ANALYSIS OF IMPLEMENTATION OF 2013
OCC BANK SUPERVISION PEER REVIEW PROJECT

DECEMBER 6, 2016

Executive Summary and Key Recommendations

At the request of the Comptroller of the Currency, a team of current and former senior supervisors from Australia, Canada, Singapore, and a former staff member of the International Monetary Fund conducted an independent review in the fall of 2013 of the OCC's supervision of large and midsize institutions. The decision to bring the team in to look at the OCC's supervisory effectiveness was publicly announced in advance and the final report was published by the OCC.[1]

The 2013 assessment was based on a review of OCC documents and briefings with senior OCC staff, bankers, and other US regulators. The review also reflected the team's understanding of successful supervisory practices in other countries. The 2013 report included a series of recommendations concerning OCC's priorities, risk identification process, supervisory methodology and resources, and the consistency of supervisory practices across the agency, which were intended to strengthen supervisory effectiveness.

The Comptroller and his senior management team addressed all of the recommendations contained in the 2013 report. Internal OCC working groups were formed in the spring of 2014 and began the lengthy process of implementing the recommendations.[2]

In the summer of 2016, the Comptroller asked that a review team return to the OCC to conduct a critical assessment of the effectiveness of OCC's implementation of the 2013 recommendations.

Some of the recommendations required a major effort on the part of the OCC to implement and resulted in significant changes to banking supervision operations. Full implementation of these recommendations may take many more months, if not years, to make sustainable. The review team's observations and recommendations, therefore, in many cases relate to programs that have only recently been implemented or are still in the process of being implemented.

Overall, the review team found that that the OCC has accomplished a significant amount in a relatively short time period.

[1] An International Review of OCC's Supervision of Large and Midsize Institutions, December 4 2013: www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184.html - 93k

[2] Summary of OCC's Responses to the Supervision Peer Review Recommendations, May 28 2014: www.occ.gov/news-issuances/news-releases/2014/nr-occ-2014-75a.pdf - 28k - 2016-07-31

Key improvements included:

- Strengthening the role and resources of the Lead Experts (LEs);
- Enhancing the National Risk Committee (NRC) process by establishing new committees and processes to identify and mitigate systemic risks;
- Enhancing the staffing and human resource strategies, including providing more career development opportunities for staff;
- Developing a risk appetite statement and establishing an Enterprise Risk Management function headed by a Chief Risk Officer (CRO);
- Making improvements to the process for issuing and tracking Matters Requiring Attention (MRAs); and
- Strengthening the enterprise-wide quality assurance program.

The changes implemented by the OCC represented a tremendous effort by staff and benefitted from the active engagement and support of senior management.

The OCC has engaged in a large number of projects simultaneously. All major transformations carry the risk that the amount of change becomes overwhelming for affected staff. The review team would like to emphasize the importance of developing a clear understanding of how people, processes, and the workplace in general are affected during the transition from the current to future state in order to adopt effective change management strategies. The capacity of an organization to successfully align how its people think, act, and behave with the desired future outcome is a key contributor to achieving success.

Generally, the review team found that the direction being taken by the OCC is fully consistent with the spirit of the 2013 recommendations. While implementation of some recommendations has proceeded further than others, the overall recommendation of the review team is that the OCC continue along the path it is headed. The review team believes, on the basis of this review, that large and midsize bank supervision at the OCC is more effective now than three years ago.

Introduction

I. Background

In the fall of 2013, a small team of current and former senior supervisory personnel from Australia, Canada, and Singapore along with a former staff member of the International Monetary Fund was asked to participate in an independent review of the OCC's supervision of large and midsize institutions. This team produced a report that contained recommendations related to improving the effectiveness of the OCC's prudential supervision of large and midsize financial institutions.

The major recommendations in the 2013 report included:

- Providing staff with greater certainty regarding the key priorities of the OCC;
- Strengthening the role and resources of LEs to enable a greater number of horizontal reviews, facilitate greater information sharing, and support more informed development of supervisory strategies;
- Improving the scope and consistency of supervisory planning, risk assessments, tracking, and practices across operating units;
- Developing a decision process with timelines, tracking, and accountability for policy development; and
- Expanding the focus on staffing and development of human resources in light of the changing needs of the agency and the high number of retirement-eligible staff.

Some of the 2013 recommendations, such as the focus on staffing, were already under consideration by the OCC. The Comptroller and his senior management team addressed all of the recommendations contained in the 2013 report. Internal working groups were formed in the spring of 2014 and began the lengthy process of implementing the recommendations.

Change in a large organization with a long institutional history such as the OCC can be very difficult to carry out. Active engagement by all levels of management was necessary to convey to staff the importance of the proposed changes.

In developing implementation plans, the OCC took the unusual but important step of seeking, and providing responses to, staff views on the different initiatives. Individual proposals were posted on the web and staff was given the opportunity to comment anonymously. The working groups developing the initiatives reviewed each of these staff comments and in finalizing their implementation plans, included summaries of the comments received and the rationale for why the comments were or were not incorporated into the final positions.

