Office of the
Comptroller of the Currency
Washington, DC 20219

OFFICE OF THE COMPTROLLER OF THE CURRENCY

A Common Sense Approach to Community Banking

Message From the Comptroller

Supervising national banks and federal savings associations is the core mission of the Office of the Comptroller of the Currency (OCC). More than 80 percent of the institutions we supervise are community banks and federal savings associations (collectively, community banks), and nearly 2,000 OCC examiners, living and working in communities across the nation, are dedicated to this important mission. OCC examiners are supported by a nationwide network of subject matter experts, economists, and lawyers who add their extensive expertise to the perspectives of our local examiners.

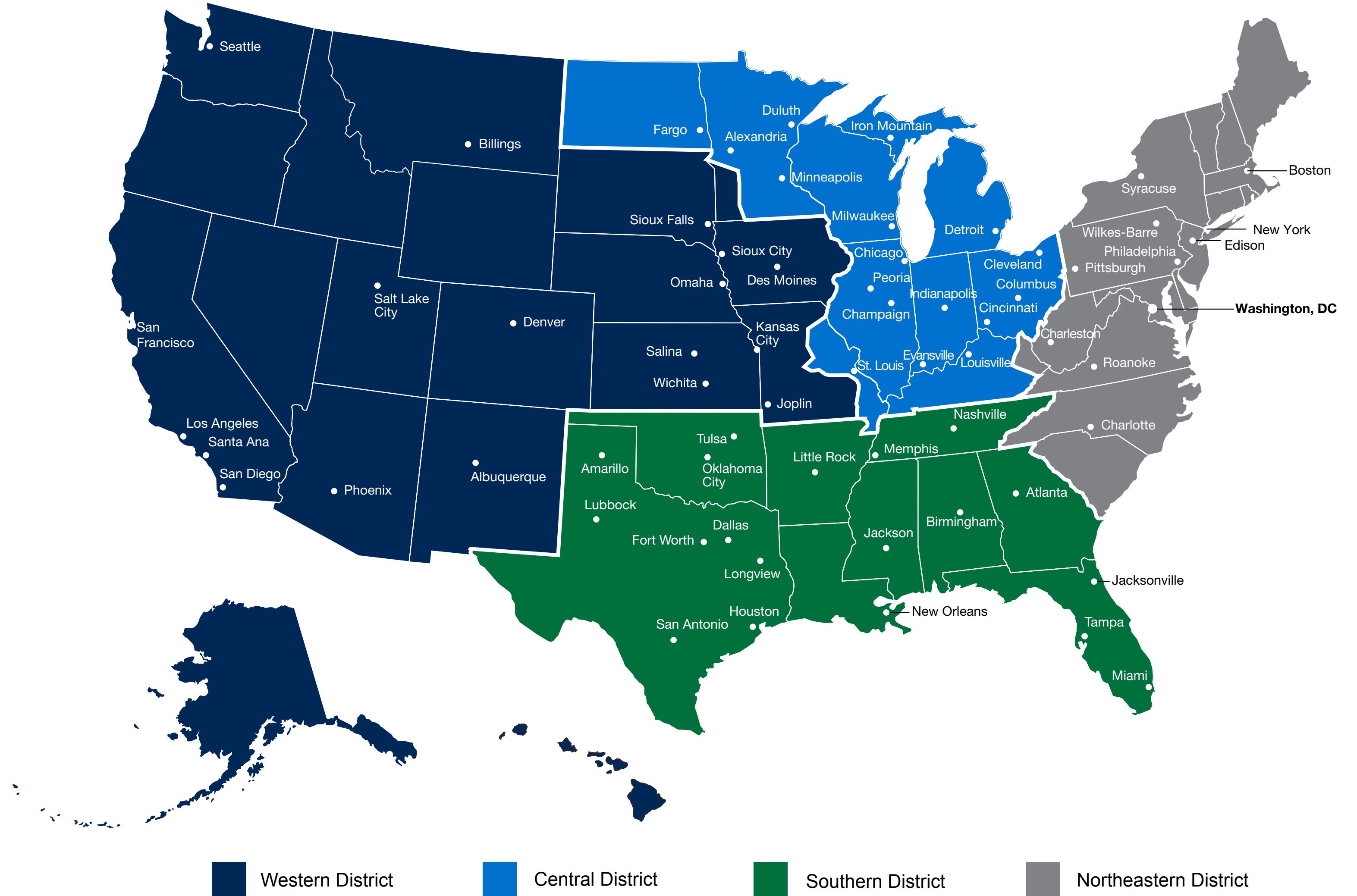
Over the years, community banking has evolved from an era of general ledger cards and hand-posted loan payments to our digital age where account information is only clicks away and many customers seldom enter their banks to transact business. While much has changed and banking has grown more complex, the core principles expressed by the first Comptroller of the Currency in 1863, when the OCC was created, remain today the bedrock of safe and sound banking. In his letter of advice to bankers, Comptroller Hugh McCulloch wrote:

