

COMPTROLLER'S HANDBOOK

SAFETY AND SOUNDNESS



ASSET QUALITY

# LENDING AND LOAN PORTFOLIO RISK MANAGEMENT

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# Introduction

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The Office of the Comptroller of the Currency’s (OCC) *Comptroller’s Handbook* booklet, “Lending and Loan Portfolio Risk Management,” is prepared for use by OCC examiners in connection with their examination and supervision of national banks, federal savings associations (FSA), and federal branches and agencies of foreign banking organizations (collectively, banks). Each bank is different and may present specific risks and issues. Accordingly, examiners should apply the information in this booklet consistent with each bank’s individual circumstances. When it is necessary to distinguish among them, the types of banks are referred to separately.<sup>1</sup>

## Overview

This booklet is designed to provide information for examiners regarding lending, risks associated with lending, risk management practices applicable to all phases of a loan’s life cycle, and risk management of the loan portfolio. This booklet also includes expanded examination procedures to assist examiners in conducting lending and loan portfolio risk management examinations beyond the core assessments in the “[Community Bank Supervision](#),” “[Federal Branches and Agencies Supervision](#),” and “[Large Bank Supervision](#)”<sup>2</sup> booklets of the *Comptroller’s Handbook*, as appropriate.

Examiners should use this booklet in conjunction with other booklets in the *Safety and Soundness* series of the [Comptroller’s Handbook](#). For example, other booklets in the “Asset Quality” category of the *Safety and Soundness* series include product-specific commercial and retail lending information and expanded examination procedures, and booklets in the “Management” category provide more detailed information on broader risk management topics.

This booklet does not cover certain topics in detail because they are covered in other booklets. The following are primary examples:

- The “[Allowances for Credit Losses](#)” booklet of the *Comptroller’s Handbook* provides detailed discussion of allowances for credit losses (ACL).
- The “[Concentrations of Credit](#)” booklet discusses concentration risks and risk management practices.
- Booklets in the *Consumer Compliance* series of the [Comptroller’s Handbook](#) provide detailed information about consumer protection-related laws and regulations.

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<sup>1</sup> Generally, references to “national banks” throughout this booklet also apply to federal branches and agencies of foreign banking organizations unless otherwise specified. Refer to the “[Federal Branches and Agencies Supervision](#)” booklet of the *Comptroller’s Handbook* for more information regarding applicability of laws, regulations, and guidance to federal branches and agencies. Certain FSAs may make an election to operate as a covered savings association (CSA). For more information, refer to OCC Bulletin 2019-31, “[Covered Savings Associations Implementation: Covered Savings Associations](#),” and [12 CFR 101](#).

<sup>2</sup> As indicated in the “Large Bank Supervision” booklet’s “Introduction” section, the “Large Bank Supervision” booklet applies to the supervision of midsize banks.

- The “[Insider Activities](#)” booklet of the *Comptroller’s Handbook* provides more information about loans to insiders and Regulation O.
- The “[Other Real Estate Owned](#)” booklet of the *Comptroller’s Handbook* discusses real estate received in satisfaction of debts previously contracted (DPC) and repossessed assets.
- The “[Related Organizations](#)” booklet of the *Comptroller’s Handbook* (national banks and CSAs), *Office of Thrift Supervision (OTS) Examination Handbook* section 730, “[Related Organizations](#)” (FSAs), and *OTS Examination Handbook* section 380, “[Transactions With Affiliates and Insiders](#)” (FSAs), provide more information about transactions with related organizations and affiliates.
- The “[Qualified Thrift Lender](#)” booklet of the *Comptroller’s Handbook* (FSAs) addresses the Qualified Thrift Lender (QTL) requirement under the Home Owners’ Loan Act (HOLA).

#### **Excerpts from other sources**

Related sections of other booklets of the *Comptroller’s Handbook* and other sources are noted in boxes like this throughout this booklet. Examiners should refer to the full text of the quoted source for more information.

This booklet makes minor text adjustments to the original sources for context and abbreviations. Outdated references in the original sources have been brought current in this booklet. Such changes are noted with brackets [ ].

## Lending Examinations and Ongoing Supervision

Examiners assess lending and loan portfolio risk management during supervisory activities conducted throughout a bank’s supervisory cycle. Credit risk assessments and criteria for assigning a bank’s asset quality component rating are included in the core assessments in the “[Community Bank Supervision](#),” “[Federal Branches and Agencies Supervision](#),” and “[Large Bank Supervision](#)” booklets of the *Comptroller’s Handbook*. Under the OCC’s risk-based supervision approach, the scope of lending and loan portfolio risk management examination work beyond the core assessment should vary based on risk. [Appendix A](#) of this booklet includes a matrix that examiners may use as a guide when assessing the quantity of credit risk associated with a bank’s lending activities. Refer to the “[Bank Supervision Process](#)” booklet of the *Comptroller’s Handbook* for more information about supervisory cycles, supervisory activities, and the OCC’s risk-based supervision approach.

Examiners should consider conclusions from relevant supervisory activities conducted during the supervisory cycle as well as conclusions as of the last full-scope report of examination (ROE). Additionally, examiners should consider findings from assurance functions such as internal audit, independent risk management, and credit risk review. Examiners should leverage findings from these functions when appropriate. Lending and loan portfolio risk management examinations can also be used to periodically validate the reliability of these functions. Refer to the “[Independent Credit Risk Review](#)” section of this booklet for more information about leveraging or validating the reliability of independent credit risk reviews.

Examiners evaluating lending and loan portfolio risk management should communicate relevant findings and observations with examiners evaluating other areas, such as examiners responsible for component rating areas and risks other than asset quality and credit risk. For example, examiners reviewing a new loan product could identify concerns with the bank's new activities processes on a broader scale, or examiners could identify product features or practices that violate consumer protection-related laws or regulations. Examiners should also review findings from other areas and leverage conclusions that have been drawn during the supervisory cycle, as appropriate. For example, examiners reviewing risk management of lending-related third parties should consider conclusions about the adequacy of the bank's overall third-party risk management processes.

Examiners may conduct a variety of lending and loan portfolio risk management examination work depending on a bank's risk profile or risks associated with a particular product, service, or activity. Examinations can provide in-depth assessments of a product (e.g., auto lending, multifamily lending), function (e.g., internal audit, credit risk review,<sup>3</sup> or collections activities), risk (e.g., credit, compliance, operational), specialty lending types (e.g., leveraged lending, Small Business Administration (SBA) lending), or strategic partnerships (e.g., original equipment manufacturer lending, private label credit cards).

Lending and loan portfolio risk management examinations can also draw conclusions about activities such as credit underwriting practices, loan administration, loan information systems, financial and collateral documentation, credit risk-rating practices and accuracy of loan risk ratings, ACLs, concentration risk management, stress testing, lending-related control systems, or compliance with laws and regulations. Focal points of examinations should be tailored to the bank's risks, with heightened focus on material financial risks.

## Ongoing Supervision

**Excerpt from the "[Bank Supervision Process](#)" booklet of the *Comptroller's Handbook***

Ongoing supervision is the OCC's process for assessing risks and reviewing core knowledge about a bank on an ongoing basis. Ongoing supervision conclusions can result in changes to the OCC's supervisory strategy, regulatory ratings, or risk assessment system [(RAS)] conclusions for a bank.

The primary objective of ongoing supervision for lending and loan portfolio risk management is to identify changes, trends, concerns, or emerging risks in a timely manner, particularly changes resulting in material financial risks. Conclusions from ongoing supervision can result in changes to RAS conclusions, the asset quality component rating, or the supervisory strategy. The following are examples of items examiners commonly consider during ongoing supervision:

- Trends in key credit risk measures such as loan growth, covenant defaults, delinquencies, classified and special mention assets, credit losses, and concentrations of credit
- Changes in bank operations and personnel, such as

<sup>3</sup> Credit risk review may be referred to as loan review in some banks. For more information on credit risk review refer to OCC Bulletin 2020-50, "[Credit Risk: Interagency Guidance on Credit Risk Review Systems.](#)"

- changes in underwriting standards
- changes in strategies related to credit risk-taking
- changes in organizational structure, key credit personnel, or outsourcing arrangements
- New, modified, or expanded products or services (collectively, new activities)
- Changes in models used in lending and loan portfolio risk management
- Changes in third-party relationships engaged for lending and loan portfolio risk management activities
- Litigation,<sup>4</sup> monetary penalties, remediations, complaints, and referrals from potential whistleblowers
- Independent credit risk review findings
- Internal audit findings
- External factors, such as economic conditions, competitive factors, geographic and environmental conditions, and technological advancement

## Loan Sampling

Examiners often select a sample of loans to assess risk selection, evaluate a bank’s internal risk-rating processes, and test individual loan quality. Results of this testing help examiners draw conclusions about the adequacy of risk management practices and the current and potential level of credit risk in the loan portfolio. The analysis of individual loans can be used to determine whether a bank’s risk-rating system is reliable, and to build conclusions about portfolio management. The “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook* provides examiners with guidance on judgmental and statistical sampling approaches. Refer to [appendix D](#) of this booklet for more detailed information about loan sampling.

## Credit Underwriting Reviews

The OCC does not require examiners to use a specific methodology to assess credit underwriting. The core assessment provides underwriting-related criteria for examiners to consider or evaluate during each supervisory cycle. Examiners should consider any credit underwriting examination work conducted throughout the supervisory cycle when completing the core assessment, developing RAS conclusions, and determining the asset quality component rating. Refer to the “[Community Bank Supervision](#),” “[Large Bank Supervision](#),” and “[Federal Branches and Agencies Supervision](#)” booklets of the *Comptroller’s Handbook* for the core assessment.

Examiners have flexibility to assess credit underwriting consistent with the OCC’s risk-based supervision approach. Therefore, credit underwriting reviews should vary based on the size, complexity, and risk profile of the bank and its products, services, activities, and lines of business (individually or in aggregate). Booklets in the “Asset Quality” category of the *Comptroller’s Handbook’s Safety and Soundness* series provide expanded examination

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<sup>4</sup> Refer to the “[Litigation and Other Legal Matters](#)” booklet of the *Comptroller’s Handbook* for more information about litigation and associated risks.

procedures for examiners to use in assessing credit underwriting when risks warrant review beyond the core assessment. Refer to the “[Bank Supervision Process](#)” booklet of the *Comptroller’s Handbook* for more information about the core assessment, the asset quality component rating, and the OCC’s risk-based supervision approach. The “[Credit Underwriting](#)” section of this booklet and appendix E, “[Assessing Credit Underwriting](#),” include expanded discussion of underwriting practices and reviews.

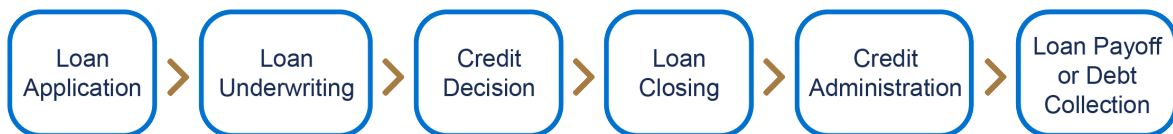
## Background

The loan portfolio is often a bank’s largest asset, the predominant source of revenue, and a primary source of material financial risk to a bank.

## Loan Life Cycle

All loans, irrespective of the loan size or type (e.g., commercial or retail), have a life cycle. Figure 1 illustrates the stages that begin when a prospective borrower identifies the need for financing. Depending on the bank’s specific offerings and processes, loan applicants can come from various sources such as direct mail and internet solicitation, marketing campaigns, referrals, affiliates, brokers, dealers, financial technology (fintech) companies, marketplace lenders, and other third parties. The bank underwrites the loan and makes a credit decision. Approved loans are closed, and the bank administers the loan until repaid, sold, or otherwise collected or charged off. A bank may release or retain servicing for loans it sells. Refer to the “[Mortgage Banking](#)” booklet of the *Comptroller’s Handbook* for more information about selling loans with servicing retained or released.

**Figure 1: Loan Life Cycle**



The parties, processes, documents, controls, and administrative activities at each stage of the life cycle vary by bank and loan type. Processes can be automated, manual, or a combination; they may also be performed by third parties. The remainder of this booklet describes risks and risk management practices associated with the phases of the loan life cycle.

During a loan’s life cycle, the economy may experience cyclical ups and downs, the exact timing of which is unpredictable. When the economy slows, borrowers can experience financial strain that affects their ability to meet the terms of their loans. Although banks cannot predict economic cycles, they can take measures to effectively manage credit risk and mitigate losses even in times of economic uncertainty. Refer to the “[Risk Management](#)” and “[Credit Administration](#)” sections of this booklet for more information.

# Risks Associated With Lending

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From a supervisory perspective, risk is the potential that events will have an adverse effect on a bank's current or projected financial condition<sup>5</sup> and resilience.<sup>6</sup> The OCC has defined seven categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, and strategic. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of and assess this interdependence. Examiners also should be alert to concentrations that can significantly elevate risk. Concentrations can accumulate within and across products, business lines, geographic areas, and legal entities. Refer to the "[Bank Supervision Process](#)" booklet of the *Comptroller's Handbook* for an expanded discussion of banking risks and their definitions.

Lending exposes a bank to all seven categories of risk. Imprudent risk-taking and inadequate credit risk management, particularly during periods of rapid economic growth, can lead to significant levels of problem assets and loan losses and can contribute to bank failures.

## Credit Risk

Credit risk is the predominant risk associated with lending.

**Excerpt from the "[Problem Bank Supervision](#)" booklet of the *Comptroller's Handbook***

Historically, the most common adverse condition shared by problem banks was asset quality deterioration. Whether caused by economic factors, excessive concentrations, weak management, ineffective board or management oversight, anxiety for earnings, insider abuse, or other factors, less-than-satisfactory asset quality is a factor in nearly all problem banks.

Examiners generally assess the quantity of credit risk in the loan portfolio through four broad categories:

- **Underwriting factors**, which include underwriting standards, risk ratings of new underwriting, origination metrics (e.g., credit score, primary and secondary sources of repayment, loan-to-value ratios), underwriting exceptions and overrides, and volumes of booked loans and approval rates.
- **Credit factors**, which include credit indicators such as delinquencies and losses, weighted average risk ratings, concentrations, trends in loan growth, syndications, borrowers' financial performance, and audit or credit risk review findings.
- **Strategic factors**, which include changes in strategy related to credit risk-taking; the effect of growth plans or changes in portfolios and product mix; performance compared with the bank's credit risk appetite; and new activities or technologies, acquisitions, and

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<sup>5</sup> Financial condition includes impacts from diminished capital and liquidity. Capital in this context includes potential impacts from losses, reduced earnings, and market value of equity.

<sup>6</sup> Resilience recognizes the bank's ability to withstand periods of stress.

new delivery channels. Refer to OCC Bulletin 2017-43, “[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#),” for more information about risks associated with new activities.

- **External factors**, which include economic, industry, competitive, and market conditions; legislative and regulatory changes; technological changes; and litigation, monetary penalties, remediations, customer complaints, and referrals from potential whistleblowers.

[Appendix A](#) of this booklet provides examples of indicators that examiners may consider when assessing the effect of lending activities on credit risk. Many *Comptroller’s Handbook* booklets about specific lending activities include appendixes with credit risk indicators that are designed to be applied to specific products, services, or activities.

Although the factors are the same, measurement across various portfolios may differ. Retail portfolios typically consist of sizeable segments of relatively homogeneous loans, and credit risk analysis lends itself to quantitative and automated techniques to identify, measure, monitor, and control risk. Commercial loans tend to be less homogeneous, and individual loans can be large enough to create material risk to a bank’s financial condition. Loan portfolio segments across retail and commercial credits can be strongly correlated. For example, home prices affect both consumer mortgages as well as residential construction and development loans.