II. 2016 Follow Up Review

In the summer of 2016, the Comptroller asked a review team to come back and critically assess the effectiveness of the OCC's implementation of the recommendations. As in the 2013 review, the review team included supervisors from countries with significant and mature financial markets, well-respected supervisory regimes, and large banks that have been consistently rated among the safest in the world. [3]

The exercise included a high level review of internal reports on the OCC's supervisory performance, work papers from the various working groups assigned to implementing the recommendations, supervisory policies and procedures, and documents prepared by the OCC for the on-site work of the review team. The review team met with OCC management and examination staff, representatives of the Federal Deposit Insurance Corporation (FDIC) and Federal Reserve Board (FRB), as well as senior management from two large banks supervised by OCC. These meetings took place from November 13 thru November 18, 2016.

The mandate to the review team was to focus on the effectiveness of the OCC's implementation of the specific recommendations made in the 2013 report. While the review team found that in many cases, the OCC had gone beyond the earlier recommendations, the review team did not assess the new areas that fell outside the scope of its 2013 work.

Some of the 2013 recommendations required a major effort on the part of the OCC to implement and resulted in significant changes to banking supervision operations, staff development, and the way business at the OCC was carried out. As such, full implementation of these recommendations may take many more months, if not years. The review team's observations and recommendations, therefore, in some cases are based on programs that are still in the process of being implemented.

The nature of the exercise did not permit an in-depth analysis of any particular areas. The report's recommendations are based primarily on an understanding of the current programs and processes as explained by the OCC staff and the documents reviewed.

As in 2013, the review team received a high level of cooperation from the staff and management of the OCC and had easy access to Examiners in Charge (EICs), LEs, and staff from support functions. The review team extends its thanks to all of the OCC staff it met, all of whom were candid in their assessments of their own performance and provided an excellent level of cooperation, and to those individuals outside of the OCC who met with the review team to participate in this process.

[3] This report was prepared by a team comprising members from Australia—Paul Tattersall, General Manager – Diversified Institutions Division, Australian Prudential Regulatory Authority; Canada—Brigitte Phaneuf, Managing Director, Office of Superintendent of Financial Institutions (OSFI); Ted Price, Consultant (former Deputy Superintendent, OSFI); Singapore—Kim Leng CHUA, Assistant Managing Director, Banking and Insurance, Monetary Authority of Singapore; and was led by Jonathan Fiechter, Consultant (former Deputy Director, Monetary and Capital Markets Department, International Monetary Fund). This report reflects the personal views of these individuals and not that of their current or former agencies.

Assessment of Implementation Initiatives and Recommendations

I. Mandate and Priorities

Areas Identified for Improvement in 2013

In 2013, the team noted that the mission, values and objectives were not fully aligned. Discussions with staff indicated that there was a material degree of uncertainty as to the priority of outcomes the OCC was seeking.

The team also focused on the need to establish a robust Enterprise Risk Management (ERM) policy to support priority setting, planning and performance measurement. Included in an ERM policy is a risk appetite and/or risk tolerance statements that help set priorities for management and staff at the OCC.

Considering the multiple priorities of the OCC, the team believed that a risk appetite statement would help staff make decisions that are aligned with the agency's risk tolerance.

2013 Recommendations and 2016 Follow Up Analysis

I A: Revise the mission statement, vision statement, strategic plan, and goals to be better aligned to make safety and soundness of institutions the primary objective of the OCC.

Observations

The OCC reviewed and decided to retain its *mission statement* because it believed it accurately conveys the three objectives of the agency: (i) safety and soundness; (ii) fair treatment of customers; and (iii) compliance with relevant legal standards.

The OCC has re-aligned its *vision statement* with these objectives. Consequently, reference to "maintain the ability of [national banks and federal savings associations] to compete effectively with other providers of financial services to meet the needs of their customers and communities for credit and financial services" has been removed.

Major initiatives and strategic goals have also been revised, consolidated and prioritized to ensure a concrete link to the mission statement.

Given the importance of compliance and fair treatment of customers, a new Compliance & Community Affairs (CCA) function has been formed to give this work greater focus, emphasis and allocation of resources. It also facilitates the development of expertise in these areas.

The OCC has put in place a system to monitor resource usage in its various activities, with the objective of ensuring that resource allocation is commensurate with the importance of the three objectives in the mission statement.

Assessment and Recommendations

The OCC has confirmed that the three objectives in its mission statement are all important and has aligned its vision statement and strategic plans to reflect this.

The OCC should be mindful that with three goals in the mission statement, there remains the challenge of ensuring that resources for meeting the safety and soundness objective remain adequate and that when conflicts arise among the goals, there is a process in place to resolve such conflicts. Creation of a standalone CCA function with dedicated resources may help mitigate such risks.