> *Treat your customers liberally, bearing in mind the fact that a bank prospers as its customers prosper, but never permit them to dictate your policy. … Pursue a straightforward, upright, legitimate banking business. Never be tempted by the prospect of large returns to do anything but what may be properly done under the National Currency Act.*

Such common sense rings true today as community banks continue to be the foundations of cities and towns across the nation. In that spirit, and with this OCC publication, “A Common Sense Approach to Community Banking,” we share best practices for successful bank management. These best practices are formed by the OCC’s philosophy of ensuring that boards of directors and management operate community banks in a safe, sound, and fair manner.

Thomas J. Curry
Comptroller of the Currency

OCC Locations



Introduction

What allows one community bank to survive and thrive while another languishes or fails? Has the formula for successful banking changed over the years or has it remained fundamentally the same? What can be done to ensure that your community bank remains successful and vibrant for the good of the community it serves?

This booklet presents the OCC's view on how a board of directors and management can implement a common sense approach to community banking. It is our perspective on what makes a difference in the community banks that excel. We share fundamental banking best practices that have proven useful to boards of directors and management in successfully guiding their community banks through economic cycles and environmental changes.

In this booklet, we focus on three long-standing, underlying concepts:

- Accurately identifying and appropriately monitoring and managing your bank's risks
- Plotting a shared vision and business plan for your community bank with sufficient capital support
- Understanding the OCC's supervisory process and how you may extract helpful information from our process

We believe in the need for a strong and healthy community banking sector. The community bank supervision division at the OCC is our agency's largest line of business. Over 80 percent of the institutions the OCC supervises are community banks, and, of those, approximately two-thirds have less than $250 million in total assets.

We hope you find this booklet helpful and of value as you set the proper direction for your community bank. If you have any questions or would like to discuss best practices further, your OCC portfolio manager and Assistant Deputy Comptroller are only a telephone call or e-mail away.

Identifying Emerging Risk: Risk Assessment System

The Risk Assessment System (RAS) is an OCC examination tool that you can also use to help identify and manage risks in your bank. The RAS is designed to address emerging risks at an early stage and allow your bank's board and management to develop and implement appropriate strategies to mitigate these risks.

How do we define risk? Risk is the potential that events, expected or unanticipated, may have an adverse effect on a bank's earnings, capital, or franchise value. Some transactions or activities may expose a community bank to risk so great that no level of sound risk management or capital can effectively control or mitigate the risk. Significant asset concentrations are a good example of this. For instance, you are likely familiar with institutions that failed during weak economic cycles because they had extremely high commercial real estate concentrations. Even with satisfactory risk management practices, the banks' concentrations were just too large when the economy began to deteriorate.

The RAS is designed to give bankers and examiners a forward-looking tool to spot excessive risk building and inadequate risk management processes before they negatively affect a community bank. The system is used to evaluate a bank's risk management processes based on management's ability to effectively manage current and prospective risk.

How does RAS work?

Our RAS tool establishes a common framework that bankers and examiners can use to assess eight categories of risk that are often present, to some degree, in all financial institutions. These risks are: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. The relevance of these risks varies by community bank and may change over time. The risks may also be interdependent, so a change in one risk category may result in a change in another risk category. For example, a new loan product may be introduced that increases credit, liquidity, and operational risks.

You have likely seen a completed version of the following RAS table in your community bank's OCC report of examination (see next page).

RAS provides a consistent means of measuring the quantity of risk, the quality of risk management, the aggregate level of risk, and the direction of risk in six of the eight risk categories listed in the RAS table.

The quantity of risk is assessed separately from the quality of risk management so that deficiencies in risk management can be identified and addressed even if the quantity of risk has not changed. A time lag often exists between when risks are created and when they materialize in a bank's financial performance. Lapses or potential weaknesses in risk management practices can often be an early warning of future problems if not corrected. In general, the higher the quantity of risk the higher the expectation should be for prudent risk management practices. Strong capital support or financial performance is not a replacement for sound risk management.

In the RAS table, "quantity of risk" means the level or volume of risk that a bank faces and is characterized as low, moderate, or high. Appendix A of the "Community Bank Supervision" booklet of the *Comptroller's Handbook* contains a detailed matrix of factors bankers should consider when drawing conclusions about the quantity of risk. Strategic and reputation risks do not reflect a quantity of risk category because they cannot be precisely measured.

