk management process is effective in identifying, measuring, monitoring, and controlling liquidity risk. The process reflects a sound culture that has proven effective over time.	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.	Liquidity risk management process is ineffective in identifying, measuring, monitoring, and controlling liquidity risk. This may hold 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.
Contingency funding plan (CFP) is well developed, effective, and useful. The plan incorporates reasonable assumptions, scenarios, and crisis management planning and is tailored to the bank's needs. CFP clearly establishes strategies that address liquidity shortfalls in a distressed environment. Stress testing (including bank-specific and market-wide scenarios) is performed and is effective.	Contingency funding plan (CFP) 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. CFP adequately establishes strategies that address liquidity shortfalls in a distressed environment but may require some minor changes. Stress testing is adequately performed but may require some enhancement.	Contingency funding plan (CFP) 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 noninvestment grade or CAMELS "3" environment. CFP does not establish or inadequately establishes strategies that address liquidity shortfalls in a distressed environment. Stress testing is not or is inadequately performed.
MIS focus on significant issues and produce timely, accurate, complete, and meaningful information to enable effective management of liquidity, even in a distressed environment.	MIS adequately capture concentrations and rollover risk, and are timely, accurate, and complete, even in a distressed environment. Recommendations are minor and do not impact effectiveness.	MIS are deficient, particularly in a distressed environment. Material information may be missing or inaccurate, and reports are not meaningful.

Price Risk

Price risk is the risk to current or anticipated earnings or capital arising from changes in the value of either trading portfolios or other obligations that are entered into as part of distributing risk. These portfolios are typically subject to daily price movements and are accounted for primarily on a mark-to-market basis. This risk arises most significantly from market-making, dealing, and position-taking in interest rate, foreign exchange, equity, commodities, and credit markets.

Price risk also arises in banking activities whose value changes are reflected in the income statement, such as in lending pipelines and mortgage servicing rights. The risk to earnings or capital arising from the conversion of a bank's financial statements from foreign currency translation should also be assessed under price risk.

Summary Conclusions

Quantity of price risk is:

☐ Low	☐ Moderate	☐ High

Quality of price risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate price risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of Price Risk Indicators

Examiners should use the following indicators when assessing quantity of price risk.

Low	Moderate	High
Exposures are primarily confined to those arising from customer transactions and involve liquid and readily manageable products, markets, and levels of activity. Bank does trades back-to-back for customers, taking no or negligible risk positions. No proprietary trading exists. Trading personnel merely execute customer orders. Earnings and capital have no vulnerability to volatility from revaluation requirements.	Trading positions exist only to position securities for sale to customers. No proprietary trading. Open positions are small and involve liquid instruments that allow for easy hedging. Limited trading exists in option-type products. Earnings and capital have limited vulnerability to volatility from revaluation requirements.	Trading activity includes proprietary transactions, with positions unrelated to customer activity. Exposures reflect open or un-hedged positions, including illiquid instruments, options, and/or longer maturities, which subject earnings and capital to significant volatility from revaluation requirements.
Daily trading gains/losses do not occur, because bank takes no or negligible risk.	Daily trading gains/losses are small and occur infrequently. Quarterly trading losses do not occur because of limited risk appetite and emphasis on customer revenues.	Daily trading gains/losses occur periodically because the bank either does not have customer transaction revenue support, or takes positions that can create losses that eclipse customer revenues. Quarterly trading profits and losses can be large relative to budget and may occasionally result in a negative public perception.
Bank has a sales-driven culture, with sales personnel exercising greater authority than traders do.	Compensation programs reflect sales orientation, but do provide limited incentives for trading profits.	Compensation programs reward traders for generating trading profits, reflecting a trader-dominated operation.
Policy limits reflect no appetite for price risk. Customer sales activities pose no or negligible threat to earnings and capital.	Policy limits reflect limited appetite for price risk.	Policy limits permit risk-taking, with the bank willing to risk losses that can impact quarterly earnings and/or capital.
Bank has non-dollar denominated positions that are completely hedged. Assets denominated in foreign currencies equal liabilities denominated in foreign currencies. Earnings and capital are not vulnerable to changes in foreign exchange rates.	Bank may have a small volume of un-hedged, non-dollar denominated positions, but it can readily hedge at a reasonable cost. There is limited vulnerability to changes in foreign currency exchange rates.	Exposure reflects a large volume of un-hedged, non-dollar denominated positions, or a smaller volume of un-hedged positions in illiquid currencies for which hedging can be expensive. Changes in foreign currency exchange rates can adversely impact earnings and capital.