## Concentration Risk

Credit risk can be amplified by concentrations of credit. Concentrations of credit played a significant role in bank failures during past financial crises. Concentrations can accumulate across products, business lines, countries, and legal entities within a banking company. Once excessive concentration risk is embedded in a bank’s balance sheet, the bank may have limited options to control that risk, particularly in an economic downturn. Products containing the same types of risks under different names and in different units, such as structured products and off-balance-sheet funding structures, can mask some exposures and risks. For more information about concentrations of credit, refer to the “[Concentrations of Credit](#)” booklet of the *Comptroller’s Handbook*. Additionally, the “[Problem Bank Supervision](#)” booklet of the *Comptroller’s Handbook* discusses the role of concentrations of credit in problem banks and bank failures.

## Risk Layering

Risk layering can also affect the quantity of credit risk. Risk layering arises when a combination of risk factors from a given borrower’s credit profile or loan terms may, in aggregate, convey a higher level of risk than the individual risk factors would suggest. Risk layering within individual loans can have a cumulative effect on credit risk within loan portfolios, especially when loans with risk layering represent a concentration. An example of risk layering is originating an auto loan in which the borrower’s credit score is at or near the bank’s minimum acceptable level, and the loan-to-value (LTV) ratio is at or near the bank’s maximum level. While the credit score and LTV are both within the bank’s policy limits, the

combination of two underwriting factors that are near the bank’s policy limits results in higher risk than if no or only one factor was near the policy limit.

## Refinance Risk

During periods of rising interest rates, loans near maturity may be exposed to refinance risk.

**Excerpt from OCC Bulletin 2024-29, “[Commercial Lending: Refinance Risk](#)”**

Refinance risk is the risk that borrowers may not be able to replace existing debt at a future date under reasonable terms and prevailing market conditions. If a borrower cannot refinance under current market conditions, a bank could be burdened with an underperforming or nonperforming loan. Refinance risk primarily affects loans with principal balances remaining at maturity and borrowers who rely on recurring debt to finance their capital structure or business operations.

## Interest Rate Risk

The level of interest rate risk (IRR) from a bank’s lending activities depends on the composition of its loan portfolio and the degree to which the terms of its loans (e.g., maturity, rate structure, duration, embedded options, or accounting designation) expose the bank’s earnings and capital to changes in interest rates. Repricing mismatches between the loan portfolio and liabilities that fund a bank’s lending activities can result in increased repricing risk. Banks that price loans using multiple indexes can face heightened basis risk exposure.

Concentrations in duration mismatches between the loan portfolio and the liabilities that fund the bank’s lending activities can result in elevated yield curve risk. Embedded options can affect IRR when the life of loans lengthens in rising rate environments and shortens in falling rate environments. Loan pricing competition can affect IRR and result in a compressed net interest margin when competitive factors drive loan pricing down on a standalone basis or in combination with competitive factors that drive liability pricing higher. Lending strategies can result in elevated IRR if the bank’s strategic initiatives do not appropriately consider IRR.

Changes in interest rates can affect both IRR and credit risk. Specifically, “[a]n increase in interest rates can expose banks with a significant concentration of adjustable-rate loans to credit risk if borrowers are unable to afford higher loan payments due to an increase in rates. For banks that are predominantly funded with short-term liabilities, a rise in rates can decrease [net interest income] at the same time that credit quality problems are increasing.”<sup>7</sup>

Refer to the “[Interest Rate Risk](#)” booklet of the *Comptroller’s Handbook* for more information about IRR and associated risk management practices.

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<sup>7</sup> “[Interest Rate Risk](#)” booklet of the *Comptroller’s Handbook*, appendix D.

## Liquidity Risk

Loans are often a primary use of funds. Loan growth, particularly when rapid, significant, or uncontrolled, can increase a bank's liquidity risk. Funding growth with new or more volatile funding sources, such as brokered deposits or borrowings, can increase liquidity risk. Asset quality problems can result in diminished liquidity when the bank does not receive expected principal and interest payments. Refer to the "[Problem Bank Supervision](#)" booklet of the *Comptroller's Handbook* for more detailed information about growth and related liquidity risk considerations.

Bank liquidity is affected by the amount of the bank's commitments to lend and the actual amount that borrowers draw against those commitments. The types of commitments, loans in the pipeline, normal usage levels, and historically high usage levels are factors that can influence whether available liquidity will be adequate for normal, seasonal, or emergency needs.

A bank's liquidity risk profile can also be affected when loans are used as a source of funds. For example, a bank's ability to sell, securitize, or pledge loans for borrowings varies depending on several factors (e.g., market conditions, economic conditions, loan type, loan quality, pricing, scheduled maturities, conformity to market standards for underwriting, and the bank's operational capabilities).

Refer to the "[Liquidity](#)" booklet of the *Comptroller's Handbook* for more information on liquidity risk and liquidity risk management.

## Price Risk

Banks that hold loans for sale face price risk due to fluctuations in value of loans designated as held-for-sale, as these loans are carried at the lower of cost or market.<sup>8</sup> In addition, loans in the pipeline and warehouse, such as those originated for sale as part of a securitization, for direct placement in the secondary market, or part of a syndication, carry price risk while they are awaiting packaging and sale. Banks with significant activities such as mortgage banking or derivatives may be exposed to increased price risk. While the risk that changes in interest rates will change the fair value of mortgage servicing assets (MSA) is normally considered IRR, it could be considered price risk if the bank is actively buying and selling MSAs.

Foreign exchange risk is another source of price risk, which is present when a loan or portfolio of loans is denominated in a foreign currency or is funded by borrowings in another currency. In some cases, banks enter into multicurrency credit commitments that permit borrowers to select the currency they prefer to use in each rollover period. Foreign exchange risk can be intensified by geopolitical, social, or economic developments. The consequences

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<sup>8</sup> For more information on the accounting treatment of loans held for sale, refer to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 310, "Receivables," and ASC Topic 948, "Financial Services—Mortgage Banking."

can be unfavorable if one of the currencies involved becomes subject to stringent exchange controls or is subject to wide exchange-rate fluctuations.

Real estate received in satisfaction of DPC can also result in price risk exposure. In many banks, especially small and noncomplex banks, changes in other real estate owned (OREO) market values are the primary source of price risk. OREO is initially recorded at fair value less estimated costs to sell. This becomes the new cost basis of the OREO. The OREO is then carried at the lower of cost (i.e., the new cost basis at initial recordation) or fair value less estimated costs to sell. Refer to the “[Other Real Estate Owned](#)” booklet of the *Comptroller’s Handbook* for more information on the acquisition, management, disposition, and accounting of OREO.

## Operational Risk

Operational risk is often present in the loan disbursement, payment systems, and credit administration processes. In general, the level of operational risk is correlated to the adequacy of systems, the quality of operating procedures, the adequacy of internal controls, the capability and integrity of employees, and the adequacy of control systems such as audit and credit risk review. For example, banks have incurred increased credit risk when information systems failed to provide adequate information to identify concentrations, problem loans, loans past maturity, or stale commercial borrower financial statements or when internal controls failed to prevent or detect issues such as loan officers operating outside of their authorities or established limits.

Banks have also incurred losses due to failures to obtain proper signatures on loan documents, improperly disbursing loan proceeds, or incorrectly perfecting or renewing collateral liens. Errors such as these can also result in billing mistakes, payment processing errors, or other customer service issues.

There can be significant operational risk in credit administration due to risks of human error or fraud, which can result from factors such as inadequate staffing (e.g., in number or expertise), insufficient segregation of duties, inadequate or outdated reporting systems, lack of proper controls, or insufficient training. Engaging in certain types of lending with heightened credit administration needs (e.g., SBA lending, asset-based lending, servicing loans for others) can result in heightened operational risk due to the systems and staffing generally needed for these operations.

Manual processes can increase risks of human error or fraud, but highly automated environments can pose heightened operational risk that may compound the effect of errors. A bank’s use of models can also result in increased operational and other risk exposures (e.g., credit or compliance risks). Refer to OCC Bulletin 2026-13, “[Model Risk Management: Revised Guidance](#),” for more information about risks associated with models.

Operational and other risks also result from the use of third-party relationships. The “[Third-Party Risk Management](#)” section of this booklet discusses common types of third-party relationships in lending and loan portfolio risk management. These relationships, particularly

those that are supporting critical activities, can affect a bank's operations. A third party's failure to meet its obligations can adversely affect the bank and its customers. Operational failures by third parties supporting critical activities can also result in financial losses, customer dissatisfaction, litigation, or other adverse consequences to a bank. For more information about the risks associated with third-party relationships, refer to OCC Bulletin 2023-17, "[Third-Party Relationships: Interagency Guidance on Risk Management](#)."

## Fraud Risk

Fraud is a form of operational risk. Fraud can occur at any point during the lending process or a loan's life cycle. As with other bank activities, loan fraud can be internal or external. External fraud can be first-party fraud (i.e., when an external party or bank customer commits fraud against the bank) or victim fraud (i.e., when a bank customer is a victim of an intentional fraudulent act). Risk management and internal control weaknesses can increase a bank's risk of loan fraud. For example, the failure to implement appropriate system access controls for bank employees can leave the bank vulnerable to insider loan fraud.

The following are examples of types of loan fraud:

- Bribes and kickbacks arising from lending activities
- Fictitious loans
- Manipulation in the sale and purchase of loan pools
- Misappropriation of loan proceeds or fraudulent disbursements
- Appraisal fraud
- Foreclosure rescue scams and debt elimination schemes
- Identity theft

Refer to the following for more information about loan fraud and fraud generally:

- "[The Detection, Investigation and Prevention of Insider Loan Fraud: A White Paper](#)," Federal Financial Institutions Examination Council (FFIEC).
- "[The Detection and Deterrence of Mortgage Fraud Against Financial Institutions: A White Paper](#)," FFIEC.
- "[The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper](#)," FFIEC.
- OCC Bulletin 2019-37, "[Operational Risk: Fraud Risk Management Principles](#)."

## Compliance Risk

Lending exposes banks to compliance risk due to the number of laws and regulations that apply to lending, particularly laws and regulations designed to protect consumers. [Appendix I](#) of this booklet lists examples of lending-related laws and regulations. Failure to comply with laws and regulations can pose risk to the bank from civil money penalties (CMP), fines, remediation costs, and restitution costs.

The number of legal documents involved in lending transactions also exposes the bank to compliance risk. Banks can face litigation risk in a variety of circumstances involving lending. Refer to the “[Litigation and Other Legal Matters](#)” booklet of the *Comptroller’s Handbook* for more information about risks associated with litigation and other legal matters.

Banks also have obligations arising from Bank Secrecy Act (BSA)/anti-money laundering (AML) laws and regulations, and the sanctions and regulations administered by the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC). The FFIEC [Bank Secrecy Act/Anti-Money Laundering Examination Manual](#)’s “Lending Activities” section includes information and examination procedures for examiners to use when assessing money laundering, terrorist financing, and other illicit financial activity risks associated with lending activities as well as associated risk management practices. Additional sections within the “Risks Associated With Money Laundering and Terrorist Financing” section of the FFIEC [Bank Secrecy Act/Anti-Money Laundering Examination Manual](#) are also relevant for specific loan or customer types.

Other booklets in the *Comptroller’s Handbook’s* “Asset Quality” category of the *Safety and Soundness Series* discuss compliance risks for various loan types in more detail.

## Strategic Risk

The failure to establish prudent lending objectives that are compatible with the bank’s risk appetite or to provide effective oversight of lending activities can increase a bank’s strategic risk and affect interdependent risks, such as credit, operational, liquidity, and compliance risks. New lending activities (e.g., offering a new product or expanding existing product offerings) can result in strategic risk.<sup>9</sup> Incomplete or inadequate consideration of operating capacity, staffing levels and expertise, market conditions in the bank’s geographic footprint, and economic and customer dynamics can increase strategic risk. Inappropriate strategic or tactical decisions about underwriting standards, loan portfolio growth, concentrations, new loan products, models, or geographic and demographic markets can affect bank earnings and capital. In some cases, these decisions can affect the bank’s viability.

An example of a decision that could affect strategic risk is when a bank expands its existing loan activities to higher-risk borrowers. The product may be regularly offered by the bank, but the borrowers’ behavior may differ considerably from the bank’s typical customer. Offering this product to higher-risk borrowers can lead to loan losses.

Uncontrolled, rapid, or significant growth also contributes to strategic risk exposure and has contributed to bank failures. The “[Problem Bank Supervision](#)” booklet of the *Comptroller’s Handbook* provides more information about assessing the quantity of risk from growth. The booklet emphasizes that quantitative measures alone are not sufficient to provide a conclusion about the risks associated with growth.

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<sup>9</sup> Refer to OCC Bulletin 2017-43, “[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#)” for more information about risks associated with new activities.

**Excerpt from the “[Problem Bank Supervision](#)” booklet of the *Comptroller’s Handbook***

Excessive growth, as measured against local, regional, and national economic indicators, is often a precursor to asset quality problems. When assessing whether growth is excessive, examiners consider the growth compared with the bank’s capital base, financial condition, risk profile, and risk management systems. Excessive growth can strain banks’ underwriting and risk selection standards, as well as management’s capacity, existing control systems, and credit administration. Excessive growth can reflect fundamental changes in bank practices warranting additional supervisory attention. Examiners should determine how the bank has grown rapidly or significantly. Changes in bank practices that often accompany excessive growth include easing underwriting or pricing standards, introducing loan products, increasing customer or product risk tolerances, introducing unbalanced compensation programs,<sup>10</sup> and expanding or changing lending areas or sources of loans.

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<sup>10</sup> Footnote 49 in the “Problem Bank Supervision” booklet states, “For more information about compensation practices, including incentive compensation, refer to the ‘Corporate and Risk Governance’ booklet of the *Comptroller’s Handbook* and OCC Bulletin 2010-24, ‘Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies.’”

# Risk Management

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Each bank should identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for the bank's size, complexity, and risk profile. Refer to the "[Corporate and Risk Governance](#)" booklet of the *Comptroller's Handbook* for an expanded discussion of risk management.

**Excerpt from 12 CFR 30, appendix A, "Interagency Guidelines Establishing Standards for Safety and Soundness"**

*Internal Controls and Information Systems.* An institution should have internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities and that provide for:

1. An organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies;
2. Effective risk assessment;
3. Timely and accurate financial, operational and regulatory reports;
4. Adequate procedures to safeguard and manage assets; and
5. Compliance with applicable laws and regulations.

Examiners should focus on whether risk management is commensurate with the quantity of risks undertaken. Examiners should also consider the bank's size and complexity when assessing risk management. Risk management practices for a bank with a low quantity of risk are generally expected to be less robust than risk management practices in a bank with high quantity of risk. Conclusions about risk management, when assessed in conjunction with the quantity of risk, help examiners draw conclusions on aggregate risks and identify material financial risks. For example, all other factors being equal, a bank with a high quantity of risk and strong risk management is likely to have less material financial risk than a bank with high quantity of risk and weak risk management.

Sound risk management at each stage of a loan's life cycle can help ensure individual loans are originated, monitored, and managed within established risk parameters. Loans are generally more likely to perform as expected through the loan life cycle when banks engage in sound risk management.

## Board and Management Oversight

In general, the board's role is to oversee the bank's lending activities, oversee credit risk and risk management activities, provide credible challenge, and hold management accountable, while management is responsible for the bank's day-to-day activities. The board or designated board committee (e.g., credit committee) generally establishes the bank's credit culture; approves the bank's strategic lending objectives, credit risk appetite, and risk limits; and oversees the bank's risk management system.

The board relies on management to promote and foster the credit culture through effective implementation of the lending strategy and objectives while managing day-to-day activities. Typically, management achieves this by

- developing lending policies and procedures.
- providing consistent communication of established lending objectives.
- operating within limits established by the board.
- monitoring portfolio performance against established lending objectives and escalating material risks and issues to the board.
- establishing training programs for lending-related staff.
- enforcing compliance with laws, regulations, and bank policies.

Refer to the “[Corporate and Risk Governance](#)” booklet of the *Comptroller’s Handbook* for more information about the roles of the board and management. For more information about board oversight, refer to the [Director’s Book: Role of Directors for National Banks and Federal Savings Associations](#) and the [Director’s Reference Guide to Board Reports and Information](#).

