



## OCC Heightened Standards for Certain Large Insured Institutions – Proposed Guidelines

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### Executive Summary

The Office of the Comptroller of the Currency (OCC) has proposed guidelines to establish minimum standards for the design and implementation of a risk governance framework (Framework) for insured national banks, insured Federal savings associations, and insured Federal branches of foreign banks with average total consolidated assets of \$50 billion or more (collectively Large Banks, or Banks), as well as minimum standards for oversight of the Framework by the boards of directors of the Large Banks (Guidelines). The proposed Guidelines, which have been developed from the “heightened expectations” implemented by the OCC following the financial crisis and informed by the results of the OCC’s “Get to Strong” initiative for Large National Banks, would be enforceable under part 30 of the agency’s regulations.

Key requirements of the proposed Guidelines include:

- Identification and implementation of the roles and responsibilities for the organizational units and management personnel considered fundamental to the design and implementation of the Framework, including front line units, independent risk management, and internal audit
- Execution and ongoing review of a comprehensive, written statement of the Bank’s risk appetite, which would serve as the basis for the Framework and should be directly tied to the Bank’s strategic plan
- Board of Director requirements, including overseeing the design and implementation of the Framework, establishing accountability for the Framework, actively challenging management’s decisions and proposals, and ensuring skilled, independent representation in the composition of the board.

#### Key Takeaways

- The proposed Guidelines would “hardwire” the heightened expectations into the OCC examination process, and would likely be further enforced by the pending “Enhanced Prudential Standards” to be promulgated by the Federal Reserve Board pursuant to Section 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.
- Although applicable to Large Banks (over \$50 billion in assets), the OCC has retained authority to require other, smaller, insured institutions to comply with the proposed Guidelines if it determines the institution’s operations are highly complex or otherwise present a heightened risk.

- The OCC currently applies, on an informal basis, “certain aspects of the heightened expectations to select uninsured entities” (such as trust banks and Federal branches or agencies of foreign banks) and is considering whether it would be appropriate to also apply the proposed Guidelines to these entities, either informally or through a separate regulation.
- Banks are expected to have risk aggregation and reporting capabilities (the ability to aggregate risk exposures and identify concentrations at the Bank level, across business lines, and among legal entities) to manage risk and ensure the risk profile remains consistent with the Bank’s risk appetite. In January 2013 the Basel Committee on Banking Supervision’s published *Principles for effective risk data aggregation and risk reporting* (Principles) which applies to firms designated as global systemically important banks (G-SIBs). The OCC states that it expects the G-SIBs it supervises to be “largely compliant” with these Principles by the beginning of 2016 and that other Banks under the OCC’s purview, while not expected to comply with the Principles by the beginning of 2016, should nevertheless consider the Principles to be leading practices and should make an effort to bring their practices into alignment with the Principles where possible.
- At least two members of the Board of Directors would be required to be independent of the Bank or its parent company and they must receive formal, ongoing, training related to the risk governance framework, including the products, services, lines of business, and risks that have a significant impact on the Bank as well as the laws, regulations, and supervisory requirements applicable to the Bank.
- A Large Bank may use the risk governance framework of its parent company if: the Framework meets the minimum standards, the risk profiles of the parent company and the institution are “substantially the same” (generally a 95 percent threshold), and the institution demonstrates through a documented assessment, conducted annually, that its risk profile and its parent company’s risk profile are substantially the same.