Fully Implemented. No further recommendations.

I B: Develop a "Risk Appetite Statement" to provide all staff with a clear and consistent understanding of what the OCC is all about—what is most important to the agency.

Observations

The OCC has invested significant effort to develop a Risk Appetite Statement and an ERM framework. The ERM framework is comprehensive and provides a disciplined process for identifying, monitoring and managing both internal and external risks agency-wide.

The Risk Appetite Statement sets out clearly the risks the OCC faces and its tolerance for each of these risks. Metrics have been developed to measure alignment with the stated risk tolerance.

The Risk Appetite Statement appears to be helping the OCC management make better choices and prioritize initiatives.

With respect to supervision, which is the focus of this review, the review team was told that examiners on the ground, however, do not yet see a meaningful link between the Risk Appetite Statement and the choices they have to make for ongoing supervision. Consequently, the Risk Appetite Statement may not help examiners prioritize work in a manner that is consistent with the risk tolerance of the agency.

Assessment and Recommendations

While ERM is in its infancy at the OCC, it is an important step towards improved decision-making, more effective prioritization of work and stronger risk management overall.

Partially Implemented.

1. The OCC should consider ways to cascade its Risk Appetite Statement down to examination staff to make it more meaningful for them. This could be in the form of more granular Line of Business-specific risk tolerance metrics and/or guidance on supervisory activities that are consistent with the Risk Appetite Statement.

II. Risk Identification and Reporting

Areas Identified for Improvement in 2013

In 2013 the team noted that the OCC was doing a good job in the area of risk identification and reporting. The team identified four areas for potential improvement:

- Institutions had signaled that they would like more comparative work, and to learn more about the range of practices. In order to improve interbank comparisons, the number of horizontal reviews needed to be increased. LEs had been heavily involved in most comparative work;

- Information sharing among experts, examiners, and across the agency needed to be increased;
- LEs provide valuable information on risks across the industry and their constructive challenge/inputs to risk assessments and supervisory strategies can help promote sharper risk identification and intervention consistency. Within Large Bank Supervision (LBS), there was not a clear process for LEs to have input to supervisory plans and follow-up supervisory actions and there did not appear to be a clear internal process for the LEs to escalate disagreements with EICs on risk assessments; and
- It was unclear how the outputs of the NRC generated radar screen and early warning metrics dashboard were linked to concrete supervisory actions, either at the individual institution or system level.

To address these issues, the team made three recommendations.

2013 Recommendations and 2016 Follow Up Analysis

II.A: Empower the LEs by moving more specialist resources to report directly to them.

II.B: Embed the LE's inputs in the supervisory planning, risk assessment and intervention processes for large institutions. This would include having their views reflected in annual examination planning, on-site review scoping, issuance of supervisory letters and MRAs. Where disagreements between LEs and the EIC persist, a formal process, within LBS, should be established for escalation to more senior OCC management.

II.C: Include in the NRC radar screen a list of the institutions most affected. This information would much better inform the EICs of the industry-wide risks that are relevant to their institutions.

Observations

LBS has expanded the organization, functions and responsibilities of the Lead Expert Program.

LBS has also established a Large Bank Risk and Steering Committee structure to promote robust discussion on identified risks at the individual institution and system levels, and facilitate communication with NRC. The committee structure allows for a more robust challenge function and escalation process for dealing with disagreements or differences in views among examiners and risk specialists.

LEs are now well integrated in the development of institution-specific supervisory strategies and are providing valued inputs into supervisory activities. There is much stronger interaction between LEs and EICs/Team Leads (TLs). LEs, however, do not yet formally provide input into the determination of CAMELS ratings and rating changes. (This latter observation is addressed later under Supervisory Methodology (section V.C))

Feedback across the agency is that the LE Program has been a success story even as start-up problems are being resolved and as practices evolve. One important component of a successful LE program will be to put aside time for more strategic planning of the use of LE resources.

Assessment and Recommendations

The organizational changes and efforts (i.e. LE Program and risk committee structure) have helped the OCC to better identify systemic risks, improve horizontal perspectives and analysis, guide supervisory strategies and promote stronger quality assurance and more consistency in supervisory activities.

Fully Implemented.

2. Given the increasing workload of LEs, there needs to be clearer prioritization of their work to ensure that limited specialist resources are being assigned to areas that matter the most.

III. Early Intervention

Areas Identified for Improvement in 2013

In 2013 the team noted instances of material time lags between the identification of an emerging sector level risk and the issuance of guidance or rules to address the risk. The time lags put the onus on examiners on the ground to try and contain the risks at the institution level. When acted upon at individual institutions, this could have led to the perception if not the actual occurrence, of uneven treatment across institutions. Institutions interviewed in the course of that review raised concerns about inconsistent treatment.