Quantity of Price Risk Indicators – continued

Low	Moderate	High
Bank has limited, or no, mortgage banking activities. The mortgage servicing asset, if any, is small relative to capital.	Bank is active in mortgage banking. The mortgage servicing asset is material relative to capital, and valuation adjustments can have a meaningful impact on earnings and capital.	Mortgage banking activities are a key business line for the bank. The mortgage servicing asset is large relative to capital, and valuation adjustments can be significant.
Bank has no current or limited exposure to other real estate (ORE).	Bank has a modest amount of or exposure to ORE, but it is in property types or areas that are not expected to realize significant value changes that could negatively impact earnings.	Bank has a large amount of or exposure to ORE, which may be concentrated in property types or areas that may realize value changes that cause significant write-downs.
Held-for-sale portfolios, if any, are small and pose minimal risk to earnings.	Bank carries a small held-for-sale loan portfolio as part of its business of distributing risk into the capital markets. However, write-downs to this portfolio would not have a significant impact on earnings.	Originating and distributing loans into the capital markets is a key business line for the bank. Write-downs occasionally have, or are anticipated to have, a significant impact on earnings.

Quality of Price Risk Management Indicators

Examiners should use the following indicators when assessing quality of price risk management.

Strong	Satisfactory	Weak
Policies reflect board's risk appetite, and provide clear authorities, conservative limits, and assigned responsibilities. Policies permit risk-taking authority consistent with the expertise of bank personnel. Policies clearly and reasonably limit the volume of translation risk and assigned responsibilities.	Policies provide generally clear authorities, reasonable limits, and assignment of responsibilities. Risk-taking authority is generally consistent with expertise of bank personnel. Policies address translation risk in a general way but may not provide specific management guidelines.	Policies reflect management's preferences for risk tolerance, rather than those of the board. Policies do not clearly assign responsibilities. Risk-taking authority does not reflect the expertise of trading personnel. The bank does not have a policy addressing translation risk or policy limits are not reasonable given management expertise, the bank's capital position, and/or volume of assets and liabilities denominated in foreign currencies. Responsibilities are not clearly assigned.
Management has broad mortgage servicing rights experience and has established strong policy controls and risk limits; policy exceptions are rare, and properly approved.	Management has sufficient mortgage servicing rights and hedging experience. Policies generally address key risk management practices; exceptions to policies occasionally occur.	Management attention to mortgage servicing is not commensurate with the risk, or management lacks sufficient experience in hedging mortgage servicing rights exposures. Policies do not address key risk management practices; exceptions frequently occur and are not properly approved.
When the bank has ORE, management obtains appraisals and takes any required write-downs on a timely basis. Management actively tries to sell ORE properties.	Appraisals for ORE are occasionally out-of-date or of lower quality. Management's actions to sell ORE properties do not always demonstrate an active interest in disposition.	The quality of appraisals for ORE properties is questionable and/or the appraisals are out-of-date. Management does not actively try to sell ORE properties (e.g., the bank may list the property for sale at an inflated price).
Policies and controls for held-for-sale assets effectively limit risk. Exceptions to policy are quickly identified and promptly raised to appropriate levels of management.	Policies and controls for held-for-sale assets are generally effective, but policy exceptions are not always identified on a timely basis and/or may not be raised to appropriate levels of management.	The bank lacks effective controls on held-for-sale assets. Policy exceptions are not identified on a timely basis and are not raised to appropriate levels of management.
Management effectively understands, measures, and has technical expertise in managing translation risk. Management and the board regularly review currency translation risk exposures and direct changes, if necessary, given market conditions and the size of the exposure.	Management has a reasonable understanding of translation risk and how to measure and hedge it. Management and the board regularly review translation risk exposures but generally don't direct changes even in unsettled markets.	Management does not demonstrate an understanding of translation risk, and does not have the ability to manage it effectively. Neither management nor the board is aware of the magnitude of translation risk or does not review reports outlining translation risks.