"Quality of risk management" evaluates whether a bank's systems are capable of identifying, measuring, controlling, and monitoring risk in the bank. The quality of risk management has an obvious connection to the quantity of risk and helps determine whether the level of risk is appropriate. A bank's quality of risk management is assessed as weak, satisfactory, or strong. As with quantity of risk,

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.

strategic and reputation risks do not have a quality of risk management assessment because they cannot be precisely measured.

No single risk management system works for all community banks. Each bank should develop a risk management system tailored to its specific needs and circumstances. The sophistication of the risk management system should be commensurate with the bank's size, complexity, and geographic diversity.

All sound risk management systems, however, share these four common fundamentals:

1. Proper risk identification
2. Accurate and timely measurement of risk
3. Prudent risk limits as set forth in the bank's operating policies and procedures
4. Accurate and timely risk monitoring

Aggregate Risk

Following the determination of the quantity of risk and the quality of risk management, an "aggregate level of risk" is assessed for each area and characterized as low, moderate, or high. Aggregate risk is a summary judgment about the level of supervisory concern. It incorporates judgments about the quantity of risk and the quality of risk management by weighing the importance of each.

For example, a bank might have a low quantity of liquidity risk, based on currently abundant sources of liquidity. The quality of liquidity risk management, however, may be assessed as weak due to ineffective policies, deficient liquidity reports, or an inadequate contingency funding plan. A low quantity of liquidity risk coupled with weak liquidity risk management may result in a bank being assessed with a moderate aggregate level of risk, depending on the nature of the weaknesses.

Strategic and Reputation Risks

Two risks—strategic and reputation—deserve special mention, as these typically permeate all of a bank's activities and products. Strategic risk is the risk to current or anticipated earnings, capital, or franchise value arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. Strategic risk focuses on more than just an analysis of your bank's written strategic plan. Other considerations include whether the board has adopted policies that are consistent with the bank's business strategies, whether initiatives are supported by sufficient capital, and whether goals are effectively articulated and communicated. Strategic risk also incorporates how your bank's management analyzes external factors that affect the bank's strategic direction.

Examples of actions that could affect your bank's strategic risk include entry into a new market, the opening of a branch or loan production office, initiation of a new loan product, and deciding to cease or not offer a product or service. Entering new lines of business without a well-defined strategy, thorough due diligence, appropriate risk controls, or sufficient capital are common pitfalls. All community banks need some degree of strategic planning tailored to the banks' size and complexity.

Reputation risk is the risk to current or anticipated earnings, capital, or franchise value arising from negative public opinion. This affects your bank's ability to establish new relationships and services or continue to service existing relationships, directly affecting current and future revenues. Reputation risk is present throughout any community bank. The impact of a formal enforcement action, lawsuits, data breaches, or privacy concerns are examples of issues that can impact reputation risk. Other examples include foreclosure activity, frequent changes in senior staff, and noncompliance with consumer protection laws.

Direction of Risk

"Direction of risk"—the final aspect of RAS—is a prospective assessment of how the aggregate risk is expected to change over the next 12 months.

It is characterized as either increasing, stable, or decreasing. The direction of risk should influence management's oversight strategy. For example, if credit risk is viewed as high and increasing, then management would likely take steps to tighten loan policies and procedures, curtail specific types of lending, or hire additional lending staff. Conversely, if credit risk is low but increasing, ongoing monitoring but no corrective action may be needed.

RAS is an examination tool that you can use to identify, measure, monitor, and control risks in your community bank. This tool allows management to allocate valuable resources to those areas evidencing signs of emerging and high risk,

creating an opportunity to ensure that appropriate risk management practices are developed and implemented. RAS can be used on a stand-alone bank basis or incorporated in a holding company structure.

Relationship Between RAS and Enterprise Risk Management

While RAS is a tool that can help you identify and monitor changes in risks across your bank's activities, enterprise risk management (ERM) is a process that can help you manage those risks in a comprehensive and integrated manner. Even if you are unfamiliar with the term ERM, your bank is likely practicing some form of the process. For example, has your board ever discussed what it perceives are the greatest risks confronting your community bank and then developed action plans to address the risks? Before introducing a new loan product, has your board sought input from your lending department as well as the compliance and operations departments?

ERM helps the board and management view risks in a high-level, holistic manner. To be successful, ERM must be embraced at the most senior levels of your bank, and the risk assessment process must be candid and self-critical. If your bank is a member of a holding company, it may be beneficial to implement ERM from an organizational standpoint.