## Background

The OCC first developed “heightened expectations” (A/K/A the “Get to Strong” Principles) for Large National Banks in response to the financial crisis in 2008. The expectations were intended to enhance the agency’s supervision of these institutions as well as to strengthen the institutions’ governance and risk management practices. Under these expectations:

- A Large Bank’s board of directors has a primary fiduciary duty to ensure that the institution operates in a safe and sound manner, commonly referred to as “preserving the sanctity of the charter”
- A Large Bank’s personnel management program must ensure appropriate staffing levels, provide for orderly succession, and provide for compensation tools to appropriately motivate and retain talent but not encourage imprudent risk taking
- A Large Bank must define and communicate an “acceptable risk appetite” across the organization, including measures that address the amount of capital, earnings, or liquidity that may be at risk on a firm-wide basis, the amount of risk that may

be taken in each line of business, and the amount of risk that may be taken in each key risk category monitored by the institution

- A Large Bank must have a “reliable oversight program,” including the development and maintenance of strong audit and risk management functions that are consistent with OCC standards and leading industry practices
- A Large Bank’s board of directors must be willing to provide a “credible challenge” to bank management’s decision-making, and independent directors in particular are expected “to acquire a thorough understanding of an institution’s risk profile and to use this information to ask probing questions of management and to ensure that senior management prudently addresses risks.”

In 2010, these heightened expectations were communicated informally to institutions in the OCC’s Large Bank program. In 2012, the OCC began examining each of the institutions for compliance with the expectations, including documenting its conclusions in the regulator’s Report of Examination noting each institution’s progress in complying with the expectations. The OCC indicates that it currently meets with each institution’s management on a quarterly basis to discuss progress toward meeting the expectations. The OCC further states that it anticipates establishing the heightened expectations as guidelines “will provide greater certainty to covered institutions and improve examiners’ ability to assess compliance.” Notably, the proposed Guidelines would apply to a broader group of institutions than currently subject to the “heightened expectations program.”

## Description

The proposed Guidelines would require Large Banks to establish and implement a risk governance framework for managing and controlling their risk taking activities. The Guidelines would be published as Appendix D to the OCC’s part 30 regulations and would set minimum standards for the required Framework.

## Applicability

The proposed Guidelines would apply to any insured national bank, insured Federal savings association, or insured Federal branch of a foreign bank, with average total consolidated assets (calculated over the four most recent consecutive quarters and as reported on the institution’s Call Report) equal to or greater than \$50 billion as of the effective date of final Guidelines (as previously defined, Large Banks).

Large Banks that meet the asset threshold subsequent to the effective date would be required to comply with the proposed Guidelines as of the date of the most recent Call Report included in the four quarter average.

The OCC reserves the authority to:

- Apply the Guidelines to any insured institutions with less than \$50 billion in total consolidated assets if the OCC determines such entity’s operations are highly complex or otherwise present a heightened risk that warrants application of the Guidelines
- Extend the time for compliance with the Guidelines
- Determine an entity is no longer required to comply with the Guidelines (based on an evaluation of the complexity of the entity’s operations or the presence of

heightened risk, including consideration of the complexity of the entity's products and services, risk profile, and scope of operations.

Large Banks may use the Framework of its parent company if: the Framework meets the minimum standards, the risk profiles of the parent company and the institution are "substantially the same," and the institution demonstrates through a documented assessment, conducted annually, that its risk profile and its parent company's risk profile are substantially the same. For this purpose, an institution's risk profile and its parent company's risk profile would be considered "substantially the same" if the Bank meets each of the following thresholds:

- Average total consolidated assets represent 95 percent or more of the parent company's average total consolidated assets
- Total assets under management represent 95 percent or more of the parent company's total assets under management
- Total off-balance sheet exposures represent 95 percent or more of the parent company's total off-balance sheet exposures.

Where the risk profiles of the Bank and its parent company are not substantially the same, a Bank would be expected to establish its own Framework that should be easily distinguished and separate from its parent's Framework (i.e., for risk management and supervisory reporting purposes as well as to ensure that decisions made by the parent company's board of directors and management do not jeopardize the safety and soundness of the Bank.)

## Standards for Risk Governance Framework

As proposed, the proposed Guidelines set out thirteen separate minimum standards for the design and implementation of a Risk Governance Framework. The OCC's p

### *Risk Governance Framework Document*

The Framework should be a formal, written document that is designed by independent risk management and approved by the board of directors or the board's Risk Committee (hereinafter, Board). The Framework should be reviewed at least annually by independent risk management to address changes in the Bank's risk profile.