Quality of Price Risk Management Indicators - continued

Strong	Satisfactory	Weak
Trading and sales personnel have broad experience in the products traded, are technically competent, and are comfortable with the bank's culture. Risk management personnel have an in-depth understanding of risk and risk management principles. Policy exceptions are rare, and formal procedures exist to report how/why they occurred and how they were resolved.	Trading and sales personnel are generally experienced and technically competent. Risk management personnel, if the bank has such a unit, have a basic understanding of risk and risk management principles. Policy exceptions occur occasionally, but the bank may not have a formal process to report them and track resolution.	Trading and sales personnel may not have a broad experience in the products they trade. A risk management unit does not exist or is not independent and staffed by personnel familiar with risk management principles. Policy exceptions regularly occur and may not be reported or tracked for resolution.
New products are subject to a formal review program, with all relevant bank units participating in risk assessment and control procedures.	New products are subject to a formal review program, but relevant bank units may or may not assess their ability to properly control the activity.	Bank does not have a new product review program or has one that assesses risk in a cursory manner.
Management reports are prepared independently of the trading desk and provide a comprehensive and accurate summary of trading activities. Reports are timely, assess compliance with policy limits, and measure loss potential in both normal (e.g., value at risk) and stressed markets. Management at all levels understands and monitors price risk.	Management reports are prepared independently of the trading desk and provide a general summary of trading activities. Reports are timely but may not fully assess loss potential. Trading unit management reviews risk reports, but management at higher levels may lack the understanding to review it on a frequent basis and in depth.	Management reports are not independent of the trading desk, do not provide risk-focused information, and may not be prepared regularly. Higher-level managers do not understand price risk and do not review risk management reports.
Incompatible duties are properly segregated. Risk monitoring, valuation, and control functions are independent from the business unit.	Incompatible duties are generally segregated. Risk monitoring and control functions may not exist or do not have complete independence from the business unit.	Incompatible duties are often not segregated. Risk control functions do not exist or are not independent from the business unit. Trading positions are frequently valued on trader prices, with limited independent verification.

Operational Risk

Operational risk is the risk to current or anticipated earnings or capital arising from inadequate or failed internal processes or systems, the misconduct or errors of people, and adverse external events. Operational losses result from internal fraud; external fraud; employment practices and workplace safety, clients, products, and business practices; damage to physical assets; business disruption and system failures; and execution, delivery, and process management.

Operational losses may be expected or unexpected and do not include opportunity costs, foregone revenue, or costs related to risk management and control enhancements implemented to prevent future operational losses. The quantity of operational risk and the quality of operational risk management are heavily influenced by the quality and effectiveness of a company's system of internal control. The quality of the audit function, although independent of operational risk management, is also a key assessment factor. Audit can affect the operating performance of a company by helping to identify and ensure correction of weaknesses in risk management or controls.

Summary Conclusions

Quantity of operational risk is:

☐ Low	☐ Moderate	☐ High

Quality of operational risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate operational risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of Operational Risk Indicators

Examiners should use the following indicators when assessing quantity of operational risk.

Low	Moderate	High
Exposure to risk from fraud, errors, or processing disruptions is minimal given the volume of transactions, complexity of products and services, and state of internal systems. Risk to earnings and capital is negligible.	Exposure to risk from fraud, errors, or processing disruptions is modest given the volume of transactions, complexity of products and services, and state of internal systems. Deficiencies that have potential impact on earnings or capital can be addressed in the normal course of business.	Exposure to risk from fraud, errors, or processing disruptions is significant given the volume of transactions, complexity of products and services, and state of internal systems. Deficiencies exist that represent significant risk to earnings and capital.
Risks from transaction-processing failures, technology changes, outsourcing, planned conversions, merger integration, or new products and services are minimal.	Risks from transaction-processing failures, technology changes, outsourcing, planned conversions, merger integration, or new products and services are moderate.	Risks from transaction-processing failures, technology changes, outsourcing, planned conversions, merger integration, or new products and services are high.
Volume of operational losses is minimal.	Volume of operational losses is moderate.	Volume of operational losses is high.
Volume of fraud and intrusions/attacks is minimal.	Volume of fraud and intrusions/attacks is moderate.	Volume of fraud and intrusions/attacks is high.
Employee turnover is low and has not affected any mission critical areas.	Employee turnover is moderate, but effect on mission critical areas is limited.	Employee turnover is excessive and has severely affected key areas of operations.
Number of outsourced servicers is low.	Number of outsourced servicers is moderate.	Number of outsourced servicers is high.
Level of insurance bond claims is low.	Level of insurance bond claims is moderate.	Level of insurance bond claims is high.