An important first step is selecting the right individual or committee to oversee the bank's ERM process. While a qualified individual independent from day-to-day business line management is preferred to oversee the ERM process, for a small bank this may not be practical or possible. In that case, consider senior level staff members who have a good understanding of the bank's operations across the various business lines. For example, a loan officer who does not have a complete understanding of operations or compliance requirements may not be fully capable of assessing all possible issues with a new deposit product. Placing that loan officer on a risk committee with staff members from other business lines, however, may result in an effective process and help ensure all relevant perspectives and potential risks are considered and addressed. As a check and balance, your bank may also consider engaging an outside consultant to periodically review the bank's ERM process independently.

Once someone is selected to lead the bank's ERM process, where does that individual or committee start? Identification of key risks is critical and can be accomplished in many ways. Sources can include the bank's last examination report (CAMELS ratings, examination findings, and RAS designations), call report data (including peer and competitor analyses), national and local economic data, discussions with

community leaders (business people, farmers, local government officials, and others), and input from the board and bank staff.

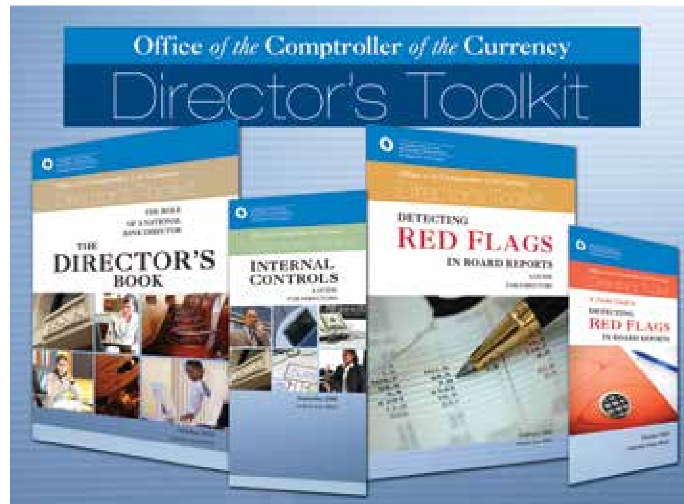
Closely examine whether the CAMELS ratings and the information technology (IT) and consumer compliance ratings evidence weakness as denoted by adverse ratings of 3, 4, or 5. These ratings suggest a bank is already exposed to a significant degree of risk in one or more areas. The comments in the OCC's examination report specifically explain the underlying issues.

The RAS page in the report, detailing the eight categories of risk, should correlate with the bank's assigned CAMELS, IT, and consumer compliance ratings and report comments. As a forward-looking tool, the RAS should assist management with risk identification and provide an indication of the severity of risk. For example, the RAS may detail a growing concentration of credit or relaxation of underwriting standards in a particular loan category resulting in a higher aggregate level of credit risk. The bank's failure to adequately manage or mitigate that risk could eventually result in a lower asset quality rating in CAMELS.

Scenario Analysis

Once the key risks are identified and a determination is made as to how they will be measured and prioritized in importance to the bank, those risks will need to be monitored to assess whether they are increasing, decreasing, or stable. Let's consider a bank that has identified interest rate risk as a key risk because its balance sheet is heavily weighted with residential real estate mortgages and long-term investments. What happens to the bank's earnings with a 100 basis point increase in interest rates? How about a 200 basis point increase in rates? Scenario analysis or stress testing can help assess how significant the risk is and if the risk is increasing or decreasing. Furthermore, with active, ongoing monitoring, your bank can better determine how to control key risks and mitigate their effects on the bank's overall condition.

Because risks cannot be avoided, the key factor becomes how they are properly controlled to ensure the bank remains safe and sound. Periodic review and reassessment of policies, procedures, and limits are crucial, especially during times when the direction of risk is increasing. In the interest rate



risk example used previously, a scenario that shows increasing exposures to rising interest rates should trigger a review of the bank's funds management, lending, and investment policies to determine whether strategies or limits need revision.

Using RAS and ERM should strengthen your bank's corporate governance and help the board and management make better decisions regarding the bank's level of risk and reward objectives. Written reports on the bank's key risks should be presented to the board for review, discussion, and required action. This enables the board and management to keep abreast of changing risks and how these risks may potentially affect your community bank.

Implementing some form of ERM can assist board members in meeting their fiduciary responsibilities and improve your bank's prospects for operating more profitably and successfully.