The team expressed concern that if policy positions took too long to produce, particularly when undertaken on an interagency basis, it would be demoralizing for the front-line supervisors who may have felt that their hard work on risk identification and warnings has not been acted on at higher levels of the agency. While this "policy paralysis" could have been for good reasons (e.g., the wish to have a level playing field that does not inadvertently drive undesirable practices into non-OCC supervised institutions or into the shadow banking sector), it exposed the OCC to the risk of not acting in a timely manner.

In 2013, the OCC staff raised concerns that legally mandated consequences made some examiners hesitant to downgrade CAMELS ratings because such consequences were viewed as inappropriate in certain cases. In particular, there were concerns that there may be some hesitation in instances when an institution falls between a "2" and "3" (sometimes referred to as a "borderline" or "dirty 2") to rate the institution a "3" because of automatic consequences for the institution of certain downgrades, such as a restriction on the institution's operations.

At the time, the team commented that it was appropriate to pay attention to the proportionality of intervention with regard to deficiencies observed in an institution and the willingness and capacity of the institution to promptly remedy the problem. However, the team also noted that a fair and rigorous risk assessment and risk rating should not be hampered by fear of pushback from the institution, or appeals, or litigation due to nondiscretionary actions triggered by a downgrade. Examiners should not feel constrained if they need to make tough calls and take timely actions, especially in cases where there are material risks.

2013 Recommendations and 2016 Follow Up Analysis

III.A: Create a formal policy development process (a "decision tree") with time lines, tracking, and accountability to address identified emerging risks to institutions when no policy exists. Importantly, this process should also clearly embed criteria and process for deciding when the OCC has to act unilaterally, even as it may continue discussions with other agencies on concerted actions.

Observations

There are multiple channels at the OCC through which emerging issues are escalated – bottom up from the EICs, via the LEs to feeder risk committees, and top down via macro analysis. All of these channels report through to the NRC, which in turn, informs the Committee on Banking Supervision (CBS).

The decision-making framework developed does not address specifically the issue of a decision tree or policy development priority and process. Decisions around policy prioritization are made by CBS. Timelines are agreed for the completion of policy with completion tracking and ongoing reporting in place.

The OCC, with accountability allocated to the Chief National Bank Examiner (CNBE), has balanced scorecard metrics focused on policy completion timeliness. The CRO monitors performance relative to the expectations.

The CNBE intends to include success measures in *"Risk Tips"*, which is being provided to examination staff, to improve outcomes from new supervisory guidance. This appears to be better practice.

Each of the bank supervisory agencies – the FRB, the FDIC and the OCC – has demonstrated an increased willingness to expedite joint policy determinations. There were numerous examples cited where the OCC has been more action-focused than it might have been previously.

Assessment and Recommendations

The collective judgment of CBS members determines policy priority. Accountability for, and the tracking of, policy development progress, has been established. The OCC's willingness to proceed ahead of the other agencies has been affirmed.

Fully Implemented. No further recommendations.

III.B: Consider ways to incorporate more flexibility into CAMELS ratings. One approach would be formally splitting the "2" rating into a "2" and "2+," which would allow for more directional guidance to an institution.

Observations

No change has been made to the CAMELS ratings; there is no graduation such that there is a differentiation between a “Borderline” or “Dirty” 2 and that of other more clearly classified 2s.

The OCC has strengthened its internal processes to identifying deteriorating “2” rated institutions. Watch list reporting on deteriorating institutions is in place to identify the potential risk of dirty 2s. Examination procedures are clear that, regardless of consequences, the ratings are to reflect the observed risk of the bank.

Banks are informed where their CAMELS ratings sit relative to the “2” boundary and are clearly informed of when they are headed in the direction of becoming a “3”.

Assessment and Recommendations

The recommendation to increase granularity in the CAMELS ratings has not been adopted. Monitoring is in place to track boundary and deteriorating “2” rated banks.

Fully Implemented. No further recommendations.

IV Supervision Staffing

Areas Identified for Improvement in 2013

In 2013, the team raised a number of issues related to staffing. OCC management had previously identified these and other issues, and a number of initiatives had been implemented or were planned.

The pending retirement of a large number of senior examiners had created a need to develop strategies to slow the departure of retirement eligible staff, to capture their institutional knowledge, and to integrate new mid-career hires more effectively.

The team also felt that the high level of retirements created a need for a clear agency-wide culture that could be embedded and maintained as the nature of the workforce changes.

The team also observed that communication and collaboration across banking supervision could be improved, particularly among large bank supervisory teams, between LEs and large bank teams, and between LBS and Midsize and Community Bank Supervision (MSCBS).

The team also identified the need to broaden examiners’ experience by rotating more staff among bank teams, particularly in LBS. Some examiners, below the EIC and LE levels, had been assigned to the same bank for many years. This ran the risk that examiners would become stale and become too familiar with the mid-management of the institution, giving rise to complacency and lack of healthy skepticism. Supervisory effectiveness might have been hampered as a result of lack of comparative experience in other institutions: examiners, lacking good comparators, may simply assume an institution’s controls are adequate.