"Independent risk management" is defined as any organizational unit within an institution that has responsibility for identifying, measuring, monitoring, or controlling aggregate risks. Independent risk management units operate independently from the front line units. They are lead by a Chief Risk Executive who reports directly to the Chief Executive Officer (CEO) and no front line unit executive may lead an independent risk management unit.

A "front line unit" is any organizational unit that either:

- Engages in revenue generating activities for the parent company or the institution
- Provides services, such as administration, finance, treasury, legal, or human resources, to the institution
- Provides information technology, operations, servicing, processing, or other support to any organizational unit covered by the proposed Guidelines.

### *Scope of Framework*

The Framework should cover the following risk categories that apply to the Bank: credit risk, interest rate risk, liquidity risk, price risk, operational risk, compliance risk, strategic risk, and reputation risk.

### *Roles and Responsibilities*

The Framework should cover three distinct organizational units that the OCC describes as fundamental to the design and implementation of the Framework: (1) front line units, (2) independent risk management, and (3) internal audit. These units should also ensure that the Board has sufficient information on the Bank's risk profile and risk management practices to provide credible challenges to management's recommendations and decisions. The independent risk management and internal audit units must have unfettered access to the Board with regard to their risk assessments, findings, and recommendations, that is independent from front line unit management and, when necessary, the CEO.

In carrying out their responsibilities within the Framework, front line units, independent risk management, and internal audit could engage the services of external experts to assist them. However, no organizational unit in the Bank would be permitted to delegate its responsibilities under the Framework to an external party

The roles and responsibilities for each would include, but not be limited to, the following:

- Front line units – should have responsibility for appropriately assessing and effectively managing all of the risks associated with their activities and should be held accountable by the CEO and the Board. In particular, front line units should:
  - Assess material risk on an ongoing basis and adjust as needed to meet the risk profile
  - Establish and adhere to written policies that include unit risk limits and ensure that unit risks are identified, measured, monitored, and controlled consistent with the institution's risk appetite, concentration risk limits, and all policies under the Framework
  - Establish and adhere to policies and processes to ensure compliance with all policies in the Bank's Framework
  - Adhere to all policies, procedures, and processes established by the independent risk management
  - Develop, attract, and retain talent and maintain staffing levels required to carry out the unit's role and responsibilities effectively
  - Establish and adhere to talent management processes that comply with the Bank's Framework
  - Establish and adhere to compensation and performance management programs that comply with the Bank's Framework.
- Independent risk management - should oversee the Bank's risk-taking activities and assess risks and issues independent of the CEO and front line units. In fulfilling these responsibilities, independent risk management should:
  - Take primary responsibility for designing a comprehensive written Framework that meets the proposed Guidelines and is commensurate with the size, complexity, and risk profile of the institution. Independent risk management should be held accountable for this responsibility by the CEO and the Board