Relationship Between RAS and Strategic Planning

After an accurate assessment of your bank's risk profile and ability to manage risk is made and various external factors that can affect and influence the bank have been determined, the board and management can set realistic goals and objectives for the bank's strategic plan. Here again, RAS can play an integral role.

For example, if the RAS page in your bank's latest report indicates liquidity risk concerns deriving from a volatile funding base and moderate operational issues stemming from IT weaknesses, what matters should be discussed and evaluated before your bank starts engaging in mortgage banking activity? While mortgage banking activity may provide badly needed income, if the bank embarks on this new venture without first addressing these risk management issues, what might be the possible repercussions?

Sound strategic decisions are essential for your bank to compete and be profitable. And well-thought-out plans for the bank's activities, products, and services are critical to ensuring a competitive stance.

In today's banking industry, margin compression and high operating expenses challenge even the most efficiently run community bank, so it has never been more important for your bank to formulate a successful strategic plan that incorporates managing risk on a prudent basis.

Strategic Planning

There are many approaches to effective strategic planning. In its simplest form, a bank's strategic planning process should answer the following four questions:

1. Where are we now?
2. Where do we want to be?
3. How do we get there?
4. How do we measure our progress?

Where are we now?

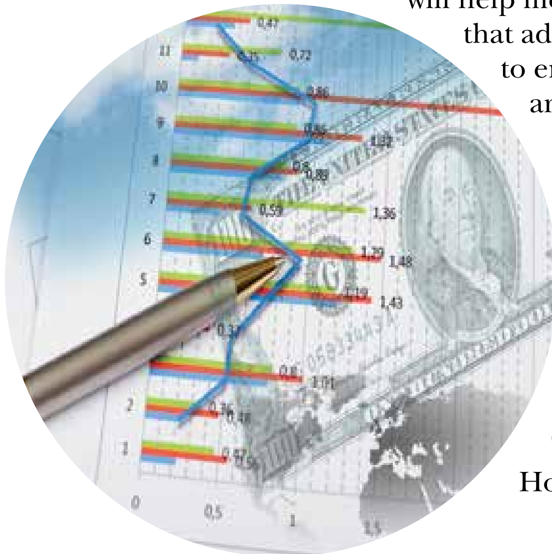
The first part of the process involves thinking about your bank's external environment and analyzing its internal situation, including its strengths, weaknesses, opportunities, and threats, commonly referred to as the SWOT analysis. The purpose of looking externally is to identify threats and opportunities. These may include regulatory, economic, competitive, and technological matters. Each issue should be considered for its possible impact on your community bank. Internal analysis looks at the bank's current situation and identifies internal strengths and weaknesses. A review of the bank's ERM process and the RAS page of your last examination report can assist in this effort. Realistic self-examination can be difficult and possibly unpleasant, but failure to perform an internal analysis could result in management not fully exploiting the bank's strengths, setting unachievable strategies, and being vulnerable to unseen weaknesses.

Where do we want to be?

The next step is to establish or confirm your bank's mission, goals, and objectives. A mission statement addresses what a bank does and what it hopes to achieve. It should be concise and tailored to your bank. For example, your mission may be stated this simply: "We provide excellent customer service and a fair return to our shareholders. We strive to expand our customer relationships and improve our profitability." As an alternative or in addition to a mission statement, your bank could establish a vision statement that describes what you want the bank to be in the future and communicates the bank's purpose and values. For example, your vision may be stated: "We strive to be

the best bank our customers ever do business with and the most profitable bank in the communities we serve. We are committed to providing exceptional service."

Goals are general statements about what must be achieved and stem from the mission and vision. Objectives are statements of specific and measurable tasks the bank must accomplish to reach its goals. If your bank's objectives include new or expanded products and services, it is important to make sure the products and services have been properly vetted, are appropriate given your bank's risk profile, and support your bank's mission and vision. For example, before introducing a new consumer product, you should ensure your assessments indicate the product will help meet your customers' needs and that adequate systems are established to ensure customer service standards are maintained.



Your bank's goals and objectives should align with who you are and where you want to be. Failure to do so has caused many banks to misallocate resources, pursue conflicting strategies, overlook profitable opportunities, and ignore significant business risks.

How do we get there?

After considering where you are now and where you want to be, you formulate your bank's strategy. Strategies define how your bank is going to realize its goals and objectives, thus accomplishing its mission. Strategies must be tailored to fit your bank's competitive environment and internal capabilities. Strategies must also consider the risks your bank is undertaking, the resources needed to reach its goals and objectives, and any assumptions made to ensure they are realistic. It also is critical to have a contingency plan that specifies actions management can pursue if significant unanticipated events occur. If the risk profile of the bank will increase due to changes in strategy, it is important to have the necessary capital to tolerate the increased risk. A bank could incorporate its capital planning process (also addressed in this booklet) within its strategic plan.