## Committees

Credit-related management and board committees (e.g., portfolio, product, credit oversight) serve as forums to discuss risks and emerging issues, provide a broad spectrum of input, and evaluate or approve decisions. Small or noncomplex banks may have fewer committees with broader responsibilities, or the full board may have some responsibilities traditionally taken on by committees. Large or complex banks may have specific committees with narrower scopes. Committee charters typically define membership, frequency of meetings, and committee responsibilities and accountabilities. Committee responsibilities often encompass both risk and business management objectives. The credit committee is a common board-level committee in many banks. Some banks also have additional credit-related committees, such as a credit review committee, ACL committee, or problem loan committee.

**Excerpt from the [Director’s Book: Role of Directors for National Banks and Federal Savings Associations](#)**

The credit committee oversees the bank’s credit risk and its associated risk management practices. The credit committee should

- establish and guide the bank’s lending strategy, credit risk appetite, and risk limits.
- review and approve lending policies and underwriting standards that reflect the bank’s risk appetite.
- approve loans as outlined in the bank’s lending policy for credits involving large dollar amounts relative to the bank’s size and capital levels.
- monitor the loan portfolio’s performance, exceptions, and the [ACL].
- oversee the bank’s compliance with credit-related policies, limits, laws, and regulations.
- receive periodic reports from the loan review function that opine on the effectiveness of the bank’s loan rating systems and credit risk management practices.

## Credit Culture

A bank's credit culture refers to the corporate culture around lending activities. While credit cultures vary from bank to bank, credit cultures generally emphasize sound risk management, ethical behavior, prudent lending decisions, compliance with laws and regulations, and accountability. These factors support a bank's overall corporate culture. Some banks approach credit very conservatively, whereas other banks approach lending more aggressively with a higher appetite for lending to borrowers who pose a higher risk of default. In general, a bank with aggressive growth targets typically warrants higher capital ratios to absorb losses and more robust risk management than a bank with low growth.

A less conservative lending culture does not necessarily equate to insufficient or weak risk management. Conversely, it is possible for examiners to identify risk management practices that need to improve in a bank with a conservative lending culture. Examiners determine whether the risks a bank assumes are warranted by assessing whether the risks are effectively managed in a manner consistent with safe and sound banking practices.

Because the credit culture can affect credit and other risks, it benefits the board to determine its desired culture, rewarding the values and behaviors it wants to reinforce. The board accomplishes this through setting the tone at the top, conveying its expectation that all employees operate within established credit risk limits. A credit culture is shaped over time by the attitudes and values of the board as well as the behaviors and attitudes of senior management. Regardless of the bank's written lending policies and procedures, the values and behaviors that are rewarded shape the bank's culture.

A bank's credit culture is influenced by the board's objectives for earnings, capital, liquidity, and asset quality. Examiners should consider whether there is alignment between a bank's credit culture and risk management.

## Strategic and Operational Planning

Excerpts from the "[Corporate and Risk Governance](#)" booklet of the *Comptroller's Handbook*

### Strategic Planning

A strategic plan defines the bank's long-term goals and its strategy for achieving those goals.

### Operational Planning

Operational plans flow logically from the strategic plan by translating long-term goals into specific, measurable targets.

## Strategic Planning

The loan portfolio typically reflects many of the bank's strategic initiatives. The lending strategy typically states the bank's intent by product type, risk appetite, geographic location,

economic sector, and anticipated profitability. Examiners should pay particular attention to how banks implement new lending activities, including new or expanded delivery channels. Refer to OCC Bulletin 2017-43, “[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#),” for more information about risk management of new activities.

An effective lending strategy is created and implemented with a clear understanding of risk and reward consequences. While the formality of the strategic planning process varies, a sound lending strategy often considers

- financial objectives (e.g., returns, capital efficiency, fee contribution, loss reduction, and liquidity).
- desired portfolio composition and loan mix, portfolio diversification goals, and concentration limits.
- goals for loan quality (e.g., risk ratings, past dues, and expected losses).
- loan growth targets by product, market, and portfolio segment.
- goals and limits for loan purchase activities. Refer to the “[Loan Purchase Activities](#)” section of this booklet for more information.
- the bank’s geographic lending area.
- targeted industries and consumers.
- targeted market share.
- community needs and service.
- information about specialized products (e.g., indirect lending, non-prime lending, SBA lending, asset-based lending).
- quantitative and qualitative measures of success for strategic initiatives.
- exit strategies for unsuccessful products, markets, or delivery strategies.
- operational capacity (e.g., staffing, infrastructure, technology, delivery channels).
- compliance requirements.

Loan portfolio objectives establish specific, measurable goals for the portfolio. Desirable loans generally accomplish three fundamental goals:

- Build sound and collectible loan portfolios
- Invest the bank’s funds profitably for the benefit of shareholders and the protection of depositors
- Serve the legitimate credit needs of their communities

Significant deviations between a bank’s actual practices relative to policies and strategic plans can indicate the credit culture is no longer aligned with the board’s desires. It could also indicate that management is not keeping frontline employees well informed about changes in policies, priorities, or strategic direction. Significant deviations can expose the bank to material financial risks.

## Operational Planning

The size, complexity, and risk profile of a bank's lending activities drive the depth and formality of operational plans. Large or complex banks typically have detailed operational plans, such as line-of-business budgets, marketing plans, and staffing plans that roll up to bank-wide plans. Small, noncomplex banks might have separate budgets, marketing plans, or staffing plans for lending, or might include lending in an overall bank budget. Refer to the "[Earnings](#)" and "[Corporate and Risk Governance](#)" booklets of the *Comptroller's Handbook* for more information about operational planning.

## Pricing Strategies

Bank management generally considers the relationship between risk and return at the individual loan level, relationship level, and portfolio level. Pricing analysis can help banks make lending decisions that meet financial goals and remain within the bank's risk appetite. Some banks use sophisticated loan pricing models that include multiple factors to differentiate risk, whereas other banks use more basic methods.

Portfolio risk and return concepts as they relate to IRR, liquidity risk, and price risk encompass almost all credit risk management principles discussed throughout this booklet. Examiners should assess the adequacy of the bank's systems to identify, measure, monitor, and control risks within portfolios.

## Risk Appetite

There are many ways to establish a credit risk appetite. Examiners should consider the bank's size, complexity, and risk profile when evaluating the structure and formality of its credit risk appetite. Small or noncomplex banks may not have a formal risk appetite statement; however, policies typically include sufficient discussion of the appetite for credit risk. Regardless of the formality, credit risk appetites typically

- establish a common understanding within the bank on how management should approach and accept risks when executing the bank's strategy and business plan.
- take into consideration the bank's historical credit losses, its ability to absorb future losses, and its desired level of return.
- include acceptable risks as well as risks that should be avoided or heavily mitigated.

Credit risk appetite statements for lending activities typically describe acceptable risk preferences (e.g., products, markets, delivery channels) and risk limits (e.g., loan portfolio composition, loan types, industry segments). For banks that do not have a formal credit risk appetite statement, these items are often included throughout the bank's lending or credit risk management policies and procedures. Effective limits typically consider both on- and off-balance-sheet exposures including loan commitments, concentrations, counterparties, investments, and other material exposures.

## Risk Assessment

A bank's internal controls and information systems should provide for effective risk assessment.<sup>11</sup>

**Excerpt from the "[Corporate and Risk Governance](#)" booklet of the *Comptroller's Handbook***

A risk assessment process should be part of a sound risk governance framework. A well-designed risk assessment process promotes the identification of emerging risks at an early stage and allows for the development and implementation of appropriate strategies to mitigate the risks before they have an adverse effect on the bank's safety and soundness or financial condition. The completed risk assessments should be integrated into the bank's strategic planning process and risk management activities.

A risk assessment can be a valuable tool to assist the bank in achieving loan portfolio objectives. These exercises allow management to consider the potential impact of events that could significantly affect the bank. The structure and formality of risk assessments depend on the bank's size, complexity, and risk profile. Banks with large, complex, or high-risk loan portfolios generally have robust risk assessment processes and documentation that work in concert with the bank's processes for developing the credit risk appetite, developing strategic plans, and conducting stress testing. Even for small or noncomplex banks, examiners should generally be able to determine the risk assessment process from discussions with management, committee meeting minutes, management reports, or through risk management documentation.

It is common for risk assessments to consider four key threat aspects: the risk event, likelihood of occurrence, practical impact, and significance. Likelihood typically considers the probability of occurrence, and may be qualitative (e.g., high, moderate, or low) or quantitative (e.g., 5 percent chance of occurring). Impact typically focuses primarily on the event's direct effect on the bank. Significance typically describes how the risk event is likely to affect business strategies or major objectives. Other factors can be part of the risk assessment exercise, such as a risk rating that considers risk levels after controls or other mitigating factors are taken into account.

The OCC does not endorse a specific method for conducting risk assessments. Examiners should consider whether each bank's exercise is a reasonable approach to identifying and assessing risk and consider whether bank management considered a reasonable range of risks, identified likely risk events, and considered the potential impact of risks.

## Personnel

Lending personnel include customer-facing front-line staff (e.g., loan officers<sup>12</sup>), underwriters, credit administration staff, credit risk managers, appraisers, independent credit

<sup>11</sup> 12 CFR 30, appendix A, II.A.2.

<sup>12</sup> A loan officer is referred to as an account officer or relationship manager in some banks.

risk review staff, and many other risk management roles. Examiners should assess whether the bank has sufficient expertise and staffing levels for the types and volumes of lending the bank engages in. Some banks outsource some of these roles to third parties or use offshore resources. Refer to the “[Third-Party Risk Management](#)” section of this booklet for additional considerations when the bank uses third parties. For more information about assessing the adequacy of personnel, refer to the “[Corporate and Risk Governance](#)” booklet of the *Comptroller’s Handbook*.

## Separation of Duties

Separation of duties, a fundamental internal control for all banking operations, is particularly important in lending activities involving disbursement of funds. Banks have incurred losses that could have been prevented by separation of duties. An example of separation of duties is controls to prevent loan officers with lending authority from disbursing funds or making accounting entries. Personnel who disburse funds and make accounting entries are typically independent of the lending function and do not report to managers in the lending function.

Examiners should assess whether the structure in place promotes the separation of duties, minimizes the potential for improper funds disbursement or the altering of loan records, and prevents undue loan officer influence on back-room personnel (even if they do not directly supervise them). In small banks with limited staff, full independence and separation of duties can be difficult to achieve. In these cases, examiners typically review the existence of other internal controls (e.g., detective controls) and whether these controls sufficiently mitigate risks in light of the specific circumstances.

For more information about separation of duties and other internal controls, refer to the “[Internal Control](#)” booklet of the *Comptroller’s Handbook* (national banks and CSAs) and *OTS Examination Handbook 340*, “[Internal Control](#)” (FSAs).

## Training

A well-trained lending staff provides a solid foundation for a bank’s loan portfolio. Comprehensive training programs provide bank staff the knowledge, skills, and abilities to perform their job functions. Examples of some typical training content include

- compliance with laws and regulations.
- products and services.
- required loan documentation by product type.
- information security and privacy.
- policies and procedures.
- financial analysis.

Examiners should assess the frequency, type, and appropriateness of credit and lending staff training and determine whether staff maintain a current knowledge of topics relevant to the specific functions of each employee.

## Loan Officer Compensation

Banks should maintain safeguards to prevent the payment of compensation, fees, and benefits that are excessive or that could lead to material financial loss to the bank.<sup>13</sup>

Some banks incentivize loan officers for loan production. When production incentives are in place, examiners should determine whether incentives are multifaceted and include risk and reward measures. Compensation packages that rely solely on production or overemphasize production and do not reflect factors such as credit quality, risk-rating recognition, or other risk management-related metrics can result in unsupported risk-taking that ultimately affects a bank's safety and soundness. This can happen when, for example, loan officers compromise originating quality loans to meet production goals. Overly aggressive production goals that are not balanced with risk management-related measures can also result in unsupported risk-taking that ultimately affects a bank's earnings and capital or harms consumers. Additionally, Regulation Z prohibits certain types of loan originator compensation in connection with consumer credit transactions secured by a dwelling.

For more information about incentive compensation, refer to OCC Bulletin 2010-24, "[Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies](#)." For more information about loan originator compensation under Regulation Z, refer to the "[Truth in Lending Act \(Interagency\)](#)" booklet of the *Comptroller's Handbook* and 12 CFR 1026.36(d) and (e).

## Policies and Procedures

Lending policies are the primary means by which senior management and the board guide lending activities. Lending policies provide a framework for achieving asset quality and earnings objectives, operating within risk tolerance levels, and conducting lending activities in a manner consistent with the bank's strategic direction and risk appetite and in compliance with laws and regulations. Sound policies typically cover all major aspects of lending and the loan life cycle.

Although policies primarily impose standards, policies are also a statement of the bank's credit culture and risk appetite. Procedures complement policies and describe how policies are put into practice. Procedures typically provide details on job responsibilities, approval authorities, necessary steps for approvals, approval documentation requirements, credit administration activities, and compliance with applicable laws and regulations. A bank can supplement its general lending policies with procedures or guidelines for specific lending departments or loan types. Policies often include outer limits, with procedures or guidelines including more granular instructions or inner targets to help ensure compliance with policies.

Policies are intended to be bank specific such that the scope and detail are commensurate with the size, complexity, and risk profile of the bank's lending activities and reflective of the bank's lending culture. Lending policies vary in length, organization, degree of detail,

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<sup>13</sup> 12 CFR 30, appendix A, II.I and III.

and breadth of topics; there is no ideal format. Certain aspects of policies may be tailored to reflect geographic diversity, economic conditions, personnel, portfolio objectives, or other relevant bank-specific factors. Examiners should be skeptical when management acquires “off the shelf” or boilerplate lending policies and does not sufficiently tailor the policies to the bank’s products, services, activities, and risk appetite.

Effective policies are consistent with a bank’s risk appetite and portfolio objectives and provide meaningful, measurable, and auditable parameters. Policies generally provide flexibility through established processes for exceptions. If policies are too prescriptive and granular, exceptions to policies could become the norm, which could mask meaningful trends, thereby diminishing the effectiveness of the policies, risk assessment, and risk management. Conversely, policies that are too generic may not provide for consistent identification of exceptions. Examiners should be alert to language in policies that would allow significant loan officer discretion or provide insufficient clarity. For example, a policy allowing loans to businesses with a reasonable length of operating history (without parameters or criteria explaining “reasonable”) provides much less clarity than a policy allowing loans to businesses in operation and demonstrating profitability for a specific number of years.

Lending policies should be tailored to a bank’s lending activities, size, complexity, and risk profile. Most lending policies, however, discuss the following topics:<sup>14</sup>

- **Lending authorities**: Lending authorities describe who is authorized to approve loans, make changes in terms, and grant exceptions to policy. Lending authorities generally establish specific approval limits for credit approvers and may be individual or committee-based. Approval limits can be set as a dollar threshold or as a percentage of capital.
- **Limits and diversification standards**: Policies typically establish limits and diversification standards such as limits on aggregate loans and commitments, loan mix by loan category and product, and concentration limits. Traditionally, limits have been set relative to deposits, capital, or total assets. Concentration limits are typically established as a percentage of capital. Refer to the “[Concentrations of Credit](#)” booklet of the *Comptroller’s Handbook* for more information about concentration risk management. Additionally, policies typically address limits imposed by law or regulation (e.g., legal lending limits under 12 CFR 32 (national banks and FSAs) or limits under 12 USC 1464(c) (FSAs)).<sup>15</sup>
- **Types of loans offered**: Policies typically articulate the types of loan products the bank offers as well as any loan types that the bank does not offer.
- **Underwriting standards**: Policies typically include underwriting standards by loan product or type. Standards generally vary based on the nature and complexity of the loan type.
- **Credit administration**: Policies typically address expectations for loan administration and portfolio management. Policies typically articulate standards for loan servicing,

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<sup>14</sup> These topics are addressed in more detail throughout this booklet.