OCC management had previously identified the importance staff development in its strategic priorities, and had a number of initiatives underway in 2013. To support those initiatives and to address the issues above, the team made the following recommendations.

2013 Recommendations and 2016 Follow Up Analysis

IV A: Ensure an ongoing focus on the staffing and Human Resource strategies set out in the Strategic Plan.

Observations:

The OCC has set a number of strategic objectives to support the key *Strategic Priority #4 "Match our workforce with our need"* to develop an enterprise-wide workforce plan that aligns the organization human capital efforts with the OCC's vision of the future.

Most recently, the OCC issued a 2017-2019 Work Force Plan (the Plan) that clearly aligns with the 2015-2019 Strategic Plan. The objective of the Plan is to develop a robust program that will ensure skilled resources are available across the OCC in order to meet its mandate both today and in the future.

The Plan is built around the following four key goals:

- Ensure that the OCC has the skills and competencies needed to support the OCC's Vision to be a preeminent prudential supervisor today and in the future;
- Ensure a strategic and integrated approach to recruitment and succession management to provide for a diverse, agile, and innovative workforce and culture;
- Ensure an integrated approach to training and development to support a versatile, engaged and highly skilled workforce; and
- Reinforce enterprise focus with efficient organizational structure and integrated workforce deployment process.

Assessment and Recommendations:

The OCC recognizes it will take time to reach the desired level of maturity of its work force planning process and is taking the necessary steps to build on a solid foundation. This initiative will require continued management support and attention.

Fully Implemented. No further recommendations.

IV B: Expand the use of employment programs to retain qualified retirement-eligible staff on a part-time basis as mentors for incoming staff and to supplement temporary shortages of staff.

Observations:

Following a review of the performance of the federal phased retirement initiative, the OCC has decided not to implement a phased retirement program.

The OCC understands the importance of retaining the invaluable experience of its retiring staff, and so it has decided to use alternative approaches.

It is, for example, using redeployed annuitants on a contract basis in training and mentoring programs for staff. Not only will these programs allow the OCC to retain some of the corporate memory, but they will also support the workforce planning efforts and leadership development. In addition, they have also had some success in getting staff eligible for retirement to consider staying on for more time.

Assessment and Recommendations:

The OCC is taking reasonable steps to ensure that the expertise and supervisory culture of the current staff is not lost over a short period and can be imparted to the next generation.

Fully Implemented. No further recommendations

IV C: Relocate examiners that are resident in commercial banks to common OCC premises. While the "resident examiner program" facilitates access to institution management and information systems, it should be continued on a much smaller scale. In select instances, moving resident examiners to a common OCC premises may not be feasible because there is no critical mass of other OCC staff in the same geographical area.

Observations:

The OCC appears to be committed to relocating LBS to common OCC facilities where and when practicable. Most examiners, however, assigned to individual large banks continue to be located at bank facilities.

The review team notes that there has been a significant shift in the proportion of LBS staff located in common OCC premises. That increase in off-site staff, however, has largely resulted from the development of the LE program whose members are in common OCC space, rather than relocation of the individual large bank supervisory teams.

Development of the LE program and better communication among the EICs and their managers has contributed to improved communication among LBS examination teams and between examination teams and LE teams. This has manifested itself in the improved ongoing dialogue among large bank EICs, and interaction between LEs and large bank examiners teams in planning and risk assessment.

Assessment and Recommendations:

Consolidating LBS staff in the field in common space with MCBS staff will contribute to:

- Strengthening a "one OCC" culture;
- Ensuring better communication among examination teams, across risk expert areas, and between LBS and MCBS;
- Allowing more flexible resource management; and
- Strengthening the external perception of the OCC's independence from institutions.

The review team recognizes the need for regular interaction with the banks. This may be addressed by ensuring that:

- Dedicated, secure and technology enabled space remains available at the banks for OCC staff when they are on site;
- OCC premises have available video and other conferencing capabilities to support effective connectivity to the banks; and
- Examiners have secure communications links to appropriately access bank information while not at bank premises.

The review team recognizes that real estate planning takes time and the LBS has many large projects underway. Now that the LE build out is largely complete and rotation program has been implemented, the OCC can refocus on the co-location program.

Partially Implemented.

3. The OCC should redouble its efforts to move LBS staff to common OCC space when there is a critical mass of other OCC staff in the same geographical area.

IV D: Establish a formal rotation process for all examination staff.

Observations:

The OCC has implemented a new Policies and Procedures Manual (PPM) to "ensure we have skilled examiner resources, in the right locations, focused on providing high quality bank supervision."

The policy:

- Is intended to broaden the experience and skill set of staff, and promote staff development;
- Applies to specified non-bargaining unit examination staff; and
- Outlines rotational, term limited, step away positions, and changes in work assignments and outside assignments.