Quality of Operational Risk Management Indicators

Examiners should use the following indicators when assessing quality of operational risk management.

Strong	Satisfactory	Weak
Governance activities are sound. Directors are qualified, appropriately compensated, ethical, and provide effective oversight. Corporate roles are clear, goals are effectively communicated, and disclosure is transparent.	Governance activities are satisfactory. Directors are qualified, appropriately compensated and ethical. Oversight provided is adequate but may have subtle weaknesses. Corporate goals and responsibilities may be clear but are not fully communicated. Disclosure is adequate.	Governance activities are deficient. Corporate structure may not be fully defined and/or communicated. Directors' qualifications, ethical standards and/or compensation are questionable. Oversight is inadequate or ineffective. Disclosure is inaccurate and process is flawed.
Management has developed a comprehensive and effective internal control environment. A commitment to internal controls is evident and well disseminated throughout the enterprise. Board oversight is strong. Integrity of control systems is tested on a regular basis.	Control environment is appropriate for the size and sophistication of the institution. Commitment to internal controls is not readily evident or well disseminated. Structure may not be fully communicated across the organization. Board oversight/control culture is considered effective, although modest weaknesses may be present. Control integrity is tested on a periodic basis.	Control environment is deficient. Findings indicate a lack of awareness, commitment and/or focus on the importance of effective and appropriate internal controls. Board oversight is ineffective. Volume and severity of control exceptions are high. Exposure to potential or realized losses from key operational areas may be present. Control integrity testing is nonexistent or is performed inconsistently.
Management anticipates and responds effectively to risks associated with operational changes, emerging/changing technologies, and external threats.	Management adequately responds to risks associated with operational changes, emerging/changing technologies, and external threats.	Management does not take timely and appropriate actions to respond to operational changes, emerging/changing technologies, and external threats.
Management fully understands operational risks and has expertise available to evaluate key technology-related issues.	Management reasonably understands operational risks and has sufficient expertise available to evaluate key technology-related issues.	Management does not understand, or has chosen to ignore, key aspects of operational risk. Expertise available to evaluate key technology-related issues is insufficient.
New/nontraditional product development and implementation is well managed with low risk exposure.	New/nontraditional product development and implementation is adequately managed, with some weaknesses and risk exposure evident.	New/nontraditional product development and implementation is inadequately managed, with significant weaknesses and high-risk exposure.
Vendor management activities are sound. Risk exposure is well managed. Management comprehensively provides for continuity and reliability of services furnished by outside providers.	Vendor management activities are satisfactory but may contain modest weaknesses. Risk exposure is satisfactorily managed. Management adequately provides for continuity and reliability of services furnished by outside providers.	Vendor management activities are severely limited or nonexistent. Risk exposure is inadequately managed. Management has not provided for continuity and reliability of services furnished by outside providers.