<sup>15</sup> Refer to [appendix K](#) of this booklet for more information about limits under HOLA (FSAs).

covenant monitoring, annual reviews of commercial loans, risk-rating practices, and other aspects of loan and portfolio management.

- **Credit risk review:** Credit risk review policies provide standards for the bank’s credit risk review processes and often address items such as the qualifications and independence of credit risk review personnel; the frequency, scope, and depth of reviews; the review of findings and follow-up; and communication and distribution of results.
- **Problem loan management, charge-offs, and ACLs:** Policies generally address collections, problem loan workout, repossession, foreclosure, and charge-offs as well as related accounting treatment. Refer to the “Allowances for Credit Losses” booklet of the *Comptroller’s Handbook* for more information about ACLs.
- **Reporting standards:** Policies generally describe the types, content, and frequency of reports provided to senior management and the board.
- **Laws and regulations:** Policies generally address the laws and regulations that apply to lending in general as well as laws and regulations pertinent to the bank’s specific product offerings.
- **Accounting:** Policies generally address relevant accounting standards.
- **Exceptions:** An effective policy describes types of acceptable exceptions and includes guidelines for identifying, justifying, approving, and reporting exceptions.

Some banks supplement their general lending policies with guidelines and procedures for specific lending departments, lines of business, or loan types. Other lending-related booklets of the *Comptroller’s Handbook* focus on policies for specific types of lending and discuss underwriting policy considerations for specific loan types. Additionally, 12 CFR 34.62 (national banks and CSAs) and 12 CFR 160.101 (FSAs) require banks to have written real estate lending policies.

Boards typically review and approve policies annually or when there are material changes. A periodic review of policies confirms that policies remain in alignment with the bank’s strategic direction and risk appetite. The review typically includes an analysis of portfolio quality; earnings objectives; and changes in business conditions, competition, technology, and regulatory requirements. The review also typically considers organizational structure, operational capacity, breadth and complexity of lending activities, capabilities and skills of lending personnel, and controls. In addition to providing an opportunity for change, the review evaluates how well the policy has guided lending decisions and influenced financial results. For example, a high volume of exceptions indicates that many loan decisions are being made outside the policy. This could mean that the bank is assuming more risk than is desirable or that the policy is too restrictive. If the bank’s policy is too restrictive, easing it could increase business opportunities without unduly increasing risk. Conversely, the absence of exceptions can indicate that the policy is too liberal or vague, and tightening the policy could strengthen the controls on loan quality.

## Credit Underwriting

**Excerpt from 12 CFR 30, appendix A, “Interagency Guidelines Establishing Standards for Safety and Soundness”**

*Loan documentation.* An institution should establish and maintain loan documentation practices that:

1. Enable the institution to make an informed lending decision and to assess risk, as necessary, on an ongoing basis;
2. Identify the purpose of a loan and the source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner;
3. Ensure that any claim against a borrower is legally enforceable;
4. Demonstrate appropriate administration and monitoring of a loan; and
5. Take account of the size and complexity of a loan.

*Credit underwriting.* An institution should establish and maintain prudent credit underwriting practices that:

1. Are commensurate with the types of loans the institution will make and consider the terms and conditions under which they will be made;
2. Consider the nature of the markets in which loans will be made;
3. Provide for consideration, prior to credit commitment, of the borrower’s overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower’s character and willingness to repay as agreed;
4. Establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors;
5. Take adequate account of concentration of credit risk; and
6. Are appropriate for the size of the institution and the nature and scope of its activities.

Assessing banks’ credit underwriting standards as documented in the bank’s lending policies provides examiners with an understanding of the bank’s expected credit underwriting practices and credit risk appetite. Examiners should periodically assess the consistency of a bank’s credit underwriting practices with policy parameters as well as safe and sound banking practices. Examiners may leverage bank reports (e.g., underwriting or exception reports), leverage the results of credit risk review and audit reviews, or analyze bank-provided data when this information is available and reliable. Testing can validate the adequacy of risk management practices, reliability of bank reporting, and effectiveness of credit risk review and internal audit. Refer to the “[Credit Underwriting Reviews](#)” section and appendixes [E](#), [F](#), and [G](#) of this booklet for more information about credit underwriting reviews.

Underwriting processes can be automated, manual, or a hybrid of the two. Automated underwriting is most common in retail loans, but can also be used for commercial loans, particularly small business loans. Refer to the “[Automated Credit Approval Processes](#)” section of this booklet for an overview of automated underwriting.

The format and depth of an appropriate underwriting analysis vary based on factors such as loan type and size. Regardless of the format, sound underwriting and related loan documentation practices should be consistent with the safety and soundness standards in 12 CFR 30, appendix A.<sup>16</sup> Other booklets in the “Asset Quality” category of the *Comptroller’s Handbook’s Safety and Soundness* series provide detailed information related to credit underwriting for specific types of loans.

## Structural Weaknesses

**Excerpt from the “[Rating Credit Risk](#)” booklet of the *Comptroller’s Handbook*, appendix F, “Structural Weakness Elements”**

Structural weaknesses are underwriting deficiencies that can compromise a bank’s ability to control a credit relationship if economic or other events adversely affect the borrower. Some degree of structural weakness may be found in virtually any aspect of a loan arrangement or type of loan, and the presence of one (or more) need not be indicative of an overall credit weakness deserving criticism. Instead, the examiner must evaluate the relative importance of such factors in the context of the borrower’s overall financial strength, the condition of the borrower’s industry or market, and the borrower’s total relationship with the bank

Structural weaknesses can occur at underwriting or later in a loan’s life cycle. Additionally, a loan may fit within the parameters of a bank’s policies but still have structural weaknesses. Some examples of potential underwriting and structural weaknesses include the following:

- Indefinite or speculative purpose
- Indefinite or overly liberal repayment program
- Nonexistent, weak, or waived covenants
- Inadequate debt service coverage
- Elevated leverage ratio
- Inadequate financial analysis
- Insufficient collateral support
- Inadequate collateral documentation and valuation
- Overly aggressive LTV or advance rates
- Inadequate guarantor support
- Repayment highly dependent on projected
  - cash flows
  - asset values
  - equity values
  - refinancing or recapitalization

Refer to the “[Rating Credit Risk](#)” booklet of the *Comptroller’s Handbook* for more information about structural weaknesses. Examiners may use a “Credit Underwriting Weaknesses” section in an ROE or supervisory letter when there are weaknesses in a bank’s credit underwriting or credit administration practices that warrant communication to bank

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<sup>16</sup> Refer to 12 CFR 30, appendix A, II.C and D.

management. This section may be used to list and provide brief information about loans or portfolios with material underwriting or credit administration exceptions and weaknesses. If applicable, this section may be used to summarize emerging underwriting or credit administration exceptions, weaknesses, or risks. Refer to the "[Bank Supervision Process](#)" booklet for more information about the content and typical format of this section of the ROE. This section may be used in supervisory letters as well as ROEs.

## Capitalization of Interest

### Excerpt from Examining Circular (EC) 229, "[Capitalization of Interest](#)"

Capitalized interest on loans is generally defined as uncollected interest which is added to unpaid principal in accordance with the contractual loan agreement. Although there are several ways this can occur, two methods predominate.

One arises when the cash interest payment required from the borrower at the regular interest payment date is less than the actual rate of interest charged. The loan contract usually provides for any difference to be added to the principal amount of the loan and repaid at a later date. Examples include "negative amortization" home mortgage loans, equipment installment loans with skip payment provisions and loans having maximum payment provisions in the initial term offset by larger payments in the latter term ("capped loans").

The second method involves loans which are renewed at maturity with the uncollected interest included in the new loan. Such arrangements occur in connection with real estate construction financing and agricultural credits. Although interest is capitalized under the terms of the loan contract and is added to the note, capitalization of interest for reporting purposes is appropriate only when the borrower has the ability to repay the debt in the normal course of business. However, present regulatory and generally accepted accounting principles do not provide specific guidance as to when interest capitalization is appropriate. The prevailing practice has generally relied upon safe and sound lending policies consistent with prudent credit judgement. The lack of specific guidance and increased frequency of the practice make the issuance of formal guidance appropriate.

Examining Circular 229 provides more information about determining the appropriateness of interest capitalization and the accounting treatment for loans with capitalized interest. Refer to the "[Rating Credit Risk](#)" booklet of the *Comptroller's Handbook* when EC 229 refers to "Section 215.1 of the Comptroller's Handbook for National Bank Examiners."

## Lending Authorities

Lending authority may be individual (e.g., single loan officer), joint, or committee-based. Each type has its strengths and weaknesses. Using individual authorities is typically faster and establishes clear accountability but can create undue credit risk if a lender's ethics, knowledge, or experience are inadequate for his or her authority. Laddered or joint authorities combine elements of both individual and committee-based authorities. In such arrangements, individuals have escalating levels of approval based on the size of the loan, exceptions to policy, borrower history, risk rating, and other factors. Large loans and loans with elevated risk characteristics generally require higher levels of approval, which may

come from a committee or individuals. The involvement of an independent loan approval authority (such as a senior credit officer or credit risk management team) whose primary goal is credit quality can introduce more objectivity to the loan approval process. Committee-based authorities may be advantageous because they allow for shared knowledge and reinforce the credit culture but can diminish accountability and can slow a bank's responsiveness. The board generally reviews and approves any commercial loan large enough to adversely affect the bank's financial condition in the event of borrower default.

The OCC does not recommend one approach over another. Sound loan approval processes include sufficient controls to confirm acceptable credit quality at origination and provide appropriate accountability for the credit decision. When examiners review a bank's credit decisioning process, they should determine if the documentation and analysis are sufficient to make an informed credit decision, and that the approver had sufficient authority based on the bank's established limits.

### **Automated Credit Approval Processes**

Many banks automate approval processes for certain loan types (e.g., automobile loans, credit cards, or small business loans). The "[Retail Lending](#)" booklet of the *Comptroller's Handbook* provides an overview of automated credit approval processes. Other *Comptroller's Handbook* booklets in the "Asset Quality" category of the *Safety and Soundness* series provide more detail regarding automated credit approval processes and other models (e.g., credit scoring models) that are commonly used in credit approval processes for specific loan types.

**Excerpt from the “[Retail Lending](#)” booklet of the *Comptroller’s Handbook***

Retail lenders often attempt to automate as much of the credit approval process as possible because of operational efficiencies that can be gained from advances in modeling and expansions in data availability. When practical, applications are often directed through rule-based criteria concerning profitability, credit standards, credit amounts, policy exceptions, and pricing. The objective is one of four main results:

- Auto-approve
- Auto-decline
- Recommended approve
- Recommended decline

Most decisions for unsecured loans fall into the auto-approve and auto-decline categories, because the underwriting criteria mainly consist of prior credit performance and some income-based capacity and loan amount standards. The recommended approve and recommended decline options generally flow to a bank staff member for manual underwriting.<sup>17</sup> Secured loans usually have some manual review and consideration of collateral values, advance rates, etc., but standard rules and decision criteria govern these aspects as well. For cost and efficiency reasons, many bank managers generally prefer to route as many applications as possible through the automated options to leverage technology and economies of scale. This makes the criteria at each decision point extremely important, and there should be policies regarding the support needed for each. Decision criteria for auto approvals and manual reviews should adhere to the bank’s written guidelines and be approved by the appropriate level of management according to internal policy delegations. Additionally, a clear audit trail should document the approval process.

Retail loans that fall outside automated lending parameters (e.g., recommend approve or recommend decline) or product types are typically decided by one or more of the lending authority types described in the “[Lending Authorities](#)” section of this booklet.

Models used for credit underwriting and decisioning should be subject to sound model risk management. Refer to OCC Bulletin 2026-13, “[Model Risk Management: Revised Guidance](#),” for more information about model risk management. For community banks, examiners should also refer to OCC Bulletin 2025-26, “[Model Risk Management: Clarification for Community Banks](#).”

## Loan Purchase Activities

If sufficient loan demand exists, direct lending within the bank’s trade area is generally lower risk and more profitable than purchasing loans. Direct lending promotes customer relationships, fosters the local economy, and helps to develop additional business for the bank. Banks can choose to purchase loans to help achieve strategic goals for specific loan products, deploy excess liquidity, improve net interest margins, or diversify the portfolio.

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<sup>17</sup> Footnote 42 from the “[Retail Lending](#)” booklet of the *Comptroller’s Handbook* states, “Examiners should also evaluate whether credit decisions made during these manual reviews are supported by prudent business processes and controls designed to manage potential fair lending and other compliance risks. These controls should include adequate monitoring reports, as well as periodic process and transaction reviews by independent control functions such as internal audit, risk management, or compliance management.”

Purchasing loans can also be a source of liquidity if such loans can be easily pledged or resold. For small or noncomplex banks, the purchase or sale of loan exposures via participations can be an effective way to diversify risk, meet the credit needs of the community, and comply with the legal lending limit, but these activities can also result in increased risks.

**Excerpt from OCC Bulletin 2020-81, “[Credit Risk: Risk Management of Loan Purchase Activities](#)”**

Failure to engage in sound risk management of loan purchase activities can subject banks to unwarranted risks such as elevated loan losses, increased legal expenses, and noncompliance with safety and soundness standards.

OCC Bulletin 2020-81, “[Credit Risk: Risk Management of Loan Purchase Activities](#),” discusses risk management of loan purchases activities in detail. This section of the booklet provides excerpts from OCC Bulletin 2020-81 for context; examiners should refer to the full text of the bulletin when reviewing loan purchase activities.

**Excerpt from OCC Bulletin 2020-81, “[Credit Risk: Risk Management of Loan Purchase Activities](#)”**

A bank’s loan purchase activities would typically be handled in a manner consistent with its other lending activities, including sound risk management commensurate with the bank’s size, complexity, and risk profile. Large or complex banks and banks engaged or planning to engage in high volumes of loan purchase activities typically have more sophisticated and formal risk management systems than small or noncomplex banks. Sound risk management of loan purchase activities generally includes

- a well-defined strategic plan and risk appetite that appropriately cover loan purchase activities.
- risk limits for loan purchase activities.
- policies and procedures governing loan purchase activities.
- underwriting analysis and due diligence of the loans, independent of analysis provided by the selling institution (referred to as the seller), before purchase.
- agreement by the borrower(s) to make full and timely credit information available to the seller or the underwriting institution.
- agreement by the seller to provide the purchaser with necessary information to make an informed credit decision and conduct ongoing credit monitoring.
- written documentation of transfer, servicing, events of default, collections, and recourse arrangements outlining the rights and obligations of each party.
- effective credit administration practices, including management and board reports.

Pre-purchase due diligence enables a bank to make an informed loan purchase decision and supports sound risk management after the purchase.

**Excerpt from OCC Bulletin 2020-81, “[Credit Risk: Risk Management of Loan Purchase Activities](#)”**

A bank should perform due diligence before purchasing loans. Due diligence promotes a well-performing, stable loan portfolio with identified risks that are within the bank’s capabilities to control. Generally, due diligence includes

- credit analysis independent of the seller that includes assessing whether the loan(s) meet the bank’s underwriting standards and other loan policy criteria.
- assessing the quality of the collateral and the appropriateness of collateral valuation methods.
- analyzing the purchasing bank’s history with the seller and the seller’s experience with the lending product and financial capacity.
- risk assessment of all applicable risks.
- thorough assessment and legal review of the purchase contract, including recourse and risk-sharing arrangements, loan administration, and collateral controls.
- assessing accounting implications, such as sales treatment and loan loss allowances.

## Model Risk Management

Banks use models for various purposes related to lending. Many banks, particularly those that originate retail or small business loans, use models for underwriting and credit administration. Banks also use models for loan pricing, financial analysis, stress testing, and portfolio monitoring. Models can be used to inform decisions regarding investment portfolio actions, the ACL, and capital planning.