- Identify and assess, on an ongoing basis, the Bank's material aggregate risks and use such risk assessments as the basis for adjustments as needed
  - Establish and adhere to Bank policies that include concentration risk limits and are intended to ensure that aggregate risks within the Bank are effectively identified, measured, monitored, and controlled, consistent with the Bank's risk appetite and the proposed Guidelines
  - Establish and adhere to procedures and processes, as necessary to ensure compliance with the policies related to the concentration risk limits
  - Ensure that front line units meet the applicable roles and responsibilities standards
  - Identify and communicate to the CEO and the Board, material risks and significant instances where the assessment of risk differs from the front line unit, and significant instances where a front line unit is not adhering to the Framework
  - Identify and communicate to the Board, material risks and significant instances where the assessment of risk differs from the CEO, and significant instances where the CEO is not adhering to, or holding front line units accountable for adhering to, the Framework
  - Develop, attract, and retain talent and maintain staffing levels required to carry out the unit's role and responsibilities effectively
  - Establish and adhere to the Framework's talent management processes
  - Establish and adhere to the Framework's compensation and performance management programs.
- Internal audit- should ensure that the Bank's Framework complies with the proposed Guidelines and is appropriate for the size, complexity, and risk profile of the Bank. In particular, internal audit should:
    - Maintain a complete and current inventory of all of the Bank's material businesses, product lines, services, and functions, and assess the risks associated with each, which collectively form the basis for the audit plan
    - Establish and adhere to an audit plan, updated at least quarterly, that takes into account the Bank's risk profile, emerging risks, and issues
    - Develop an audit plan that requires internal audit to evaluate the adequacy of and compliance with policies, procedures, and processes established by front line units and independent risk management under the Framework
    - Report in writing, conclusions, issues, and recommendations from audit work to the Board's Audit Committee. The report should identify the root cause of any issue and include a determination of whether it impacts one or more organizational units within the Bank as well as a determination of the effectiveness of front line units and independent risk management in identifying and resolving issues in a timely manner
    - Establish and adhere to processes for independently assessing the design and effectiveness of the Framework on at least an annual basis, including a conclusion on the Bank's compliance with the standards in the proposed Guidelines and the degree of consistency with leading practices
    - Identify and communicate to the Board's Audit Committee significant instances where front line units or independent risk management are not adhering to the Framework
    - Establish a quality assurance department that ensures internal audit's policies, procedures, and processes comply with applicable regulatory and industry guidance, are appropriate for the size, complexity, and risk profile of

the bank, are updated to reflect changes to internal and external risk factors, and are consistently followed

- Develop, attract, and retain talent and maintain staffing levels required to effectively carry out the unit's role and responsibilities
- Establish and adhere to the Framework's talent management processes
- Establish and adhere to compensation and performance management programs.

### *Strategic Plan*

The CEO should develop a written strategic plan with input from front line units, independent risk management, and internal audit. The Board should evaluate and approve the strategic plan and monitor management's efforts to implement the strategic plan at least annually. The strategic plan should cover, at a minimum, a three-year period and

- Contain a comprehensive assessment of risks that currently or could impact the institution over the period of the strategic plan
- Articulate an overall mission statement and strategic objectives with an explanation of how to achieve those objectives
- Explain any necessary updates to the Framework to account for changes in the Bank's risk profile projected under the strategic plan
- Be reviewed, updated, and approved, as necessary, due to changes in the Bank's risk profile or operating environment that were not contemplated when the strategic plan was developed.

### *Risk Appetite Statement*

The Bank should have a comprehensive written statement that articulates its risk appetite, including quantitative limits and qualitative components, and serves as the basis for the Framework.

- The quantitative limits should incorporate sound stress testing processes, as appropriate, and address the Bank's earnings, capital, and liquidity position including appropriate capital and liquidity buffers as well as prompt intervention by management and the Board to reduce risk before the institution's risk profile jeopardizes the adequacy of its earnings, liquidity, and capital.
- The qualitative components should describe a safe and sound risk culture and how the Bank will assess and accept risks, including those that are difficult to quantify.

### *Concentration and Front Line Unit Risk Limits*

The Framework should include concentration risk limits and, as applicable, front line unit risk limits, for the relevant risks. Concentration and front line unit risk limits should ensure that front line units do not create excessive risks and, when aggregated across such units, these risks do not exceed the limits established in the Bank's risk appetite statement.