The new policy increases opportunities for staff development and experience.

In addition to the policy, LBS and LE teams have informal programs that move team members among banks to expand their experience.

However, while the policy will provide opportunities to change work assignments within a bank team, it does not appear to address the main objective of the 2013 recommendation -- that is, to broaden examiners experience between banks. Moreover, at this stage, the policy only applies to non-bargaining unit staff.

Assessment and Recommendations

The policy is an important step towards meeting the expectations of the 2013 Peer Review. However, the new policy is limited and only partially meets the expectation of the peer review

Partially Implemented.

4. The OCC should implement an expanded rotation policy that rotates staff among different banks and, as with EICs, limits the amount of time spent by an examiner on a single bank; when feasible, this rotation policy should be expanded to include all bank examiners.

IV E: Consider alternative career development and examination structures for a new work force environment in which the OCC may not have the benefit of lifetime career examiners because of changing demographics and a tendency of more recent college graduates to change employers more routinely.

Observations:

The model of bringing college graduates into the OCC, training them to be examiners, and then having them spend their professional career at the OCC may not be a reliable means of ensuring adequate numbers of examiners going forward. Newer generations may expect to have multiple jobs over their career. At the same time, mid-career industry hires, with significant experience, may not need the entire intensive examiner education program that is required of younger, less experienced staff.

Recognizing the need to be agile and flexible in order to adapt to a rapidly changing environment, the OCC has continued the development of alternative career paths and recruitment strategies to attract mid-career industry hires and seasoned supervisors.

The OCC has enhanced its individual development planning process, refreshed its specialty skills career development programs and continued the deployment of the Excel 1 and Excel 2 programs, which are accelerated training development programs for seasoned examiners and specialty development programs.

The recently introduced rotation program will also provide more opportunities for staff to broaden their knowledge base and experience, providing for a more diverse and flexible workforce.

All of these initiatives form part of the OCC's 2017-2019 Work Force Plan.

Assessment and Recommendations:

The OCC has continued to make significant progress on initiatives that had already been introduced at the time of our 2013 review.

Fully Implemented. No further recommendations.

IV F: Coordinate EIC turnover with that of LEs.

Observations:

Sequencing the rotation of senior examiners assigned to an institution will assist in providing appropriate continuity of knowledge of individual institutions.

The OCC has indicated it will sequence the turnover of EICs with the rotation of senior examiners assigned to supervise individual institutions to the extent possible.

Assessment and Recommendations:

Fully Implemented. No further recommendations.

V. Supervisory Methodology

Areas Identified for Improvement in 2013

There were five areas for suggested improvement:

Benchmarking review: In 2013 the team noted that there are a variety of supervisory approaches taken by regulators around the world, each with its own merits. Over time each of the agencies represented on the review team had initiated global benchmarking exercises of their methodology. In some cases these reviews have resulted in fundamental changes in the supervisor's methodology.

RAS: At the time of the 2013 review, and through to today, the OCC uses the Risk Assessment System (RAS) to complement the CAMELS rating approach. The team noted that this was consistent with the step many developed countries had taken to move away from CAMELS ratings and adopt more forward-looking supervisory approaches.

The team considered that the RAS had tremendous potential in terms of providing a more forward-looking view of risk. The RAS focuses on categories of risk across the institution, however, rather than according to business lines, which is likely the focus of bank management. The team observed that because the RAS assessment was segmented by risk category, this could hinder the ability of the examiner to really understand the nature of the risk by business activity. In addition, such segmentation may make it difficult to determine who in the institution is accountable for the remediation of the issues.

At the time, and currently, the OCC communicates its views on risk using both CAMELS and RAS. The CAMELS rating was, and remains, the primary means to communicate the OCC's risk ratings to institutions. Although the OCC had tried, it remained a challenge to incorporate more-forward-looking elements into CAMELS. In part this is because CAMELS is an interagency tool. The team was concerned that the objectives of RAS and CAMELS differed and that could result in conflicting assessments.

Lead Expert input to strategy and ratings: As noted in Section II, the team felt that the LEs could provide valuable information on risks across the industry and their constructive challenge/inputs to risk assessments and supervisory strategies can help promote sharper risk identification and intervention consistency. The team also felt that LE input to supervisory ratings would provide greater consistency.

Escalation of strategic issues: In 2013, the team found that the process of when and whether to engage senior OCC management in the decision process of strategic and material supervisory issues, such as major licensing decisions, was not clearly defined. Developing guidelines and a process so it was clear when it is appropriate for OCC senior management's strategic input into material supervisory issues was considered desirable.

Such a process was expected to provide greater consistency in the supervisory approach and supervisory assessments across institutions. In addition, it would be helpful in assessing the individual EICs' level of overall understanding of the risk profile and activities of the institution for which they are responsible.