Models can help increase efficiency and consistency, but model use can also increase risks. Models and their outputs can have a material effect on business decisions related to credit risk management.

Models used for credit underwriting and decisioning should be subject to sound model risk management. Refer to OCC Bulletin 2026-13, “[Model Risk Management: Revised Guidance](#),” for more information about model risk management. Additionally, many booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller’s Handbook* provide detailed information about models commonly used for specific types of lending. For community banks, examiners should also refer to OCC Bulletin 2025-26, “[Model Risk Management: Clarification for Community Banks](#).” OCC Bulletin 2025-26 reinforces the OCC’s position that model risk management should be commensurate with the bank’s risk exposures, its business activities, and the complexity and extent of its model use.

## Third-Party Risk Management

**Excerpt from “Interagency Guidance on Third-Party Relationships: Risk Management” conveyed by [OCC Bulletin 2023-17](#)**

Whether activities are performed internally or via a third party, banking organizations are required to operate in a safe and sound manner<sup>18</sup> and in compliance with applicable laws and regulations.<sup>19</sup> A banking organization’s use of third parties does not diminish its responsibility to meet these requirements to the same extent as if its activities were performed by the banking organization in-house.

The following are common third-party relationships related to lending:

- Attorneys
- Data processors
- Providers of models
- Marketing firms
- Appraisers, appraisal management companies, and appraisal review companies
- Collateral valuation or inspection firms
- Environmental firms
- Financial analysis firms
- Loan brokers and correspondents
- Debt buyers
- Repossession agents
- Financial technology (fintech) companies.
- Outsourced credit risk review firms
- Outsourced internal audit firms

Third parties offer a wide range of services that can be customer-facing or behind the scenes. Third-party risk management is particularly important when third parties have significant contact with banks’ customers or when banks rely extensively on third parties to conduct operations.

Examiners should assess the adequacy of the bank’s third-party risk management for third parties that support critical activities related to lending and loan portfolio risk management. Examiners should also consider the OCC’s conclusions about the adequacy of the bank’s overall third-party risk management process.

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<sup>18</sup> Footnote 3 from the “Interagency Guidance on Third-Party Relationships: Risk Management” states, “See [12 USC 1831p-1](#). The agencies implemented section 1831p-1 by regulation through the ‘Interagency Guidelines Establishing Standards for Safety and Soundness.’ See [12 CFR part 30, appendix A](#) [...]”

<sup>19</sup> Footnote 4 from the “Interagency Guidance on Third-Party Relationships: Risk Management” states, “References to applicable laws and regulations throughout this guidance include but are not limited to those designed to protect consumers (such as fair lending laws and prohibitions against unfair, deceptive or abusive acts or practices) and those addressing financial crimes.”

## Independent Credit Risk Review

Independent credit review is a key internal control and an element of the “Interagency Guidelines Establishing Standards for Safety and Soundness” in appendix A of 12 CFR 30 and is essential to effective loan portfolio management.<sup>20</sup> Credit risk reviews provide the board and senior management with an objective, independent, and timely assessment of the overall quality of the loan portfolio.

This section of the booklet focuses on independent credit risk review (i.e., credit risk reviews independent of loan officers and loan production staff). For more information about credit risk rating processes and risk-rating reviews performed by loan officers (e.g., annual commercial credit reviews), refer to the “[Credit Risk Rating Systems](#)” section of this booklet and the “[Rating Credit Risk](#)” booklet of the *Comptroller’s Handbook*. Other “Asset Quality” category booklets include specific considerations for independent credit risk review for specific loan types.

A key examination objective is determining the reliability of the bank’s independent credit risk review. Examiners may use conclusions from independent credit risk reviews the OCC has determined are satisfactory when determining the scope of lending-related supervisory activities. For banks with satisfactory independent credit risk review, examiners should primarily focus on any changes to credit risk review, such as changes in scope, depth, timing, or staffing. High levels of credit risk review staff turnover or changes in third-party credit review firms may warrant a deeper review by examiners. Examiners should also determine whether credit risk review has evolved commensurate with any changes in the size, complexity, or risk profile of the bank’s lending activities.

Even when the OCC has concluded a bank’s credit risk review is satisfactory, examiners should conduct periodic testing to validate their assessments. Comparing results of the OCC’s transaction testing with independent credit risk review findings is a common way that examiners test the reliability of credit risk review’s work. For example, if examiners discover risk-rating or credit administration concerns that credit risk review did not identify, examiners should assess the root cause and determine if there are deficient practices in the bank’s credit risk review.

Independent credit risk review may be structured in various ways depending on the bank’s size, complexity, loan types, risk profile, operational structure, and risk management practices. Regardless of the way a bank structures its credit risk review processes, examiners focus on the effectiveness of the bank’s credit risk review.

The credit risk review function is not intended to be performed by the bank’s internal audit function. Some banks coordinate the internal audit function with several risk monitoring functions, such as the credit risk review function. The functions may share information, coordinate plans, and conduct joint reviews. Coordination of credit risk review with the internal audit function can facilitate the reporting of material risk and control issues to the

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<sup>20</sup> For more information, refer to OCC Bulletin 2020-50, “[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#),” and 12 CFR 30, appendix A, II.D.4.

audit committee, increase the overall effectiveness of these monitoring functions, better utilize available resources, and enhance the bank's ability to comprehensively manage risk.

Refer to OCC Bulletin 2020-50, "[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#)," for more information about credit risk review.

## Internal and External Audit

**Excerpt from the "[Internal and External Audits](#)" booklet of the *Comptroller's Handbook***

Well-planned, properly structured auditing programs are essential to effective risk management and internal control systems.<sup>21</sup> Effective internal and external audit programs are also a critical defense against fraud and provide vital information to the board of directors about the effectiveness of internal control systems.

### Internal Audit

**Excerpt from the "[Internal and External Audits](#)" booklet of the *Comptroller's Handbook***

The internal audit function is the third line of defense.<sup>22</sup> The internal audit function's primary role is to independently and objectively review and evaluate bank activities. This role helps to maintain and improve the efficiency and effectiveness of the bank's risk management system, internal controls systems,<sup>23</sup> and corporate governance.

Internal audit objectively and independently reviews and evaluates lending activities, including accounting systems, management reporting, and operations.

Lending audits typically focus on the adequacy of policies and procedures, internal controls, underwriting, collateral valuation processes, disbursement, credit administration, collections and workout activities, credit risk review, and ACL methodologies and processes. Most audit reviews include credit and loan documentation file samples to review specific transactions for adherence to policies and procedures and compliance with laws and regulations. Many internal audit reviews also include reviews of the proper processing of cash disbursements, loan payoffs, and loan charge-offs. Internal audit also typically reviews and reconciles important management reports, including testing the accuracy and timeliness of reports

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<sup>21</sup> Footnote 2 of the "Internal and External Audits" booklet of the *Comptroller's Handbook* states, "Refer to the '[Internal Control](#)' booklet of the *Comptroller's Handbook* (national banks) and *[OTS] Examination Handbook* section 340, '[Internal Control](#)' (FSAs), which supplement the internal control core assessment standards in the '[Large Bank Supervision](#)' and '[Community Bank Supervision](#)' booklets of the *Comptroller's Handbook*. Refer to other *Comptroller's Handbook* booklets for guidance on assessing controls for specific banking products and activities."

<sup>22</sup> Footnote 67 of the "Internal and External Audits" booklet of the *Comptroller's Handbook* states, "Refer to the '[Corporate and Risk Governance](#)' booklet of the *Comptroller's Handbook*."

<sup>23</sup> Footnote 68 of the "[Internal and External Audits](#)" booklet of the *Comptroller's Handbook* states, "Per 12 CFR 30, appendix A, II.A, internal control systems include internal controls and information systems."

provided to the board and senior management. Effective internal audit programs cycle through all lending products within scheduled and defined time frames to promote regular and thorough coverage of all lending activities. Typically, audit coverage is risk-based with high-risk activities receiving more frequent or more in-depth reviews than low-risk activities. In many cases, internal audit reviews other control functions, such as credit risk review.

In some banks, independent credit risk review coordinates with internal audit to facilitate the reporting of material risk and control issues to the audit committee, increase the overall effectiveness of these monitoring functions, better use available resources, and enhance the bank's ability to comprehensively manage risk. Although there are advantages to coordination, an effective internal audit function maintains the ability to independently audit the credit risk review function.

## External Audit

**Excerpt from the "[Internal and External Audits](#)" booklet of the *Comptroller's Handbook***

An external audit program provides the bank board with information about the bank's financial reporting risk areas, e.g., the bank's internal controls over financial reporting, the accuracy of its recording of transactions, and the completeness of its financial reports prepared in accordance with applicable accounting standards.

The bank's ACL is one of the most common lending-related items reviewed by external audit. External audit also typically tests other internal controls over financial reporting for activities significant to the bank's condition or material to the bank's financial statements.

# Credit Administration

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Credit administration is an important control mechanism, and it is often the operations arm of the lending function. In many banks, the credit administration function has two primary components, loan administration and portfolio management.

Credit administration practices vary from bank to bank and rely on effective management, experienced staff, well defined operating procedures, satisfactory reporting, sound internal controls, and diligent oversight. Credit administration weaknesses can pose significant safety and soundness issues for a bank. Independent credit risk review and internal audit normally review credit administration periodically. Concerns about the adequacy of credit administration could signal the need for more extensive testing or, if examiners identify concerns that were not self-identified by the bank, could be an indication of weaknesses in the independent credit risk review or audit functions.

## Loan Administration

Effective administration processes can help control risks throughout a loan's life cycle. The function is often referred to as back-office operations. The loan administration function often encompasses the following types of activities:

- Pre-closing reviews
- Loan closing
- Loan booking
- Post-closing reviews
- Loan servicing and monitoring
- Problem loan management
- Secondary marketing

Effective loan administration generally includes various internal controls such as segregation of duties, dual controls, independent reconciliation of fund disbursement and accounting records, and quality control processes.

## Pre-Closing Reviews

Pre-closing reviews are reviews that occur before loan closing and disbursement. Pre-closing includes activities such as

- confirming the accuracy of credit underwriting information and key underwriting metrics (e.g., debt to income (DTI), debt service coverage ratio (DSCR), LTV).
- checking for consistency with bank policies.
- verifying that loan documents are appropriate for the loan type and consistent with approved terms and conditions.
- reviews of compliance with laws and regulations.

- legal review of loan documents, as warranted based on the loan type (e.g., for complex or non-standard loan documentation).

## Loan Closing

Loan closing includes executing loan documents and, in most cases, disbursing funds. The loan closing may be performed by bank staff, an attorney, or a title company or agent. In some instances, the loan closing process may be fully automated (e.g., for certain retail loans).

## Loan Booking

Loan booking includes recording loans in the bank's systems in accordance with documented loan terms as well as attaching and perfecting the bank's lien on the collateral. This also generally includes capturing exceptions to policy and ongoing monitoring requirements for tracking and reporting purposes.

## Post-Closing Reviews

Post-closing reviews are reviews that occur after a loan is closed and booked. Post-closing reviews typically verify that documents are complete and properly executed and that liens are attached and perfected. Any missing, incomplete, or improperly executed items are tracked for resolution. Post-closing reviews also generally confirm that loan information has been accurately entered into the bank's systems.

## Loan Servicing and Monitoring

Loan servicing and monitoring involve ongoing maintenance of each loan until payoff. Loan servicing and monitoring generally include activities such as

- processing of draws and revolving credit advances.
- interest rate adjustments for variable rate loans, including commercial loans with performance-based pricing.
- periodic loan billing.
- escrow administration.
- monitoring flood, property and casualty, and liability insurance (e.g., policy changes, terminations) and force placing coverage when a borrower fails to provide evidence of insurance.
- payment processing and balancing of appropriate general ledgers.
- processing participation loan payments.
- loan maturity monitoring.
- monitoring trailing document exceptions.
- lien perfection monitoring for recorded mortgages or deeds of trust and recorded Uniform Commercial Code (UCC) filings, which generally have a five-year expiration from the filing date.

- monitoring the status of required periodic borrower financial statements and loan covenant testing.
- monitoring the status of periodic commercial loan reviews (e.g., annual analysis and risk-rating reviews).
- processing loan payoffs and lien releases.

## Secondary Marketing

Secondary marketing generally involves developing, pricing, and selling loan products and delivering loans to investors as well as managing price risk from loan commitments in the pipeline and warehouse as well as loans held for sale. The secondary market function may be embedded in a loan operations department for banks with limited activity. Secondary market activities encompass many types of loan products, but the most common are mortgage loan products. For more information about secondary marketing activities, refer to the “[Mortgage Banking](#)” booklet of the *Comptroller’s Handbook*.

## Problem Loan Management

Even when a bank performs sound underwriting and properly monitors a loan, a loan’s credit quality can deteriorate. Effective problem loan management practices include positive support from senior management and the board to help ensure lenders identify weaknesses and adverse trends in a borrower’s financial condition at the earliest possible stage. Orderly and full repayment is the goal, with repossession, foreclosure, or other legal action a last resort.

Problem loan management includes collections, workouts, and foreclosure or repossession activities. Collections activities involve bringing past-due accounts current and negotiating payment plans for charged-off accounts. Collections activities may also include short-term accommodations before a loan reaches workout status. Loan workout activities generally refer to loss-mitigation activities such as forbearance, renewing or extending loan terms, granting additional credit to improve the prospects of repayment, or restructuring a loan with or without concessions. The goal of a workout arrangement is improving the bank’s prospects for repayment.

Financial difficulties of borrowers that escalate to default can result in foreclosure or repossession of collateral, with the bank becoming an owner and subsequent seller of the collateral. In some instances, a bank elects to sell a debt to a third party to generate a partial recovery. Refer to booklets in the *Consumer Compliance* series of the *Comptroller’s Handbook* for more information about consumer protection-related laws and regulations related to collections, bankruptcy, and debt sales. OCC Bulletin 2014-37, “[Consumer Debt Sales: Risk Management Guidance](#),” provides banks with guidance on consumer debt sales. Some consumer protection-related laws and regulations apply to certain commercial exposures, such as certain small business loans. Additionally, topic 2E of the [Bank Accounting Advisory Series](#) and the FFIEC’s “Instructions for Preparation of Consolidated Reports of Condition and Income” (call report instructions) provide more information about accounting for loan sales.

There are unique considerations for borrowers who have filed for bankruptcy. Additionally, refer to product-specific booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller’s Handbook* for more information about collections and workout activities related to specific loan types. The “[Problem Bank Supervision](#)” booklet of the *Comptroller’s Handbook* also provides information about problem loan management.

Collections and workout programs are generally customized based on the bank’s size, complexity, and risk profile as well as the types of lending the bank engages in. Collections and loan workouts are time-consuming activities integral to mitigating or minimizing portfolio losses and preserving capital. Organizational structures and staffing approaches for collections and workouts models vary, such as

- loan officers who provide oversight throughout the entire loan life cycle.
- a small number of staff who perform both collections and workout activities.
- large, dedicated departments for each function.

## Collections

Collections activities involve bringing past-due accounts current and negotiating payment plans for charged-off accounts. Many different approaches can be effective as long as staffing levels, skills, and experience are consistent with the volume and complexity of loans in collection status; the products offered (e.g., retail vs. commercial loan collections may require specialized levels of knowledge and expertise); and the bank’s size, complexity, and risk profile. In small or noncomplex banks, loan officers may be responsible for collecting their own loans. As volumes increase, separate collection personnel or collections departments are common. The additional resources and closer management supervision of dedicated staff normally improve results. Some banks outsource some or all collections activities to third-party specialists. For example, some banks handle early-stage delinquencies in house and transfer delinquent accounts to a third-party agency once the account becomes 90 days past due.

The complex compliance (including legal) risks that stem from mortgage collections and foreclosures generally warrant specialized knowledge or staff dedicated to mortgage workout, loan modification, and foreclosure processes. For more information about residential real estate collections, refer to the “[Mortgage Banking](#)” and “[Residential Real Estate Lending](#)” booklets of the *Comptroller’s Handbook*. Booklets in the *Consumer Compliance* series of the *Comptroller’s Handbook* provide more information about consumer protection-related laws and regulations applicable to collections activities.