Quality of Operational Risk Management Indicators – continued

Strong	Satisfactory	Weak
Controls to safeguard physical assets, data, and personnel are comprehensive and effective in appropriately mitigating risks. Information security program is comprehensive, effective, and tested on a regular basis. Procedures to identify and report potential data losses are effective. Privacy practices are sound.	Controls to safeguard physical assets, data, and personnel are satisfactory but may have modest weaknesses. Information security program is acceptable overall but may require minor enhancement and/or more frequent testing to be fully comprehensive and effective. Procedures to identify and report potential data losses are satisfactory. Privacy practices are satisfactory.	Controls to safeguard physical assets, data, and personnel are deficient or nonexistent. Information security program is flawed, incomplete, and/or inadequate. Annual testing and/or reporting have not occurred and procedures to identify and report potential data losses are absent. Privacy practices are inadequate.
Processes and systems to monitor, track, and categorize operating losses are sound.	Processes and systems to monitor, track, and categorize operating losses are satisfactory but may contain modest weaknesses.	Processes and systems to monitor, track, and categorize operating losses are weak or nonexistent.
MIS provide appropriate monitoring of transaction volumes, error reporting, fraud, suspicious activity, security violations, etc. MIS is accurate, timely, complete and reliable.	MIS for transaction processing are adequate, although moderate weaknesses may exist.	MIS for transaction processing are unsatisfactory and exhibit significant weaknesses or may not exist.
Insurance coverage is sufficient and policies are current. An effective process for provider/agent selection and monitoring is present and overall coverage adequacy is reviewed at least annually.	Insurance coverage is sufficient and policies are current. Provider/agent selection process is acceptable and ongoing monitoring is limited. Coverage adequacy is reviewed on a periodic basis.	Insurance coverage is insufficient for the exposure present. Inadequate tracking procedures have allowed policies to lapse. Due diligence programs for provider/agent selection and/or ongoing monitoring are inadequate, flawed, or ineffective.
Audit coverage is strong. Audit activities are frequent and ongoing and address all key areas of operations. Audit function is fully independent and competent, and scope is comprehensive. Risk assessment is effective and current. Follow-up and correction of deficiencies is proactive and effective. Repeat issues are rare or nonexistent. Board oversight is effective.	Audit coverage is satisfactory. Function is fully independent and competent, but scope may be limited. Risk assessment is acceptable overall but may be missing substance in some areas or require updating. Follow-up and correction of deficiencies is adequate but with moderate weaknesses noted therein. Repeat issues are few. Board oversight is adequate.	Audit coverage is inadequate. Independence may be impaired, competency may be questionable and scope may be inappropriate. Risk assessment is ineffective or nonexistent. Follow-up and correction of deficiencies is highly inconsistent. Repeat issues are numerous. Board oversight is limited and ability to self police is impaired.

Compliance Risk

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

Compliance risk is not limited solely to risk from failure to comply with consumer protection laws; it encompasses the risk of noncompliance with *all* laws and regulations, as well as prudent ethical standards and contractual obligations. It also includes the exposure to litigation (known as legal risk) from all aspects, of banking, traditional and nontraditional.

Summary Conclusions

Quantity of compliance risk is:

☐ Low	☐ Moderate	☐ High

Quality of compliance risk management is:

☐ Strong	☐ Satisfactory	☐ Weak

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

Aggregate compliance risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Quantity of Compliance Risk Indicators

Examiners should use the following indicators when assessing quantity of compliance risk.

Low	Moderate	High
Violations or compliance program weaknesses are insignificant in number and issues or do not exist.	Violations or compliance program weaknesses exist and represent technical issues with some reimbursement to consumers that are resolved in a timely manner.	Violations or compliance program weaknesses are significant in number, resulting in large consumer reimbursements or regulatory fines and penalties.
No e-banking or the Web site is informational or non-transactional.	Bank is beginning e-banking and offers limited products and services.	Bank offers a wide array of e-banking products and services (e.g., account transfers, e-bill payments or accounts opened via the Internet).
All loans are originated in-house with no broker or third-party relationships.	Low volume of consumer and business loans are originated by local brokers or other third parties.	High volume of consumer or business loans is originated by multiple statewide or nationwide brokers or other third parties.
Limited/no marketing or advertising of products and services.	Limited marketing or advertising practices commensurate with strategic focus.	Marketing and advertising of new products offered through multiple of channels (branch network, Internet, direct mail, solicitations, etc.).
Bank offers traditional mix of non-complex lending, investment, and deposit products.	Bank offers traditional investment and deposit products and a mix of traditional and complex lending products.	Bank offers a broad array of traditional and complex lending, investment, and deposit products.
Bank offers products and services to local market/service area.	Bank offers products and services to regional market/service area.	Bank offers products and services to national market/service area.
Financial institution competition within its marketplace is minimal.	Financial institution competition within its marketplace is considerable.	Financial institution competition within its marketplace is significant and may include large national and international companies.
Volume of products and services offered is reasonable considering its financial strength and capability, and growth is stable.	Volume of products and services offered is increasing considering its financial strength and capability, and growth is steady.	Volume of products and services offered is outpacing its financial strength and capability, and growth is unstable.
Bank has few offices, some automated teller machines and centralized operations.	Bank has statewide branching and automated teller machine network with decentralized operations.	Bank has regional or national branching and automated teller machine network with decentralized operations.
Volume of consumer complaints is minimal.	Volume of consumer complaints is moderate.	Volume of consumer complaints is high.

Quality of Compliance Risk Management Indicators

Examiners should use the following indicators when assessing the quality of compliance risk management.