### *Risk Appetite Review, Monitoring, and Communication Processes*

The Framework should require:

- The Board to review and approve the risk appetite statement at least annually based on the size and volatility of risks and any material changes in the Bank's business model, strategy, risk profile, or market conditions



- The initial communication and ongoing reinforcement of the Bank's risk appetite statement to be conducted in such a manner that ensures employees align their risk-taking decisions with the risk appetite statement
- Independent risk management to monitor the Bank's risk profile relative to its risk appetite and compliance with concentration risk limits, and to report to the Board at least quarterly on such monitoring
- Front line units to monitor compliance with their respective risk limits and to report to independent risk management at least quarterly
- When necessary given the level and type of risk, independent risk management to monitor front line unit compliance with front line unit risk limits and to engage in ongoing communication with front line units regarding adherence to the limits and to report concerns to the CEO and the Board.

### *Processes Governing Risk Limit Breaches*

The Bank should establish and adhere to processes that require front line units and independent risk management to:

- Identify breaches of the risk appetite statement, concentration risk limits, and front line unit risk limits ;Distinguish breaches based on the severity of their impact on the Bank
- Establish protocols for when and how to inform the Board, front line unit management, independent risk management, and the OCC of a risk limit breach taking into account the severity of the breach and its impact on the Bank
- Describe in writing how a breach will be resolved
- Establish accountability for reporting and resolving breaches that includes consequences for risk limit breaches that consider the magnitude, frequency, and recurrence of breaches.

### *Concentration Risk Management*

The Framework should include policies and supporting processes appropriate for the bank's size, complexity, and risk profile for effectively identifying, measuring, monitoring, and controlling the Bank's concentration of risk.

### *Risk Data and Aggregation*

The Framework should include a set of policies, supported by appropriate procedures and processes, designed to ensure that the Bank's risk data aggregation and reporting capabilities are appropriate for its size, complexity, and risk profile and support supervisory reporting requirements. The policies, procedures and processes should provide for:

- The design, implementation, and maintenance of a data architecture and information technology infrastructure that supports the Bank's risk aggregation and reporting needs during normal times and during times of stress
- The capturing and aggregating of risk data and reporting of material risks, concentrations, and emerging risks in a timely manner to the Board and the OCC
- The distribution of risk reports to all relevant parties at a frequency that meets their needs for decision-making purposes.

### *Relationship of Risk Appetite Statement, Concentration Risk Limits, and Front Line Unit Risk Limits to Other Processes*

Front line units and independent risk management should incorporate the risk appetite statement, concentration risk limits, and front line unit risk limits into the following:

- Strategic and annual operating plans



- Capital stress testing and planning processes
- Liquidity stress testing and planning processes
- Product and service risk management processes, including those for approving new and modified products and services
- Decisions regarding acquisitions and divestitures
- Compensation and performance management programs.

### *Talent Management Processes*

The Bank should establish and adhere to processes for talent development, recruitment, and succession planning to ensure that management and employees who are responsible for or influence material risk decisions have the knowledge, skills, and abilities to effectively identify, measure, monitor, and control relevant risks.

The Board should:

- Hire a CEO and approve the hiring of direct reports to the CEO who have skills and abilities to design and implement an effective Framework
- Establish a reliable succession plan for the CEO and the CEO's direct reports
- Oversee the talent development, recruitment, and succession planning processes for individuals two levels down from the CEO
- Hire one or more Chief Risk Executives (to lead independent risk management) and a Chief Audit Executive (to lead internal audit) with the skills and abilities to effectively implement the Framework
- Establish a reliable succession plan for the Chief Risk Executives and the Chief Audit Executive
- Oversee the talent development, recruitment, and succession planning processes for independent risk management and internal audit.

### *Compensation and Performance Management Programs*

The Bank should establish and adhere to compensation and performance management programs that meet the requirements of any applicable statute or regulation and are appropriate to

- Ensure the CEO, front line units, independent risk management, and internal audit implement and adhere to an effective Framework
- Ensure front line unit compensation plans and decisions appropriately consider the level and severity of issues and concerns identified by independent risk management and internal audit
- Attract and retain the talent needed to design, implement, and maintain an effective Framework
- Prohibit incentive-based payment arrangements, or any feature of any such arrangement, that encourages inappropriate risks by providing excessive compensation or that could lead to material financial loss.