How do we measure our progress?

Regular measurement and reporting on your bank's objectives keep the board and management focused on whether your bank is moving forward and achieving established goals. A periodic progress report or scorecard should indicate whether timelines are being met and if additional or alternative actions need to be implemented. For example, if one of your bank's financial objectives is to improve its net interest margin by 10 percent over last year's performance, then the bank may decide to measure and report on its progress quarterly upon the filing

of its call report. As the saying goes, “What gets measured gets done.”

Once a strategic plan has been developed and approved, the plan should be shared and communicated with bank employees so they understand the bank’s mission, vision, goals, and objectives and the employees’ role in achieving them. The strategic planning process should be dynamic: As change occurs, planning and implementation should adjust to reflect changing conditions. If your bank is associated with a holding company, consider developing one consolidated strategic plan.

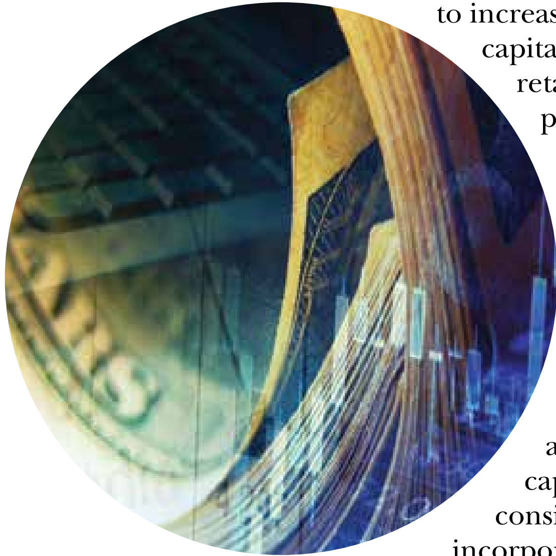
Capital Planning Process

Capital planning is integral to ensuring your bank’s safe and sound operations and ongoing viability. In fact, capital and ongoing capital planning underpin the successful operation and profitability of a bank. The exact content, extent, and depth of the capital planning process should be commensurate with your bank’s overall risks, complexity, and corporate structure.

Because each bank is unique in its strategic plans, complexity, and products and services, the appropriate level of capital for a bank cannot be determined solely by applying a mathematical formula. For example, what may be an acceptable capital level in one $50-million bank may be inadequate in another similarly sized bank with significant concentrations of credit or an aggressive investment philosophy. Regulatory minimum capital ratios are standards that address only some of the common risks faced by banks. Therefore, given the risks and emerging risk factors a bank faces, the bank should generally maintain capital well *above* regulatory minimum capital ratios.

Capital planning is a dynamic and ongoing process that should be forward looking and incorporate changes in your bank’s strategic focus, risk tolerance levels, business plans, operating environment, and other factors that materially affect capital adequacy. This is why capital planning becomes an integral part of a bank’s strategic planning process. The most effective capital planning considers short- and long-term capital needs over a forecast horizon of at least two years. Banks also should factor in events that can occur outside of normal considerations, for example, a natural disaster and its potential impact on capital needs.

Your bank’s range of business activities, overall risks, and operating environment have a significant impact on the level of detail needed in your bank’s capital planning. A more complex bank with higher overall risk is expected to have a more detailed planning process than a bank with less complex operations and lower risks. The corporate structure is also a factor. Mutual savings associations have very limited means



to increase capital quickly and build capital almost exclusively through retained earnings. As such, capital planning is critical for a mutual savings association.

The first component of capital planning is to identify and evaluate all material risks. Risks that can be quantified with reasonable confidence should be measured to determine how those risks affect your bank's overall capital adequacy. You also should consider qualitative factors that incorporate management's experience and judgment in evaluating all risks. The OCC's RAS and the bank's ERM processes can assist the board and management with this first step.

The second component of effective capital planning is to determine your bank's capital needs in relation to material risks and strategic direction. Because raising capital normally becomes more difficult and expensive once a bank is confronted with problems, optimally any capital raising events should begin before any major issues materialize. A well-run bank regularly assesses capital to ensure that capital levels remain adequate, not just at one point in time, but over time.