MRA follow-up: In 2013, the team observed that the level of MRAs outstanding in LBS had shown a constant and significant increase since 2005. The identification of weaknesses is important, but the follow-up and resolution of such findings is equally if not more important. In addition to monitoring MRAs that are outstanding, there needed to be a focus on the quality and robustness of the follow-ups in order to ensure timely and effective remediation.

Systems to track the aging and progress to resolution of MRAs were recommended to provide greater consistency and more timely closure. Ensuring that MRAs continued to be an effective tool was considered a high priority.

2013 Recommendations and 2016 Follow Up Analysis

V.A: The OCC should conduct a benchmarking review of its supervisory framework in comparison to international peers.

Observations

The review team recognizes that the OCC initiated the 2013 International Review of OCC's Supervision of Large and Midsize Institutions, which provided a high level review of the supervisory processes, risk identification and follow-up, and the supervisory culture at the OCC.

On an ad hoc basis, the OCC actively seeks to understand the process followed by other supervisory agencies as it develops its supervisory approach. Recent examples include the Risk Appetite Framework and ERM framework.

OCC also is an active participant in international fora where policy supervisory methodology is discussed and developed.

While the review team believes the OCC has reached out to other supervisory agencies as it develops various policies, it is best practice for supervisors to conduct periodic benchmarking reviews of their supervisory methodologies. To our knowledge, OCC has not recently conducted such a review.

Each of the agencies represented in the review has a group responsible for supervisory methodology, which is charged with considering international practices and ensuring that their own agency's methodologies remain fit for purpose.

Assessment and Recommendations

The OCC has made a concerted effort to gain the benefit of external input in its policy development and supervisory methodology. This input has helped shape the OCC's supervisory approach. One example of renewal of OCC's supervisory approach is the build out of the LE program and the integration of that program to risk assessment.

The review team believes that a benchmarking review will serve to further strengthen and update its supervisory approach through an understanding of the strengths and weaknesses of other regulators' methodologies.

Partially Implemented.

5. The OCC should periodically conduct a benchmarking review of its supervisory methodology.

V.B: The OCC should consider the feasibility of either developing alternatives to CAMELS or, if this is not a feasible option under the statutes, the OCC should work with the other agencies to prioritize the incorporation of more forward-looking elements into the CAMELS rating system to closely align it with the RAS.

Observations

After review the OCC chose not to change CAMELS because it believed that there was sufficient flexibility in the Uniform Financial Institutions Rating System to include forward looking elements.[4]

The OCC's Bank Supervision Process includes an updated explanation of the relationship between CAMELS and the Risk Assessment System. A number of other marginal changes to the CAMELS rating process were made concurrently with the update.

Discussions with other US regulatory agencies indicate that they also use other means beyond the CAMELS to rate risk in banks. Given the legislated and multifaceted role of CAMELS, making change is difficult. The question remains, however, whether CAMELS continues to deliver the best "fit for purpose" outcome. Regulators expect institutions to monitor and validate the ongoing performance of their models. If better outcomes could be achieved by an alternative means, the expectation would be for the institution to change to the more fit for purpose approach.

Assessment and Recommendations

The OCC's Bank Supervision Process has been updated to include an expanded explanation of the relationship between CAMELS and the Risk Assessment System.

[4] This was discussed in OCC Bulletin 2015-48 (refer: https://occ.gov/news-issuances/bulletins/2015/bulletin-2015-48.html) in relation to the international peer review's findings on CAMELS.

Partially Implemented.

6. The OCC should periodically review whether the CAMELS rating approach remains fit for purpose. This review could be part of the earlier referenced benchmarking review of its supervisory methodology.

V.C: LBS should implement a robust review process that includes both LBS EICs as well as LEs (referenced earlier) to scrutinize supervisory strategies and supervisory ratings of large banks.

Observations

This recommendation is closely linked to 2013 Recommendation II.C, discussed earlier.

As noted, LEs are now well integrated in the development of institution-specific supervisory strategies and are providing valued inputs into supervisory activities. There is much stronger interaction between LEs and EICs/TLs. LEs do not yet routinely provide input into the determination of CAMELS ratings and rating changes.

Assessment and Recommendations

Partially Implemented.

7. The OCC should establish a process to ensure LE input when setting or changing CAMELS ratings.

V.D: Develop a process to clarify when strategic supervisory issues (e.g., mergers and acquisitions, intervention actions) need to be escalated to senior management (e.g., **Major Matters Supervision Review Committee** ***(MMSRC). The protocol should include examples of situations and also suggest what strategic outcomes are sought.***

Observations

The OCC has developed explanatory guidance and procedures on what should be elevated to the MMSRC. The guidance and procedure provide clarity on the role of the committee and the general nature and examples of the items that should be escalated to the MMSRC. Process and approval authority for items referred to the MMSRC has occurred. The relevant Deputy Controller and Large Bank EIC have a voice in the process.