Strong	Satisfactory	Weak
Board has adopted compliance management policies that are consistent with business strategies and risk tolerance.	Board has adopted compliance management policies that are generally consistent with business strategies and risk tolerance.	Board has adopted compliance management policies that are inconsistent with business strategies and risk tolerance.
Management fully understands all aspects of compliance risk; exhibits clear commitment to compliance. Commitment is communicated throughout the institution.	Management reasonably understands the key aspects of compliance risk. Commitment to compliance is reasonable and satisfactorily communicated throughout the institution.	Management does not understand or has chosen to ignore key aspects of compliance risk. Importance of compliance is not emphasized or communicated throughout the organization.
Authority and accountability are clearly defined and enforced.	Authority and accountability are defined, although some refinements may be needed.	Management has not established or enforced accountability.
Management anticipates and responds well to market, technological, or regulatory changes.	Management adequately responds to market, technological, or regulatory changes.	Management does not anticipate or take timely or appropriate actions in response to market, technological, or regulatory changes.
Compliance considerations are incorporated into product/system development and modification processes, including changes made by service providers or vendors.	Although compliance may not be formally considered when developing products and systems, issues are typically addressed before they are fully implemented.	Compliance considerations are not incorporated into product and system development.
Control systems effectively identify violations or compliance system weaknesses and corrective action is prompt and reasonable.	Control systems are adequate for identifying violations or compliance system weaknesses but not always in a timely manner. Management is usually responsive and corrective action is generally timely but not in all instances.	Control systems are ineffective in identifying violations and compliance system weaknesses. Management is unresponsive; corrective action is weak.
Management provides effective resources/training programs to ensure compliance.	Management provides adequate resources/training, given the complexity of products/operations.	Management has not provided adequate resources or training.
Bank has a strong record of compliance. Considering the scope and complexity of its operations and structure, compliance management systems are sound and minimize the likelihood of significant or frequent violations or instances of noncompliance.	Bank has a satisfactory record of compliance. Considering scope and complexity of operations and structure, compliance management systems are adequate to avoid significant or frequent violations or instances of noncompliance.	Bank has unsatisfactory record of compliance. Considering scope and complexity of operations and structure, compliance management systems are deficient, reflecting inadequate commitment to risk management.
Bank has strong record of acting on and monitoring consumer complaints.	Bank has satisfactory record of acting on and monitoring consumer complaints.	Bank has a weak record of acting on and monitoring consumer complaints.

Strategic Risk

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

Strategic risk focuses on more than an analysis of the written strategic plan. It focuses on how plans, systems, and implementation affect the bank's franchise/enterprise value. It also incorporates how management analyzes external factors that affect the strategic direction of the company.

Summary Conclusions

Aggregate strategic risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Strategic Risk Indicators

Examiners should use the following indicators when assessing aggregate level of strategic risk.

Low	Moderate	High
Board has adopted policies that are fully consistent with business strategies and risk tolerance.	Board has adopted policies that are generally consistent with business strategies and risk tolerance.	Board has adopted policies that are inconsistent with business strategies and risk tolerance.
Risk management practices are an integral part of strategic planning.	Quality of risk management is consistent with the strategic issues confronting the organization.	Risk management practices are inconsistent with strategic initiatives. A lack of strategic direction is evident.
Strategic goals, objectives, corporate culture, and behavior are effectively communicated and consistently applied throughout the organization. Strategic direction and organizational efficiency are enhanced by management's depth and technical expertise.	Management has demonstrated ability and technical expertise to implement goals and objectives. Successful implementation of strategic initiatives is likely.	Strategic initiatives are inadequately supported by operating policies and programs that direct behavior. Structure and managerial and/or technical talent of the organization do not support long-term strategies.
Management has been successful in accomplishing past goals and is appropriately disciplined.	Management has a reasonable record of decision making and controls.	Deficiencies in management decision making and risk recognition do not allow the institution to effectively evaluate new products, services, or acquisitions.
MIS effectively support strategic direction and initiatives.	MIS reasonably support the company's short-term direction and initiatives.	MIS supporting strategic initiatives are seriously flawed or do not exist.
Strategic goals are not overly aggressive and are compatible with developed business strategies.	Strategic goals are aggressive but compatible with business strategies.	Strategic goals emphasize significant growth or expansion that is likely to result in earnings volatility or capital pressures.
Strategic initiatives are well conceived and supported by appropriate communication channels, operating systems, and service delivery networks. Initiatives are well supported by capital for the foreseeable future and pose only nominal possible effects on earnings volatility.	Corporate culture has minor inconsistencies with planned strategic initiatives. Initiatives are reasonable considering the capital, communication channels, operating systems, and service delivery networks. Decisions are unlikely to have significant adverse impact on earnings or capital. If necessary, decisions or actions can be reversed without significant cost or difficulty.	Impact of strategic decisions is expected to significantly affect franchise value. Strategic initiatives may be aggressive or incompatible with developed business strategies, communication channels, operating systems, and service delivery networks. Decisions are difficult or costly to reverse.