## Standards for Boards of Directors

Under the proposed Guidelines, the Board of Directors would be required to meet certain minimum standards to carry out their role of providing oversight for the design and implementation of the risk governance framework. Those minimum standards would require:

- Every member of a Bank's Board to bear responsibility for oversight of the Bank's compliance with safe and sound banking practices and to ensure that the Bank establishes and implements an effective risk governance framework that meets

the minimum standards described in the proposed Guidelines. The Board (or the Board's Risk Committee) should approve any changes to the Framework

- Board members are expected to exercise sound, independent judgment
- Board members should actively oversee the Bank's risk-taking activities and hold management accountable for adhering to the Framework by questioning, challenging, and when necessary, opposing recommendations and decisions made by management that could cause the Bank's risk profile to exceed its risk appetite or jeopardize the safety and soundness of the Bank
- Membership of the Board should include at least two members that are not members of the Bank's management or its parent company's management (i.e., independent directors). A formal, ongoing training program for independent directors should be established and adhered to. It should address:
  - Complex products, services, lines of business, and risks that have a significant impact on the Bank
  - Laws, regulations, and supervisory requirements applicable to the Bank
  - Other topics identified by the Board
- Board members to conduct an annual self-assessment that includes an evaluation of the Board's effectiveness in meeting the standards applicable to Boards of Directors in the proposed Guidelines.

## OCC Enforcement of the Proposed Guidelines

The OCC is proposing the Guidelines pursuant to Section 39 of the *Federal Deposit Insurance Act*, which authorizes the OCC to prescribe safety and soundness standards in the form of a regulation or guidelines. The proposed Guidelines would be published as an appendix to the agency's regulations at 12 CFR part 30. Issuing the heightened standards as guidelines rather than as regulation "provides the OCC with the flexibility to pursue the course of action it determines to be the most appropriate given the specific circumstances of a Bank's noncompliance with one or more standards, and the Bank's self-corrective and remedial responses." In contrast, if a Bank "fails to meet a standard prescribed by regulation, the OCC must require it to submit a plan specifying the steps it will take to comply with the standard." The OCC may initiate enforcement remedies, including the submission of a compliance plan, when it determines that a Bank has failed to meet the standards in the proposed Guidelines. The OCC also has the authority to initiate formal enforcement actions under Section 39 "independently of, in conjunction with, or in addition to any other enforcement action available to the OCC."

Comments on the proposed Guidelines will be accepted through March 28, 2014

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## Commentary

In September 2013, Thomas Curry, Comptroller of the Currency, speaking before the American Banker Regulatory Symposium, acknowledged the OCC's intention to formalize as guidelines its "heightened expectations," sometimes referred to as "Get to Strong standards," under the agency's part 30 regulations. He stated that the heightened expectations had "raised the bar significantly" with respect to larger banks by:

- Insisting that internal controls and audit be raised to the standard of "strong"

- “Making it clear that satisfactory ratings are not acceptable”
- Expecting boards of directors to be “significantly engaged and to have the knowledge and focus to present a credible challenge to management”
- Expecting rigorous processes to be in place to ensure qualified employees are attracted and retained to manage the businesses in a safe and sound manner.

In its proposal, the OCC states that issuing the standards as guidelines would give the agency flexibility to determine the course of action to address a Bank’s noncompliance with one or more of the standards. It may also give the agency the ability to act more quickly to address noncompliance, including the imposition of monetary fines.