Escalations of non-legal or enforcement related matters are a result of supervisory judgment and culture, with the OCC culturally endorsing a "no surprises policy". There is ample structure in place to assist elevation of issues though the organization. Different judgments at execution level, and through the escalation chain, on the materiality of issues will, however, always present such risks.

Assessment and Recommendations

Fully Implemented. No further recommendations.

V.E: OCC should undertake an analysis of the effectiveness of the Matters Requiring Attention process and consider developing controls to better manage the MRA follow-up process to promote more timely and consistent resolution of identified deficiencies by the institutions.

Observations

The OCC issued a PPM on the MRA in October of 2014. It emphasized that MRAs should be used to require change to deficient practices and not to recommend best practices. It also emphasized the need for supervisory follow-up.

Training of examiners to help them understand the PPM has been provided.

Timely closure of MRAs has been a strategic priority with associated metrics, which are included in the OCC's balanced scorecard and accountability assigned. That strategic focus on MRAs is expected to continue. Tracking of MRAs is provided to CBS and the Executive Committee ensuring ongoing focus.

The review team's discussions with large banks confirmed the emphasis that the OCC has placed on timely closure of MRAs. Improvement in the clarity of communications with the institutions with respect to the closing out of MRAs was also mentioned.

While the number of outstanding MRAs is beginning to decline, there remains a high backlog of MRAs for examiners to work through. The review team also observed that the inflow of new MRAs remains high. The OCC might consider whether issuing a large number of MRAs might reduce their overall impact and the ability of the institutions to focus on key issues. Do some MRAs address manifestations of a problem rather than the root cause?

Assessment and Recommendations

There has been clear improvement in the MRA process with institutions noting that they are observing the efforts made by the OCC to clarify expectations. A more disciplined approach to achieving timely closure of MRAs has improved the process and should make the recent improvements sustainable.

Fully Implemented. No further recommendation

VI Enterprise Governance

Areas Identified for Improvement in 2013

To ensure effective and consistent application of its supervisory framework, the OCC must develop a robust internal control framework including quality assurance. In 2013, the team recognized early efforts to enhance internal controls and identified LBS` quality assurance program and Enterprise Governance (EG) work on documentation as two areas that required particular attention.

At the time, the quality assurance program in LBS was underdeveloped. LBS was developing a Lean Six Sigma program in order to promote consistency and enhance the effectiveness of its internal controls. The EG unit was in its initial development stage and had not begun its work on documenting department goals, processes, systems and quality management activities.

2013 Recommendations and 2016 Follow Up Analysis

VI A: Complete LBS` Lean Six Sigma process. Findings from this exercise should be shared with MCBS.

Observations

The review team noted that the Lean Six Sigma program has been implemented in LBS and relevant initiatives have been implemented. The program highlighted the need to improve consistency in documentation for supervisory activities, including documenting evidence for supervisory actions. In response LBS has put in place a framework to promote proper documentation through the use of templates, IT systems and quality assurance processes.

LBS shared its findings with other parts of the organization, including MCBS. The review team understands that a Lean Six Sigma program is being considered/adopted across the agency.

Assessment and Recommendations

Fully Implemented. No further action recommended.

VI B: Commence work by the Enterprise Governance unit on documentation as soon as possible to identify current practices and allow the OCC to determine the standard and consistency of practices it wishes to put in place across the agency.

Observations

The EG unit has developed and implemented a comprehensive Quality Management Program (QMP) for promoting the overall effectiveness and efficiency of the OCC. The QMP ensures there are strong policies and procedures in place and operations are properly carried out. This is done through regular testing and validation, providing recommendations where gaps or deficiencies are identified, reporting to management, and tracking the progress and closure of audit findings.

The EG has implemented a 3-year audit cycle that clearly sets out the scope and frequency of each review in a manner that that is consistent with the risk tolerance of the agency. While still in its early days, the audit plan appears to be executed effectively with thorough audits conducted, and robust tracking, reporting and escalation of findings, issues and overdue items.

Assessment and Recommendations

The QMP that the OCC has put in place is comprehensive and consistent with that of organizations with strong governance and second line of defense.

Fully Implemented. No further action recommended.

VII. Conclusions

The review team believes that large and midsize bank supervision at the OCC is more effective than three years ago.

The OCC has devoted significant resources and management time to implementation of the 2013 recommendations. In several instances, the OCC went further than what was recommended in the 2013 review. The review team's assessment is that the OCC has adopted most of the recommendations presented in the 2013 report although several will take time to implement fully.

The review team recognizes that making major changes to an institution such as the OCC with its long history can be disruptive and will take time to become embedded in the way staff carries out their work. Continued attention by management to helping staff understand how the changes will benefit their work is very important. On the basis of the concentrated effort the OCC has devoted to implementation over the past three years as well as the quality and professionalism of the staff that the review team met during its two reviews, the review team is optimistic that these changes will be sustainable and are having the intended effect of improving the overall quality of supervision.