The third component of capital planning is having a strategy to maintain capital adequacy and build capital. Through discussions with management, your board should evaluate internal and external sources of capital to define a strategy to build capital whenever necessary. One strategy may be to strengthen capital through earnings retention. Another option may be to build capital by an infusion from principal shareholders or the parent holding company, or, in the case of a mutual savings association, by a partial or full conversion to stock. Your bank's capital planning process also should consider contingency or backup plans, including identification or enhancement of credible strategies for capital preservation during economic downturns or other times of stress.

The fourth component of capital planning is ensuring the integrity, objectivity, and consistency of the process through adequate corporate governance. Your bank's success depends on strong and independent oversight by your board in all areas, including capital planning. Documenting the capital planning process and the board's expectations is important to maintaining the integrity of the capital planning process and the appropriateness of capital level determinations. Capital planning needs to evolve as your bank's overall risks and activities and risk measurement and management practices change. To ensure that a sufficient level of capital exists at all

times and that capital can fully support the current and anticipated needs of your bank, the board should review its capital planning process and capital goals at least annually.

Supervision by Risk

The key objective of banks of all sizes is to operate profitably, primarily through taking various risks to meet the needs of customers and shareholders. The presence of risk is not by itself a reason for supervisory concern. The bank's board of directors must determine whether the risks the bank assumes are warranted, effectively managed, and consistent with safe and sound banking practices. Generally, a risk is effectively managed when it is identified, understood, measured, monitored, and controlled as part of a deliberate risk/reward strategy. Understanding the OCC's "supervision by risk" principle can aid the board and management in the supervision of your bank.

Oscar Harvey, Associate Deputy Comptroller for the Southern District, who is based in Dallas, Texas, reviews a community bank's examination findings.

The types of products and services that your community bank offers determine the risk management systems that need to be implemented. Because the complexity and severity of risks vary by bank, the resources required to ensure effective risk management also vary. And, just as bank management must tailor its resources and processes to the unique nature of the bank's risks, the OCC in our supervision of community banks must do the same.

The goal of supervision by risk is to maximize the effectiveness of the supervisory process by assessing all bank activities under one supervisory strategy plan. With this integrated approach, the local Assistant Deputy Comptroller has responsibility for all supervisory activities, including safety and soundness, information technology, asset management (trust), and compliance. Integrating all examination functions under one Assistant Deputy Comptroller ensures that we assess risks in these areas using the same criteria and that the most significant risks to a bank receive the most supervisory attention. A significant benefit of integration is that the coordination of supervisory activities minimizes duplication of effort and leverages resources. For example, audit and internal controls are generally reviewed once for all bank areas, rather than at different times for the individual safety and soundness, information technology, asset management, and compliance examinations.

The OCC's supervisory strategy is a living document that includes a description of key risks facing the bank, as well as expectations for examiner resources needed to address emerging, evolving, or unknown risks. How do we ensure that we truly have a grasp of the key risks at any point in time? We have a longstanding policy that encourages frequent and ongoing dialogue between the bank and the OCC's local field office. Each bank is assigned to a portfolio manager who is responsible for ongoing communication with bank management, not only during an examination, but also on an interim basis. This open, two-way communication is critical to ensuring effective supervision by risk.

Alyssa McDonnell, left, Problem Bank Analyst in the Northeastern District, who is based in New York, N.Y., meets with Jennifer Kellem, an Analyst in the Northeastern District, who is based in Philadelphia, Pa.

Using this process, examiners draw conclusions about your bank's risks and the adequacy of its related risk management systems. When risks are high; when activities, products, and services are more complex; or when significant issues or problems are identified, examiners expand the scope of our supervisory activities to ensure that management has appropriately identified, measured, monitored, and controlled risk.

A Dynamic and Tailored Examination Process

A common misconception is that the OCC's examination process is simply a group of examiners converging on a bank every 12 to 18 months to perform standard procedures. This is just not the case. Our examination process is dynamic, tailored to each bank, and encourages clear communication throughout the supervisory cycle, including the time between on-site examinations.

To provide continuity in the examination process, the next supervisory cycle essentially begins at the conclusion of the current examination. Based on the examination findings and conclusions, the examiner-in-charge (and the portfolio manager, if they are not the same) consults with the local Assistant Deputy Comptroller to develop the supervisory strategy. The strategy describes the specific activities to occur and focal points during the next 12 to 18 months, including off-site quarterly reviews and the next planned on-site examination.

Quarterly reviews are a key component of our examination process to ensure that examiners

have analyzed the most recent, relevant financial information submitted by your bank. Your bank's portfolio manager contacts the bank president or other key management officials during these quarterly reviews to discuss any observed changes in the bank's financial information.