Participants in the OCC’s Large Bank program have been actively working with examiners and preparing to meet the OCC’s heightened expectations for the past few years. In contrast, mid-size Banks, insured Federal savings associations, and insured Federal branches that would be covered by the proposed Guidelines may have significant work yet to do to meet the minimum standards, including implementing the organizational requirements (such as establishing separate units to monitor risks across all business units – e.g., front line units, independent risk management, internal audit), building the necessary internal controls structure and reporting processes, and strengthening the composition and oversight of the Board and top tier management (CEO, Chief Risk Executive, Chief Audit Executive). Notably, the OCC indicates the Banks’ organizational units would be permitted to engage outside service providers to assist with carrying out their duties under the Framework but would not be permitted to delegate their responsibilities to the external party.

And, it may be difficult for many of these Banks to satisfy the “substantially the same” risk profile requirement (95 percent or more of the Bank’s average total consolidated assets, assets under management, and balance sheet exposures must equal those of its parent company) in order to rely on the parent company’s Framework, and necessitating a separate and distinct Framework to be established.

As comprehensive as the proposed Guidelines are, they are only one of several significant standards-oriented rulemakings directed at Large Banks. In the near term, the Federal Reserve Board is expected to release final rules implementing the enhanced prudential standards requirements of Sections 165 of the Dodd-Frank Act (please refer to Regulatory Practice Letter 12-04 for an outline of the proposed rules). These rules, which are applicable to U.S. bank holding companies with total consolidated assets of \$50 billion or more and nonbank financial companies deemed systemically important by the Financial Stability Oversight Council and supervised by the Federal Reserve, will address risk-based capital and leverage, liquidity, single-counterparty credit limits, overall risk management and risk committees, and stress tests. Some in the industry surmise that the OCC’s proposed Guidelines may be an indicator of the final provisions in the Section 165 rulemaking, certainly with regard to risk management and risk committees. Most likely, the proposed Guidelines and the Section 165 provisions will work in concert – e.g., as proposed, the Guidelines would require the risk appetite statement (the basis for the Framework) to be incorporated into strategic and annual operating plans, capital stress testing and planning, liquidity stress testing and planning, and product and service management processes.

G-SIBs are also expected to meet the Basel Committee's *Principles for effective risk data aggregation and risk reporting* (please refer to Regulatory Practice Letter 14-01) though others not covered directly by the Principles would be expected to consider the Principles to be leading practices and to make an effort to bring their practices into alignment with the Principles where possible.

Finally, Bank boards of directors will likely feel the direct weight of the proposed Guidelines that require Board members to "ensure" the Bank establishes and implements an effective risk governance framework as well as oversee the risk-taking activities, approve the strategic plan and risk appetite statement, oversee the hiring and compensation of the CEO and top-tier risk management, and facilitate independent communication channels with the CEO and top tier management in the front line units, independent risk management, and internal audit, among other things.

Boards would also be required to have at least two board members that are independent of Bank management or the parent company and all board members are expected to provide a "credible challenge" to bank management's decision-making. As proposed by the Federal Reserve, the Section 165 Risk Committee provisions would impose similar independence requirements, including a requirement that the Risk Committee be chaired by an independent board member. Some foreign banks in particular (i.e., those that would be subject to the Section 165 provisions through the Federal Reserve Board's pending rulemaking to introduce new regulatory requirements for foreign banking organizations operating in the U.S. – please refer to Regulatory Practice Letter 12-23) have expressed concern about the difficulty of meeting the independent Risk Committee requirements (having a local Chief Risk Officer and Independent member of Board of Directors for the intermediate holding company) in the U.S., which would require people in these positions to have the expertise, seniority, and ability to challenge Group level decisions, particularly in time of stress.

#### Key Takeaways

- The proposed Guidelines would "hardwire" the heightened expectations into the OCC examination process, and would likely be further enforced by the pending "Enhanced Prudential Standards" to be promulgated by the Federal Reserve Board pursuant to Section 165 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.
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- At least two members of the Board of Directors would be required to be independent of the Bank or its parent company and they must receive formal, ongoing, training related to the risk governance framework, including the products, services, lines of business, and risks that have a significant impact on the Bank as well as the laws, regulations, and supervisory requirements applicable to the Bank.
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