Strategic Risk Indicators – continued

Low	Moderate	High
Strategic initiatives are supported by sound due diligence and strong risk management systems. Decisions can be reversed with little difficulty and manageable costs.	Strategic initiatives do not materially alter business direction, can be implemented efficiently and cost effectively, and are within management's abilities.	Strategic goals are unclear or inconsistent and have led to imbalance between institution's tolerance for risk and willingness to supply supporting resources.
Compensation programs achieve an appropriate balance between risk appetite and controls. Compensation strategies reflect core principle of "pay for performance." Performance goals and metrics to measure achievement are reasonably transparent.	Compensation programs are appropriately balanced between risk appetite and controls but may be informal or reflect modest weaknesses. Incentives are appropriate. Performance goals and metrics to measure achievement are reasonably transparent overall but may contain some minor obscurities.	Compensation programs unduly focus on short-term performance. Incentives may be inappropriate. Use of performance goals and metrics to measure achievement are obscure.
Board and management succession strategies are formalized, effective, and well incorporated into ongoing planning activities. Adequate expertise exists within the institution for successor management. Board vacancies are few, anticipated and replacement candidates are identified and discussed well in advance.	Board and management succession strategies are acceptable, but may be informal. Adequate expertise exists to stabilize the bank until an acceptable outside or inside candidate is identified. Board succession is discussed as needed, with candidates identified prior to vacancy.	Succession planning is not considered and no strategies are evident. Internal expertise may be questionable, with no action plans evident if management is unable to perform. Board may have several pending vacancies with limited or no discussion of suitable replacements.
Due diligence for new products and services is robust. Process considers all appropriate factors including: assessing the impact to the bank's strategic direction, assessing the associated risks, consulting with relevant functional areas, determining regulatory requirements, determining the expertise needed, researching any vendors, developing a realistic business plan, and developing viable alternatives. After introduction, appropriate risk management processes have been developed including performance monitoring and ongoing vendor management.	Due diligence for new products and services is satisfactory. Process may not fully consider all appropriate factors but provides for a general understanding of the risks associated with any new product or service. After introduction, appropriate risk management processes have been developed but may not be fully implemented.	Due diligence for new products and services is insufficient. Process does not consider the appropriate factors and the risks associated with any new product or service are not known. After introduction, appropriate risk management processes have not been developed or implemented.

Reputation Risk

Reputation risk is the risk to current or anticipated earnings, capital, or franchise/enterprise value arising from negative public opinion. This affects the organization's ability to establish new relationships or services or continue servicing existing relationships, directly affecting its current and future revenues. This risk may expose the organization to litigation or financial loss, or impair its competitiveness. Reputation risk exposure is present throughout the organization and requires management to exercise an abundance of caution in dealing with customers, investors, and the community.

The assessment of reputation risk recognizes the potential effect of public opinion on a bank's franchise/enterprise value. This risk is inherent in all bank activities. Banks that actively associate their name with products and services, such as asset management, are more likely to have higher reputation risk exposure. As the bank's vulnerability to public reaction increases, its ability to offer competitive products and services may be affected.

Summary Conclusions

Aggregate reputation risk is:

☐ Low	☐ Moderate	☐ High

Direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Aggregate Risk Matrix

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

This matrix is a guide to assessing aggregate risk. Aggregate risk is the level of supervisory concern, which is a summary judgment incorporating the assessments of the quantity of risk and the quality of risk management (examiners weigh the relative importance of each). The assessments on this matrix are guides only; examiners should feel free to consider other relevant factors not depicted on this matrix.