Additionally, the quarterly discussion includes other topics that cannot be gleaned from financial information—such as the introduction of new products or services, changes in key management or board members, changes in risk management or audit activities, and planned corporate activities. These discussions may result in early identification of risk, and the portfolio manager may initiate changes to the supervisory strategy to ensure that the newly identified risks are appropriately considered in future quarterlies and the next on-site examination. In some cases, the quarterly review may affect our assessment of your bank's RAS or CAMELS ratings. The quarterly activities and ongoing dialogue with management are designed to ensure effective supervision and early identification and resolution of supervisory concerns.

Before the start of the next on-site examination, the examiner-in-charge will more fully develop the examination scope using the information obtained since the last examination. Based on this scope, the examiner-in-charge will tailor a request letter listing the documents and information needed to complete the examination and share that request with bank management 30 to 45 days prior to beginning the on-site examination.

Central District Deputy Comptroller Bert Otto, right, who is based in Chicago, Ill., meets with Dan McKee, former Regional Director with the Office of Thrift Supervision and currently Associate Deputy Comptroller, OCC Central District, Chicago, Ill.

Examination procedures are not always the same from one examination to the next, or from one bank to the next. For areas of low risk, the scope of the planned supervisory activities generally consists of completing minimal objectives to confirm the bank's ratings and the examiner's assessment of the bank's risk profile. For areas of higher risk

or supervisory concern, the strategy may direct examiners to complete more detailed objectives. When determining the appropriate depth of supervisory activities for a specific examination area, the examiner-in-charge takes into account both the level of risk and the potential impact that area would have on the bank.

We believe effective communication is essential throughout the examination process. During the on-site examination phase—from discussing the scope and focal points of the examination at the entrance meeting to sharing the preliminary examination findings at the exit meeting—we place great emphasis on maintaining an open dialogue. Our goal is to avoid surprises for the bank and the OCC at the examination's conclusion. To further ensure accuracy of our findings and to confirm management commitments, a draft report of examination is shared with management before issuance of our final report. As soon as the final report is issued, our supervisory cycle begins anew, with the formulation of a new supervisory strategy.

Understanding the OCC's supervision by risk principle should assist management in preparing for our examinations and quarterly reviews. If your bank's last examination resulted in surprises relative to areas targeted for review, stated expectations, or required corrective actions, determine why in order to enhance oversight. Was there a breakdown in the bank's internal processes? Were there regulatory changes? Or were other external factors involved? Whatever the reason, understanding the cause will help improve your supervision process.

Key Importance of the Portfolio Manager

Each community bank supervised by the OCC has a portfolio manager, who serves as the point of contact between the bank and the OCC. The portfolio manager is typically an experienced, commissioned examiner who carries a great deal of responsibility for communicating directly with your bank throughout the examination process to ensure that conclusions, analysis, and feedback are appropriately delivered and received. Through this dialogue, the portfolio manager develops an understanding of your bank's activities that guides the OCC's supervisory strategy. The portfolio manager is a resource who understands the local economy and the operating conditions and risks in your bank's market.

The portfolio manager is also a knowledgeable individual who can discuss with you recently implemented or proposed regulations, trends in current examination findings, or other current topics. If your bank is contemplating a new product or service, the portfolio manager can be a good source of information when conducting due diligence. Because of ready access to OCC specialists, the portfolio manager can enlist additional assistance

to benefit your bank. Outside directors, in particular, who have questions or are interested in obtaining other perspectives should consider your OCC portfolio manager as a resource. Whatever the issue, the portfolio manager should be able to provide your bank an independent perspective worthy of consideration.

Conclusion

Well-run, financially sound community banks share a common bond. Each has an engaged and proactive board and management. These management teams see that their banks have sound policies and procedures in place and strive to ensure that risk management systems are effective, that strategic planning is carried out and sufficient capital exists to support their banks through good and bad economic times, and that bank supervision is strong. In particular, these community banks view risk management not as a cost of doing business, but as a competitive advantage that is critical to their success in the marketplace.

In this booklet, we have covered these key functions: identifying and managing risks through RAS and ERM; utilizing strategic planning and ensuring sufficient capital; and understanding the OCC's supervisory process. These fundamental banking practices, when implemented, will enable your board and management to lead your bank through economic cycles and industry changes.

The OCC values community banking and is committed to working with community bankers to ensure their banks remain successful and vibrant for the good of the communities they serve. For additional information on the topics covered in the booklet or other banking subjects, please refer to our Web site, www.occ.gov. Directors and management of national banks and federal savings associations also have access to information and various regulatory support models and tools through BankNet at www.occ.gov.

www.occ.gov

OCC Mission

To ensure that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations.