KPMG

Regulatory Alert

Regulatory Insights for Financial Services

May 2023

Bank Supervision: OCC "Persistent Weaknesses"

KPMG Regulatory Insight:

- *Strengthening of regulatory actions (e.g., divestiture, growth restrictions) in cases of "persistent weaknesses".*
- *Ties expansion of regulatory actions to prior speeches/issuances, including "too big to manage" and "repeat offenders".*
- *Reiterates the critical importance of bank risk management, issues management, and governance.*

The Office of the Comptroller of the Currency (OCC) plans to implement new policies and procedures when considering supervisory and enforcement actions against banks that exhibit or fail to correct persistent weaknesses (i.e., previously identified by the OCC as "deficient practices and/or violations").

The new policies and procedures are included as a new "Appendix C, Actions Against Banks With Persistent Weaknesses", within the OCC's Policies and Procedures Manual 5310-3, "Bank Enforcement Actions and Related Matters". They outline additional supervisory or enforcement actions the OCC may take against banks with "continuing, recurring, or increasing deficiencies over a prolonged period", and particularly when the bank has not made "sufficient progress" toward correcting the deficiencies.

Applicability.

In general, Appendix C is directed toward:

— Banks subject to the OCC's Heightened Standards (at 12 CFR Part 30, Appendix D - banks with $50 billion or more in average total assets and any bank with average total assets less than $50 billion if that institution's parent company controls at least one covered bank).

— Other banks with operations that are "highly complex" or otherwise present a "heightened risk" throughout the bank based on:

  - The bank's size, risk profile, complexity of products and services, and scope of operations.
  - Consideration of (1) the affiliate structure and whether affiliates engage in nonbank activities, and (2) the extent of the bank's reliance on third-party service providers.

— Any OCC-supervised bank determined by the OCC, in its discretion, to be appropriate.

"Persistent Weaknesses"

"Persistent weaknesses" may include:

— Composite or management component ratings that are "3" or worse, or three or more weak or insufficient quality of risk management assessments, for more than three years.

— Failure by the bank to adopt, implement, and adhere to all the corrective actions required by a formal enforcement action in a timely manner.

— Multiple enforcement actions against the bank executed or outstanding during a three-year period.

When a bank exhibits "persistent weaknesses", the OCC will consider additional actions, such as assessing civil money penalties (CMPs) or issuing other enforcement actions. A

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resulting enforcement action may include requirements or restrictions such as one or more of the following:

- A requirement for the board to oversee the development and implementation of an enterprise-wide action plan to promptly resolve the bank's "persistent weaknesses", including to improve composite or component ratings or quality of risk management assessments.
- Restrictions on the bank's growth (overall or in discrete areas), business activities, or payment of dividends.
- Requirements for the bank to take affirmative actions, including making or increasing investments targeted to aspects of its operations or acquiring or holding additional capital or liquidity.

Should a bank fail to correct its "persistent weaknesses" in response to prior enforcement actions or other measures, the OCC will consider further actions that would require the bank to simplify or reduce its operations, including:

- Reducing asset size.
- Divesting subsidiaries or business lines.
- Exiting from one or more markets of operation.

Too Big To Manage: Remarks from the Acting Comptroller

The new policies and procedures echo the escalation framework outlined by the Acting Comptroller in January 2023 in remarks about "detecting, preventing, and addressing" banks that are "too big to manage (TBTM)".

The Acting Comptroller stated that an escalation framework ensures "that deficiencies are clearly identified, that banks are given opportunities to address them, and that failure to do so results in proportionate, fair, and effective consequences… A well-calibrated escalation framework gives banks sufficient opportunities to address deficiencies. A bank's "repeated failures" to do so then become, by themselves, presumptive evidence that it is at the limits of its manageability. Under such a framework, the need for simplification and divestitures at a bank is clear from management's actions and outcomes, or lack thereof."

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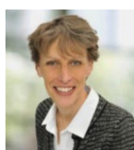

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