Examiners should determine if the number of collectors, training programs, and level of expertise are adequate to handle current and near-term projected collection volumes. In general, collection efforts are more effective when supported by experienced stable management and staff. Overall productivity suffers as experience levels decrease or turnover increases, and severely understaffed units tend to show disproportionately poor results.

## Workouts

Loan workouts can take many forms, such as forbearance, renewing or extending loan terms, extending additional credit, or restructuring with or without concessions. Prudent workouts support effective structures to resolve problem assets and not simply defer losses. A bank's loan workout processes should be appropriate for the complexity and nature of its lending activities, consistent with safe and sound lending practices, and in compliance with laws and regulations. Sound workout processes generally involve

- management infrastructure to identify and manage the volume and complexity of workout activity.
- documentation standards to verify the borrower's financial condition and collateral values.
- internal controls, systems, and reports to identify and track loan performance and risk.
- preparation of regulatory reports consistent with regulatory reporting requirements and GAAP. Refer to topic 12B of the [Bank Accounting Advisory Series](#) and the call report instructions for more information on accounting for loan modifications to borrowers experiencing financial difficulties.
- collateral administration to help ensure proper lien perfection of collateral interests for both real and personal property.
- ongoing credit risk review to promote accurate and timely risk-rating changes and loss recognition.

Refer to the following guidance as appropriate when reviewing workouts for specific loan types:

- OCC Bulletin 2023-23, "[Credit Administration: Final Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts](#)"
- OCC Bulletin 2007-38, "[Working with Borrowers: Statement on Residential Real Estate Loan Restructurings for Serviced Loans](#)"
- OCC Bulletin 2007-14, "[Working with Mortgage Borrowers: Interagency Statement](#)"
- OCC Bulletin 2003-1, "[Credit Card Lending: Account Management and Loss Allowance Guidance](#)"
- OCC Bulletin 2000-20, "[Uniform Retail Credit Classification and Account Management Policy: Policy Implementation](#)"

In addition, the OCC and other bank regulatory agencies often issue workout guidance in response to specific events.

## Workout Processes

Banks differ on the methods and organization used to manage problem loans. Managing problem loans is time-consuming and often warrants special knowledge. In many cases, banks use a hybrid approach, with workout specialists advising loan officers on workout strategies until a trigger requires the loan officer to relinquish the credit to the workout group.

Typically, the loan committee or a related subcommittee regularly reviews the level and trend of new problem loans, existing problem loans, and plans to enforce remedial action.

There are advantages and disadvantages to keeping a problem loan with the loan officer or transferring it to a workout specialist or workout group (e.g., special assets group). Relationship managers are most familiar with the credit and likely have an ongoing relationship with the borrower, giving them insight into potential workout solutions and rapport that might make it easier to negotiate concessions from the borrower. Those close relationships, however, could make a loan officer too optimistic about a borrower's rehabilitation plans or reluctant to accept that an exit strategy is the best workout plan. While workout specialists don't have the loan officer's familiarity and rapport, they usually have a specialized skill set including experience in managing problem credits, strong understanding of legal and accounting matters, and willingness to act in the case of default.

Workout specialists or workout units can save a bank considerable money, especially during an economic downturn. These specialists can help craft a strategy to return a troubled borrower to financial health or exit a relationship when optimal from a collateral value or cost perspective. Because of their proficiency with both rehabilitation and exit strategies, workout personnel can assist in developing strategy for marginally rated borrowers or problem loans that are supervised by the loan officer. Experienced workout staff can provide valuable guidance that can help to minimize losses in the event of default.

In banks with a workout department, an automatic transfer policy enables a bank to provide uniformity in its dealings with borrowers experiencing financial difficulty. In banks where a relationship may include loans managed by more than one department, it is generally preferable to transfer the entire credit relationship to ensure consistent treatment of the borrower. Some banks outsource workouts to a third party, though this is more common in retail lending than commercial lending.

Examiners should evaluate how bank management controls the risks associated with keeping a problem loan with the originating loan officer or transferring it to a workout group.

Workout staffing levels typically follow the credit cycle, shrinking during strong credit periods and building when problem loans increase. Even during a period of low problem loan volumes, adequate staffing by experienced personnel is a key factor in effectively managing problem loans.

### **Workout Plans**

Prudent loan workouts are often in the best interest of both banks and borrowers, particularly during difficult economic conditions. Effective workout plans typically include

- a summary and analysis of the root cause of the credit's deterioration.
- a decision to rehabilitate or exit the relationship.
- updated and comprehensive financial information on the borrower and guarantor(s).
- current valuations of the collateral supporting the loan and workout plan.

- analysis and determination of appropriate loan structure (e.g., term and amortization schedule), curtailment, covenants, or re-margining requirements.
- an estimation of any expected loss
- appropriate legal documentation for any changes to loan terms.
- actions and time frames to be taken by the bank and borrower.
- triggers for risk-rating changes (upgrades and downgrades) and accrual treatment.

Problem loan workouts involve a high degree of judgment and rely on the relationship between the borrower and the bank. Banks typically update workout plans periodically, with the frequency of updates increasing depending on the severity of the situation or other factors. Banks also update workout plans as circumstances change. Examiners should assess whether loan workout processes are effective and whether loan workout plans serve to mitigate loan losses. Prudent loan workout processes prioritize protecting the bank's interest in the loan or collateral.

## Foreclosure and Repossession

Financial difficulties of borrowers that escalate to default can result in foreclosure or repossession of collateral, with the bank becoming an owner and subsequent seller of the collateral. Foreclosure and repossession processes often vary depending on the collateral type. Refer to product-specific booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller's Handbook* for more information about foreclosure or repossession of collateral associated with specific loan types. Numerous laws and regulations apply to foreclosure and repossession activities, such as fair lending laws and regulations, mortgage servicing rules regarding foreclosure, regulations designed to protect tenants of non-owner-occupied properties, the Servicemembers Civil Relief Act, and laws prohibiting unfair, deceptive, or abusive acts or practices. Refer to the following booklets in the *Consumer Compliance* series of the *Comptroller's Handbook* for more information about consumer protection-related laws and regulations related to foreclosure and repossession:

- [“Fair Lending”](#)
- [“Protecting Tenants at Foreclosure Act”](#)
- [“Servicemembers Civil Relief Act”](#)
- [“Unfair or Deceptive Acts or Practices and Unfair, Deceptive, or Abusive Acts or Practices”](#)

The [“Other Real Estate Owned”](#) booklet of the *Comptroller's Handbook* discusses risks and risk management practices for OREO. Although the “Other Real Estate Owned” booklet focuses on foreclosed real property, the acquisition accounting and reporting guidance described in the booklet may apply to other types of foreclosed (repossessed) property, such as consumer and commercial goods, financial instruments, and intangible assets. Information regarding other repossessed property can be found in the [“Installment Lending”](#) booklet of the *Comptroller's Handbook*, the [Bank Accounting Advisory Series](#), and the call report instructions.

## Postmortem Reviews

An important part of the collections and loan workout processes is postmortem reviews to understand how problem loans and losses develop. Postmortems can inform strategic execution and changes in risk selection. The following are examples of items commonly included in postmortem reviews:

- Comparing each loan's terms and characteristics with underwriting guidelines
- Reviewing the borrower's financial condition at the time of loan approval and over time
- Assessing the timeliness of risk-rating changes and problem loan identification
- Assessing the timeliness and effectiveness of collections and workout activities undertaken
- Assessing the adequacy and timeliness of collateral valuations
- Assessing the effectiveness of the loan and covenant structure

## Portfolio Management

Portfolio management is the process banks use to identify, measure, monitor, and control risks in the bank's loan portfolio.

### Exceptions

There are different types of exceptions, and the process to identify, measure, monitor, and control exceptions often differs based on the type of exception. Underwriting exceptions occur when the loan is underwritten and approved. Banks sometimes approve loans outside of policy standards to service creditworthy borrowers and meet the legitimate credit needs of the communities they serve, and loans with approved exceptions that are properly justified often present acceptable credit risk. A loan portfolio with a high level of underwriting exceptions, however, is generally an indication that the bank's practices deviate from the bank's risk appetite. Financial exceptions are identified during the life of the loan and are most commonly applicable for commercial loans. Credit administration exceptions can occur at any time (e.g., at underwriting, shortly after closing, or any other time during the life of the loan). Table 1 provides an overview and examples of types of exceptions. Banks may refer to the types of exceptions by different terminology; the table is intended to provide a high-level overview.

**Table 1: Overview of Exception Types**

<b>Type</b>	<b>Description</b>	<b>Examples</b>
<b>Underwriting</b>	Loans approved outside of the bank's underwriting policies or standards.	<ul style="list-style-type: none"> <li>• Retail: DTI, payment to income (PTI), LTV, supervisory loan to value (SLTV), term, credit score exceptions at the time of underwriting</li> <li>• Commercial: DSCR, LTV, SLTV, fixed charge coverage (FCC), term, amortization, no guarantor or covenants (if required by bank policy) at the time of underwriting</li> </ul>
<b>Financial</b>	Financial exceptions that occur during the life of a loan (i.e., after origination). Financial exceptions are generally for commercial loans.	<ul style="list-style-type: none"> <li>• Covenant breaches (even if waived)</li> <li>• DSCR below policy at the time of annual review</li> <li>• LTV above policy at the time of annual review</li> </ul>
<b>Credit administration</b>	Administrative exceptions, such as missing or stale documentation.	<ul style="list-style-type: none"> <li>• Stale financial statements, tax returns, or borrowing base certificates</li> <li>• Missing lien recordation or final title opinions</li> <li>• Expired, insufficient, or cancelled insurance</li> </ul>

Many banks differentiate between administrative and financial exceptions. Administrative exceptions can indirectly affect repayment capacity, risk recognition, and loss recovery due to lack of transparency about borrower financial condition. Financial exceptions can have a direct effect on repayment capacity and loss recovery. Consequently, some lending policies include heightened reporting requirements to senior management and the board for financial exceptions.

Sound risk management generally includes identifying, approving, and tracking exceptions. Underwriting exceptions are typically documented in the credit approval, generally along with justification or mitigating factors, and approved by the appropriate person(s) or committee in accordance with the bank's policies and procedures. Financial exceptions are typically identified during ongoing analysis and can require approval in accordance with a bank's policies depending on the nature of the exception (e.g., covenant breaches).

Examiners should not criticize a loan solely because it has an exception. A bank's policies establish parameters that cover a broad range of borrowers, industries, geographies, loan types, collateral types, and other loan and borrower characteristics. Exceptions indicate a level of credit risk outside of the bank's normal standards, but do not automatically represent excessive risk-taking. Examiners should consider all the facts and circumstances regarding the exception when determining the level of credit risk in the transaction. Determining whether an exception is critical or noncritical is a matter of judgment. Exceptions that do not significantly weaken the bank's ability to protect its interest in a loan are generally noncritical; however, a consistent pattern of these exceptions can reflect a critical lack of internal controls or other risk management concerns. Exceptions that weaken the bank's ability to protect its interest in a loan are critical.

## **Unidentified Exceptions**

Credit risk review, audit, or examiners can discover exceptions that bank staff failed to identify at the appropriate point in the lending or credit administration process. Isolated

unidentified exceptions are not necessarily a cause for concern. A large volume of unidentified exceptions, however, could be indicative of less than satisfactory exception processes and generally merits examiner scrutiny and determination of the root cause. Unidentified exceptions are often the result of errors, miscalculations, breakdowns in the pre- or post-closing review process, or system failures.

## **Exception Limits, Monitoring, and Analysis**

Limits allow the board and senior management to further enforce the credit culture and risk appetite and to maintain credit discipline in a competitive environment. Exception limits are commonly established as a percentage of the loan portfolio and capital. Limits are often set on the level of exceptions in aggregate, by portfolio, and by type. For example, the bank may limit commercial real estate (CRE) loans without cash equity, car loans with DTI exceptions, or loans with exceptions to other underwriting criteria. Some banks track exceptions by loan officer, broker, or dealer.

Examiners should determine whether the bank tracks and analyzes exceptions in a thorough and timely manner and whether corrective action follows when necessary. The absence of policy exceptions could indicate the policy is overly broad or that underwriting standards represent a more liberal risk appetite than senior management and the board are willing to accept. Conversely, an excessive volume or a pattern of exceptions could signal an unintended or unwarranted relaxation of underwriting practices. When viewed individually, exceptions may not appear to increase risk significantly because exceptions are often appropriately mitigated at underwriting. Nevertheless, when aggregated, even well mitigated exceptions can increase portfolio risk significantly. By aggregating and regularly analyzing exception levels and reporting them to the board, the board and management can evaluate underwriting practices, detect shifts in risk characteristics, and assess the overall level of compliance with the bank's lending policies.

If the volume of exceptions is high or the performance of pools of loans with exceptions is poor, the board could be prompted to reconsider its risk tolerance; to revise the lending policy to bring it more in line with the bank's credit culture or current market conditions; to place new limits on the aggregate volume of exceptions; or to change the type of exceptions permitted in the loan portfolio. When policy is revised in response to the volume of exceptions, examiners should assess the implications of the revision and the impact on risk.

Exceptions pose varying degrees of risk, and their relative significance changes as portfolio composition, risk levels, and external conditions change. Over time, the analysis of aggregate exceptions enables a bank to correlate types of lending policy exceptions with a higher probability of default. Sound exception monitoring practices include periodically comparing the performance of loans with exceptions to the performance of loans without exceptions.

## Management Information Systems

Effective loan portfolio risk management depends on adequate management information systems (MIS) that produce effective management and board reports.

**Excerpt from the “[Corporate and Risk Governance](#)” booklet of the *Comptroller’s Handbook***

MIS broadly refers to a comprehensive process, supported by computer-based systems, that provides the information necessary to manage the bank. To function effectively as an interactive, interrelated, and interdependent feedback system for management and staff, MIS should be useable. The five elements of a useable MIS are timeliness, accuracy, consistency, completeness, and relevance. The effectiveness of MIS is hindered whenever one or more of these elements is compromised.

Data accuracy is a critical aspect of data quality. No matter how robust a bank’s reporting is, the information will be meaningless if the data are not accurate. Credit administration, credit risk review, and internal audit play vital roles in ensuring data are accurate. Examiners should determine if MIS deficiencies or inaccuracies affect credit risk management practices.

## Management and Board Reports

This section of the booklet discusses general information about management and board reports relevant to most loan portfolios. Booklets in the “Asset Quality” category of the *Comptroller’s Handbook’s Safety and Soundness* series provide more information about product-specific reporting. For example, reports used by floor plan lenders generally include the composition of new versus used inventory, past-due floor plan inspections, and dealer risk ratings.

Management and board reports should be appropriate for the size, complexity, and risk profile of the bank’s lending activities. For example, more robust reporting is typically necessary for large portfolios or portfolios with high-risk characteristics compared with lower-risk portfolios or products.

Reporting should be appropriately tailored to the target audience. For example, first-line lending managers and staff have different reporting needs than senior management and the board. While higher-level, periodic reports are appropriate for the board and some senior managers, line managers and first-line decision makers often need more frequent and detailed reporting. Examiners should evaluate the frequency and quality of management reports as part of the quality of credit administration practices.

Effective credit administration reporting promotes prompt detection of emerging risks and changes in portfolio quality. The following are examples of monitoring reports:

- Portfolio composition and performance
- Loan pipeline and warehouse
- Maturing loans and lines of credit

- Loan approval and growth trends (e.g., portfolio, geography, loan officer)
- Loans purchased or sold
- Loan servicing reports
- Underwriting and financial exception reports, including SLTV exception reports. Refer to the “[Exceptions](#)” section of this booklet for more information.
- Credit administration exceptions
- Covenant breaches and waivers
- Risk-layering reports
- Concentrations of credit
- Large borrowers
- Insider loans
- Status of annual and interim reviews of commercial borrowers (e.g., coming due and late)
- Risk-rating reports, such as
  - special mention and classified loans
  - rating migration
- Delinquent, nonaccrual, nonperforming, and charged-off loans
- OREO and repossessed assets
- Credit score migration reports
- Out-of-territory lending reports
- Loan workout reports
- ACL balance and trends

Typically, reports compare actual results with the bank’s strategic plan, budget projections, and established limits (e.g., policy limits). Risk-layering reports can be used to assess a combination of multiple features that elevate credit risk. For example, a risk-layering report could include the volume of loans originated with multiple policy exceptions, or the volume of loans with multiple high-risk features.

Reports on performance trends can provide management and the board with perspective and a deeper understanding of portfolio composition and migration of risk. For example, a report presenting the level and trend of classified assets relative to capital provides more insight than a report presenting the dollar volume of classified assets at a single point in time.

## Stress Testing

Excerpt from the “[Corporate and Risk Governance](#)” booklet of the *Comptroller’s Handbook*

Stress testing is an important element of the capital planning process. Banks can use stress testing to establish and support a reasonable risk appetite and limits, set concentration limits, adjust strategies, and appropriately plan for and maintain adequate capital levels.

In stress testing, a bank alters assumptions about one or more financial, structural, or economic variables to determine the potential effect on the performance of a loan or portfolio segment, including portfolio concentrations. All banks can benefit from applying stress testing to their loans and portfolios. An effective stress testing process

- is appropriate to the complexity of the loan portfolio.
- asks plausible “what if” questions about key vulnerabilities.
- makes a reasonable determination of how much impact the stress event or factor might have on earnings and capital.
- incorporates the resulting analysis into the bank’s overall risk management processes.

This section of the booklet provides an overview of loan-level and portfolio-level stress testing. More information on stress testing can be found in the following issuances:

- OCC Bulletin 2012-33, “[Community Bank Stress Testing: Supervisory Guidance](#)” (banks with less than \$10 billion in assets)
- OCC Bulletin 2012-14, “[Stress Testing: Interagency Stress Testing Guidance](#)” (banks with over \$10 billion in assets)
- OCC Bulletin 2014-5, “[Dodd-Frank Stress Testing: Supervisory Guidance for Banking Organizations With Total Consolidated Assets of More Than \\$10 Billion but Less Than \\$50 Billion](#)” (banks with over \$250 billion in assets)<sup>24</sup>

## Loan-Level Stress Testing

Loan-level stress testing, also referred to as transaction stress testing, occurs as part of initial and ongoing credit evaluation. It assesses the effect of changing economic conditions on a borrower’s ability to service debt. Loan-level stress testing can help in a “bottom up” analysis to gauge a borrower’s vulnerability to default and loss, foster early problem loan identification and strategic decision making, and strengthen strategic decisions about key loans. Examples of stress factors include

- decreases in
  - rents.
  - sales prices.
  - collateral values.
- increases in
  - vacancy rates.
  - marketing costs.
  - energy costs.
  - insurance costs.
  - costs of materials.
  - labor costs.
  - interest rates.
  - capitalization rates.

As part of ongoing monitoring, most banks compare the borrower’s actual financial performance to planned performance at initial underwriting. It is generally prudent to update

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<sup>24</sup> Subsequent to issuance of OCC Bulletin 2014-5, the threshold for conducting the Dodd-Frank Act stress test was raised to \$250 billion. Refer to OCC Bulletin 2019-47, “[Amendments to the Stress Testing Rule for National Banks and Federal Savings Associations: Final Rule](#).”

stress scenarios during ongoing monitoring based on current or anticipated changes in the borrower's operations or industry and changes in market conditions or the broader economy. Some banks use software to conduct multifactor stress conditions while other banks use simple spreadsheets. The most effective stress tests are risk-based and tailored to a borrower's risk characteristics.

### **Loan-Level Stress Test Example**

This section of the booklet includes an example of a CRE loan-level stress test in table 2. Retail loans are typically stressed at the portfolio or product level due to the lower individual loan amounts and homogeneous sensitivity to macroeconomic factors. The OCC does not endorse a specific method for stress testing. The example is provided as a simple hypothetical for illustrative purposes. The extent and depth of stress testing should be commensurate with the risk of the borrower and transaction.

**Fact pattern:** The borrower refinanced a medical office building from another lender. The origination figures were from year-end financial information. Occupancy, income, and expense trends had been stable for three years. Debt service requirements consist of monthly principal and interest payments for seven years based on a 20-year amortization. The interest rate was fixed at 4.00 percent for 12 months followed by variable rate.

At the end of year three, a small space is vacant, property insurance costs have increased, the management fee has increased, and interest rates have increased. The borrower informs the bank the largest tenant has indicated they may not renew their lease upon expiration at the end of year four. The borrower may have to lower rents to retain existing tenants and attract a new tenant for the large space.

Table 2: CRE Stress Test Example

Item	Actual at origination (20XX)	Notes (20XX)	20X3 actual	Notes (20X3)	20X5 stress test projection	Notes (20X5)
Rents	2,025	\$20.25 per square foot	2,025	No notes.	1,772	\$17.50 per square foot
Credit loss	20	1.00%	30	1.50%	27	1.50%
Vacancy	101	5.00%	142	7.00%	266	15.00%
<b>Net rental income</b>	<b>1,904</b>	\$18.85 per square foot	<b>1,853</b>	\$18.35 per square foot	<b>1,480</b>	\$14.73 per square foot
<b>Effective gross income</b>	<b>2,306</b>	No notes.	<b>2,181</b>	No notes.	<b>1,762</b>	No notes.
Real estate taxes <sup>25</sup>	171	\$1.69 per square foot	171	No notes.	171	No notes.
Property insurance	20	\$0.20 per square foot	30	No notes.	30	No notes.
Common area maintenance	152	\$1.50 per square foot	152	No notes.	152	No notes.
Management fee	81	3.50%	87	4.00%	35	2.00%
General and administrative expenses	10	\$0.10 per square foot	10	No notes.	10	No notes.
Replacement reserves	15	\$0.15 per square foot	15	No notes.	10	\$0.10 per square foot
<b>Operating expenses</b>	<b>449</b>	No notes.	<b>465</b>	No notes.	<b>408</b>	No notes.
<b>Net operating income</b>	<b>1,858</b>	No notes.	<b>1,716</b>	No notes.	<b>1,354</b>	No notes.
Cap rate	7.00%	No notes.	9.00%	No notes.	11.00%	No notes.
<b>Market value</b>	<b>26,539</b>	No notes.	<b>19,065</b>	No notes.	<b>12,310</b>	No notes.
Debt service	1,452	No notes.	1,488	Impact of interest rate increase	1,524	Impact of interest rate increase
<b>DSCR</b>	<b>1.28x</b>	No notes.	<b>1.15x</b>	No notes.	<b>0.89x</b>	No notes.

## Portfolio Stress Testing

Portfolio stress testing focuses on the effects of various stress events on capital, earnings, and ACLs. Insight gained from portfolio stress testing can provide useful information for strategic and capital planning and inform management's understanding of capital at risk. Additionally, management can use stress testing results to develop contingency plans for loans or portfolio segments that stress testing indicates are vulnerable. Contingency plans can include increasing supervision, limiting further advances, restricting portfolio growth, devising exit strategies, or using hedging strategies to manage risk.

<sup>25</sup> Although not included in this example, changes in the collateral value may have a significant effect on real estate taxes.

Selecting the appropriate factors to stress depends on the nature of the bank's risks. Some banks use complex interest rate, economic, and credit models that consider the interrelationships between many variables simultaneously. Less sophisticated testing methods can also be useful. The usefulness of even simple stress testing depends on the accuracy of the information and data used to quantify the sensitivity of loan or portfolio performance to the selected variables. Important omitted variables or interrelationships among variables can influence the results of a stress test.

Banks with an ability to perform migration analysis of credit risk ratings in commercial loans may be able to use that information in evaluating changes in credit quality across different loan portfolios because higher-grade credits typically withstand market stresses better than lower-grade credits. The results of commercial loan-level stress testing can also be rolled up to a portfolio-level analysis to assess the potential effect on portfolio credit quality. The test results can then be used to identify what percentage of the portfolio is vulnerable to specific stress events (e.g., a hypothetical decrease in rental rates).

In contrast to the commercial approach, retail stress testing occurs almost exclusively at the portfolio or product segment level. Lower individual loan amounts and a relatively homogenous sensitivity to macroeconomic factors typically support such an aggregated approach. Common stress testing variables include expected loss rates, interest rate shocks, or profitability hurdles. Idiosyncratic risk drivers to a particular product or geography could also warrant stress scenarios (e.g., stressing mortgage portfolios for property insurance rates in select geographies or declines in the valuation of used cars in an auto portfolio). Results of stress testing are used to assess impact to capital adequacy, return, and resiliency expectations and to inform current and future adjustments to underwriting and account management policies.

Stress test results that indicate capital vulnerability can provide the board with information and opportunity to potentially change course and protect the bank from a risk event. Action items could include establishing a plan that requires closer monitoring of market information, adjusting strategic and capital plans to mitigate risk, changing risk appetite and risk tolerance levels, limiting or stopping loan growth, adjusting the portfolio mix, adjusting underwriting standards, raising more capital, or selling or hedging loans to reduce the potential impact from such stress events.

## Credit Risk-Rating Systems

Effective risk identification is vital to managing credit risk, and the OCC expects banks to have credit risk management systems that produce accurate and timely credit risk ratings. Well-managed credit risk-rating systems promote bank safety and soundness by facilitating informed decision making. Effective commercial and retail risk-rating systems allow the prompt detection of changes in portfolio quality, enabling management to intensify the supervision of weaker credits in a timely manner and modify portfolio strategies. Risk ratings, when used in conjunction with other information (such as delinquency trends, renewal and extension activity, exception levels, risk-rating migration, loan recovery trends, and loan growth), can produce an informative picture of current asset quality and credit risk

exposure. Credit risk ratings are pertinent to functions throughout the loan's life cycle, including the following:

- Credit underwriting and approval
- Loan pricing
- Relationship management and credit administration
- ACLs
- Loan portfolio management reports

Accurate and timely risk identification is foundational to identifying problem loans in a timely manner, which enhances the bank's flexibility in problem loan resolution, reduces risk of loan losses, contributes to the timely recognition of losses, and enables the maintenance of an appropriate ACL.

Examiners should assess the banks' credit risk identification processes and determine whether the processes produce accurate and timely risk ratings. Refer to the following sources for detailed information about credit risk-rating systems:

- [“Rating Credit Risk”](#) booklet of the *Comptroller's Handbook*
- OCC Bulletin 2020-50, [“Credit Risk: Interagency Guidance on Credit Risk Review Systems”](#)
- OCC Bulletin 2000-20, [“Uniform Retail Credit Classification and Account Management Policy: Policy Implementation”](#)

## Nonaccrual Status

This section provides excerpts from the call report instructions regarding key nonaccrual topics: the general rule for nonaccrual status, exceptions to the general rule, purchased credit-deteriorated (PCD) assets, and returning loans to accrual status.

The OCC's [Bank Accounting Advisory Series](#), topic 2B, “Nonaccrual Loans,” provides more information for the recognition of nonaccrual loans, including the appropriate treatment of cash payments for loans on nonaccrual and returning loans to accrual status.

## General Rule for Nonaccrual Status

### **Excerpt from “Instructions for Preparation of Consolidated Reports of Condition and Income,” “Glossary”**

General rule – Banks shall not accrue interest, amortize deferred net loan fees or costs, or accrete discount on any asset (1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.

An asset is “well secured” if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. An asset is “in the process of collection” if collection of the asset is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

For purposes of applying the third test for nonaccrual status listed above, the date on which an asset reaches nonaccrual status is determined by its contractual terms. If the principal or interest on an asset becomes due and unpaid for 90 days or more on a date that falls between report dates, the asset should be placed in nonaccrual status as of the date it becomes 90 days past due and it should remain in nonaccrual status until it meets the criteria for restoration to accrual status described below.

Any state statute, regulation, or rule that imposes more stringent standards for nonaccrual of interest takes precedence over this instruction

## Exceptions to the General Rule for Nonaccrual Status

### **Excerpt from “Instructions for Preparation of Consolidated Reports of Condition and Income,” “Glossary”**

Exceptions to the general rule – In the following situations, an asset need not be placed in nonaccrual status:

- The asset upon which principal or interest is due and unpaid for 90 days or more is a consumer loan (as defined for Schedule RC-C, Part I, item 6, “Loans to individuals for household, family, and other personal expenditures”) or a loan secured by a 1-to-4 family residential property (as defined for Schedule RC-C, Part I, item 1.c, Loans “Secured by 1-4 family residential properties”). Nevertheless, such loans should be subject to other alternative methods of evaluation to assure that the bank’s net income is not materially overstated. However, to the extent that the bank has elected to carry such a loan in nonaccrual status on its books, the loan must be reported as nonaccrual in Schedule RC-N, column C.
- The following criteria are met for a purchased credit-deteriorated (PCD) asset, including a PCD asset that was previously a purchased credit-impaired (PCI) asset or part of a pool of PCI loans, that would otherwise be required to be placed in nonaccrual status under the general rule:
  - The institution reasonably estimates the timing and amounts of cash flows expected to be collected, and
  - The institution did not acquire the asset primarily for the rewards of ownership of the underlying collateral, such as use of collateral in operations of the institution or improving the collateral for resale

## Nonaccrual Status for Purchased Credit-Deteriorated Assets

### **Excerpt from “Instructions for Preparation of Consolidated Reports of Condition and Income,” “Glossary”**

When a PCD asset that meets the criteria above is not placed in nonaccrual status, the asset should be subject to other alternative methods of evaluation to ensure that the institution’s net income is not materially overstated. If an institution is required or has elected to carry a PCD asset in nonaccrual status, the asset must be reported as a nonaccrual asset at its amortized cost basis in Schedule RC-N, column C. (For PCD loans for which the institution has made a policy election to maintain previously existing pools of PCI loans upon adoption of ASC Topic 326, the determination of nonaccrual or accrual status should be made at the pool level, not the individual asset level.) For further information, see the Glossary entry for “Purchased Credit-Deteriorated Assets.”

For more information about PCD loans, refer to the call report instructions’ “Glossary” section, “Purchased Credit Deteriorated Assets” entry.

## Returning a Loan to Accrual Status

**Excerpt from “Instructions for Preparation of Consolidated Reports of Condition and Income,” “Glossary”**

Restoration to accrual status – As a general rule, a nonaccrual asset may be restored to accrual status when (1) none of its principal and interest is due and unpaid, and the bank expects repayment of the remaining contractual principal and interest, or (2) when it otherwise becomes well secured and in the process of collection. If any interest payments received while the asset was in nonaccrual status were applied to reduce the amortized cost basis of the asset, as discussed in the preceding section of this entry, the application of these payments to the asset’s amortized cost basis should not be reversed (and interest income should not be credited) when the asset is returned to accrual status.

The call report instructions’ “Glossary” section includes more detailed discussion of restoring loans to accrual status.

# Examination Procedures

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This booklet contains expanded procedures for examining specialized activities or specific products or services that warrant extra attention beyond the core assessment contained in the “[Community Bank Supervision](#),” “[Federal Branches and Agencies Supervision](#),” and “[Large Bank Supervision](#)” booklets of the *Comptroller’s Handbook*. **Examiners determine which expanded procedures to use, if any, based on a bank’s risks.** Focal points of examinations should be tailored to the bank’s size, complexity, and risk profile, with heightened focus on material financial risks.

Examiners may use the sample request list in [appendix C](#) of this booklet as a guide when determining what materials to request from the bank for the lending and loan portfolio risk management examination. Request letters should be tailored to the scope of the examination and the bank’s specific activities and business model.

Transaction testing may be used to support examination work. Transaction testing may fulfill multiple objectives or purposes. For example, underwriting transaction testing may be combined with transaction testing for other purposes, as appropriate. Additionally, transaction testing does not necessarily entail comprehensive loan-level transaction testing in every case. For example, examiners may use transaction testing to verify the accuracy of bank reports, validate the results of credit risk reviews, or form conclusions about underwriting when bank sources are not reliable. In these cases, examiners would review only the aspects of the loan or transaction relevant to the exam scope. [Appendix D](#) of this booklet and the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook* provide more detailed information about selecting samples.

This booklet does not include procedures for examining ACLs. Refer to the “[Allowances for Credit Losses](#)” booklet of the *Comptroller’s Handbook* for ACL examination procedures.

## Scope

These procedures are designed to help examiners tailor the examination to each bank and determine the scope and supervisory activities focused on overall lending activities or credit risk management. Examiners should consider work performed by internal and external auditors, independent credit risk review, independent risk management, and other examiners reviewing related areas. Examiners should perform only those objectives and procedures relevant to the scope of the examination as determined by the following objectives. Seldom is every objective or step of the expanded procedures necessary.

Examiners should reevaluate the scope of the examination after performing any objectives or procedures in the “Quantity of Risk” section. For example, if examiners conclude that a high-risk area has changed and is now low-risk, examiners should reassess the planned examination work in light of the decreased risk profile. Conversely, examiners should consider expanding the scope of the examination (i.e., completing more objectives or procedures, as relevant) if a low-risk area has increased to high risk. Additionally,

conclusions from the “Quality of Risk Management” section may prompt examiner reevaluation of the examination scope.

**Objective:** To determine the scope of the examination of lending and loan portfolio risk management and identify examination objectives and activities necessary to meet the supervisory strategy for the bank.

1. Review the following sources of information:

- Supervisory strategy.
- Scope memorandum.
- Previous supervisory activity work papers.
- Previous supervisory letters and reports of examination and management’s responses.
- Credit risk review reports and management’s responses.
- Bank correspondence with the OCC regarding lending.
- Internal and external audit reports and management’s responses.
- Complaints and litigation. Examiners should review complaint data from the OCC’s Customer Assistance Group, the bank, and the Consumer Financial Protection Bureau (when applicable). When possible, examiners should review and leverage complaint analysis already performed during the supervisory cycle to avoid duplication of effort.

From these sources, the examiner should gain an understanding of the bank’s supervisory history related to lending and loan portfolio risk management and identify items that may require follow-up.

2. Determine whether satisfactory internal audit or independent credit risk reviews will be leveraged for the examination and, if so, how this affects the scope of the examination.
3. Identify key characteristics of the bank’s loan portfolio and determine if there have been any significant changes (for example, in policies, processes, personnel, control systems, third-party relationships, products, services, delivery channels, volumes, markets, and geographies) since the prior examination of lending. Information reviewed in procedures 4 and 5 may also be beneficial for performing this procedure.
4. Review the Uniform Bank Performance Report (UBPR) and OCC reports or analytical tools. Identify trends in growth rates, portfolio composition, concentrations, portfolio performance, pricing, and other factors that could affect the bank’s risk profile. Review the call report as needed (e.g., to get more detailed information about items on the UBPR or in OCC reports).
5. Review policies, procedures, and reports that management uses to supervise lending activities and loan portfolio risk management. Identify significant changes since the last examination. Reviewing policies provides examiners with important context about the bank, its operations, internal controls, and the likely risk profile of the activities in which the bank engages. Reviewing policies also assists examiners in reviewing bank reports. For example, policies provide the necessary context (e.g., underwriting standards) for

examiners to perform an accurate analysis of a bank's exception reporting to help inform conclusions about the bank's material financial risks.

6. Determine whether the examination will include transaction testing. If so,
  - document the purpose and objectives of transaction testing (e.g., assess credit underwriting, test compliance with laws and regulations, confirm accuracy of risk ratings and accrual status, validate results of independent credit risk review or audit).
  - select a sample of loans to be reviewed. Selection of the sample should be consistent with the examination objectives and supervisory strategy. Refer to [appendix D](#) of this booklet and the "Sampling Methodologies" booklet of the *Comptroller's Handbook* for more information about sample selection.
7. Determine whether changes to the supervisory strategy are warranted and revise the strategy as appropriate, subject to appropriate approvals. Select applicable objectives and examination procedures necessary to meet the examination objectives.

## Quantity of Risk

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**Conclusion: The quantity of each associated risk is (low, moderate, or high).**

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Certain items are assessed across multiple risk areas. Examiners should collaborate to avoid duplication of efforts. Examiners should avoid redundancy between risk disciplines when documenting conclusions. For example, examiners may cross-reference to comments in other parts of the examination procedures to avoid duplication.

Not all items within each examination procedure are relevant to every bank's lending activities. Examiners should consider each item relative to the scope of the examination and the bank's operations. Examiners' reviews should generally focus on those items that directly relate to the scope of the examination and key items that drive the conclusions for quantity of risks associated with lending.

Assessing the quantity of risk provides key information for examiners to use to further refine the scope of the examination, as appropriate, based on the bank's risks.

**Objective:** To determine the quantity of credit, interest rate, liquidity, price, operational, compliance, and strategic risks associated with the bank's lending activities. Unless explicitly stated that a procedure applies to a specific risk, procedures underlying this objective apply to multiple risk categories. Refer to [appendix A](#) of this booklet for a quantity of risk matrix job aid.

1. Assess the quantity of credit risk reflected in key metrics. Consider whether extensions of credit generally reflect low, moderate, or high credit risk. Examples include
  - the level of loans outstanding relative to total assets and capital.
  - growth rates.
  - trends in the weighted average risk ratings of existing portfolios compared with new underwriting.
  - diversification income streams and the extent of dependence on interest and fee income from loans. Consider balance of risks and returns and whether dependence on interest and fee income from loans is consistent with the bank's asset mix.
  - trends and volumes of booked loans and approval rates.
  - trends in credit origination metrics (e.g., credit score, LTV, debt-to-income (DTI), or DSCR) and risk layering.
  - levels and trends of delinquencies, nonperforming loans, special mention and classified assets, losses, forbearances, and reserves in both on- and off-balance-sheet accounts.
  - trends in volume and quality of lending and fee-based lending activities.
  - changes in portfolio analytics, risk attributes (e.g., refreshed credit scores, changes in LTV, DTI, or DSCR), performance, loss forecasting, and stress testing results.

- effect of credit mitigation or credit enhancement used to manage the level of on- or off-balance-sheet credit risk.
  - volume of risk-rating changes made by independent credit risk review, regulators, or auditors.
  - level and trend of credit administration exceptions.
2. Assess the effect of credit concentrations on credit risk. Refer to the “Concentrations of Credit” booklet of the *Comptroller’s Handbook* for more information.
  3. Assess the quantity of risks associated with the bank’s lending activities as reflected in the bank’s strategic plan.
  4. Assess risks associated with new activities or technologies. Consider both actual and planned new activities and technologies. For more information about new activities, refer to OCC Bulletin 2017-43, “[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#).” “New activities” refers collectively to new, modified, or expanded products or services.
  5. Assess the effect of portfolio and product mix, new products, delivery channels, third-party originations or acquisitions, syndications, concentrations, and securitizations.
  6. Assess the quantity of risks associated with asset growth from lending activities.
  7. Assess risks associated with the use of third parties to support lending and loan portfolio risk management activities.
  8. Assess performance relative to stated risk appetite(s) and other risk metrics.
  9. Assess the level and criticality of reliance on manual processes in lending and loan portfolio risk management.
  10. Assess the nature and extent of model use in lending and loan portfolio risk management.
  11. Assess trends in internal, external, and regulatory findings related to lending and loan portfolio risk management.
  12. Assess the amount and significance of litigation, monetary penalties, remediations, customer complaints, and referrals from potential whistleblowers related to lending and loan portfolio risk management.
  13. Assess the level, nature, and trend of noncompliance with lending-related laws and regulations.

14. Assess the effect of external factors on associated risks. Consider the following:

- Effect of economic conditions on material loan portfolios.
- Changes in the banking industry and competitive landscape.
- Impact of geographic (including country) risks and environmental conditions on material portfolios.
- Effect of technological advancement on loan products, services, and delivery channels, and on material portfolios.

15. Assess the effect of changes in policies and underwriting standards on the quantity of risks.

16. Assess the effect of repricing, basis, yield curve, and options risk factors from lending activities on the bank's IRR.

17. Assess the quantity of price risk associated with the bank's lending activities.<sup>26</sup> Consider options risk, basis risk, volume of open positions and concentrations, and stability of revenue. The following are examples of factors to consider when completing this procedure:

- **Options risk**
  - Amount of assets and liabilities with nonlinear price sensitivity.
  - Amount of assets and liabilities that hedge positions with nonlinear exposure (e.g., mortgage pipeline, mortgage servicing rights, and credit valuation adjustments (CVA)).
  - Amount of assets and liabilities used in hedging strategies that employ nonlinear instruments (e.g., options, swaptions, caps, and floors), such as dynamic hedging.
- **Basis risk**
  - Sensitivity of hedged portfolios' fair value to a change in the correlation between the hedge(s) and the portfolios.
- **Volume of open positions and concentrations**
  - Level of OREO as a percent of capital.
  - Level of loans subject to foreign exchange risk.
  - Level and diversification among products or types of products, including dominant positions in products or markets and/or replication of large positions from other market participants (same way risk).
  - Existence of concentrations in market factors (e.g., option strike prices).
  - Large positions concentrated in higher-risk counterparties (e.g., reliance on a single dealer for a product type or concentrated CVA exposure).

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<sup>26</sup> Many of the items in this procedure do not apply to most small, noncomplex banks. This procedure should not be included in the scope of the examination for most small, noncomplex community banks. For example, if OREO is the only source of price risk for the bank, there generally would not be a reason to include it in the scope of the examination.

- **Stability of revenue**
  - Revenue derived from portfolio management activities (such as profits derived from structural hedges of the balance sheet, mortgage servicing rights positions, credit valuation adjustment exposures, and other aggregated/portfolio-level hedging activities).

18. Consider the effect of the following factors on the quantity of operational risk:

- Volume, types, and complexity of loan transactions, on- and off-balance-sheet exposures, products and services offered, delivery methods employed, and models or other quantitative tools used by the bank.
- Level and trend of lending-related operational errors, loss events, and near misses.
- Level and trend in lending-related fraud.
- Software and hardware obsolescence, security, capacity, and operational resilience for lending and credit administration software.
- Volume and severity of incidents and system outages related to lending and credit administration activities.

19. Assess the effect of lending activities on the quantity of BSA/AML, OFAC, Servicemembers Civil Relief Act, Flood Disaster Protection Act, fair lending, and other significant compliance risks.

## Quality of Risk Management

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**Conclusion: The quality of risk management is (strong, satisfactory, insufficient, or weak).**

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The conclusion on risk management considers all of the bank's risks associated with lending activities.

Examiners should focus on whether the quality of risk management is commensurate with the quantity of risks undertaken. Risk management practices for a bank with a low quantity of risk are generally expected to be less robust than risk management practices in a bank with high quantity of risk. Examiners should also consider the bank's size and complexity when assessing the quality of risk management. Conclusions about the quality of risk management, when assessed in conjunction with the quantity of risk, help examiners draw conclusions on aggregate risks in the "Conclusions" section of the examination procedures. These conclusions are used to inform future risk-based supervision of lending and loan portfolio risk management.

### Internal Controls and Information Systems

**Objective:** To determine whether internal controls and information systems are appropriate to the size of the bank and the nature, scope and risk of its lending activities.<sup>27</sup> For any procedures completed under this objective, examiners should consider the size of the bank and the nature, scope, and risks in its lending activities.

1. Determine whether the bank's organizational structure establishes clear lines of authority and responsibility for monitoring adherence to established policies.<sup>28</sup> Consider whether
  - lines of authority and responsibility are defined.
  - management provides consistent communication of established lending objectives.
  - management monitors loan portfolio performance against established lending objectives and escalates material risks to the board.
  - management operates within limits established by the board and reports limit breaches in a timely manner.
  - management enforces compliance with bank policies.
  - the bank's lending-related committees<sup>29</sup> promote effective risk management over the bank's lending activities.

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<sup>27</sup> 12 CFR 30, appendix A, II.A.

<sup>28</sup> 12 CFR 30, appendix A, II.A.1.

<sup>29</sup> Some small, noncomplex banks do not have lending-related committees. Instead, management and the board, in their respective roles, oversee the bank's lending activities outside of a formal committee forum.

2. Determine whether the bank has conducted effective risk assessments of lending activities.<sup>30</sup>
3. Determine whether the bank produces timely and accurate financial, operational, and regulatory reports.<sup>31</sup>
4. Determine whether the bank has adequate procedures to safeguard and manage assets.<sup>32</sup> Consider conclusions from other in-scope examination procedures related to safeguarding and managing assets (e.g., credit underwriting, credit administration, problem loan management).
5. Determine whether the bank has internal controls and information systems that provide for compliance with applicable laws and regulations.<sup>33</sup>
6. Assess the adequacy of internal controls over lending activities, particularly for functions that involve lending decisions, disbursement of funds, and maintenance of loan records. Consider whether
  - the bank has established appropriate preventive controls (e.g., such as separation of duties).
  - the bank has established appropriate detective controls.
  - the structure in place prevents undue loan officer influence on back-office personnel.

Examiners may use the “[Internal Control Questionnaire](#)” as a tool to help assess the existence of certain controls.

## Personnel

**Objective:** To determine sufficiency of lending and credit risk management staff.

1. Assess the management structure and staffing for lending-related activities. Consider
  - the adequacy of staffing levels.
  - the staff’s capacity to support current operations and planned growth.
  - whether reporting lines encourage open communication and limit the chances of conflicts of interest.
  - the level of staff turnover.
  - the use of outsourcing arrangements.

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<sup>30</sup> 12 CFR 30, appendix A, II.A.2.

<sup>31</sup> 12 CFR 30, appendix A, II.A.3. For more information and examination procedures related to regulatory reporting, refer to the “Regulatory Reporting” booklet of the *Comptroller’s Handbook*.

<sup>32</sup> 12 CFR 30, appendix A, II.A.4.

<sup>33</sup> 12 CFR 30, appendix A, II.A.5.

- responsiveness to weaknesses or other issues, including those identified by regulators, internal or external audits, independent risk management, or self-identified by bank management.
  - responsiveness to regulatory, accounting, industry, and technological changes.
2. Assess the experience, education, training, and demonstrated expertise and competency of management and staff. Consider
    - the depth of technical expertise relative to the bank’s lending activities.
    - the adequacy of training programs for lending staff.
  3. Assess the reasonableness of lending and credit risk management staff workloads. Consider
    - the responsibilities to provide ongoing management (e.g., routine check-ins with borrowers, responsibilities for collecting and analyzing periodic financial information for commercial borrowers).
    - the number and complexity of relationships managed by or assigned to loan officers and other staff (e.g., credit administration staff, collectors, loan workout staff).
  4. Assess performance management and compensation programs for lending and credit risk management staff. Consider whether these programs measure and reward performance that aligns with the bank’s strategic objectives and risk appetite. If the bank offers incentive compensation programs, determine whether they (1) provide employees with incentives that appropriately balance risk and reward; (2) are compatible with effective controls and risk management; and (3) are supported by strong corporate governance, including active and effective oversight by the bank’s board of directors. Refer to OCC Bulletin 2010-24, “[Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies](#).”

## Strategic and Operational Planning

**Objective:** To determine the adequacy of strategic and operational planning for lending activities.

1. Determine whether asset growth from lending activities is prudent and considers<sup>34</sup>
  - the source, volatility, and use of the funds that support asset growth.
  - any increase in credit risk or interest rate risk as a result of growth.
  - the effect of growth on the bank’s capital.
2. Determine whether strategic plans for lending are consistent with the bank’s risk appetite and capital plan and whether operational plans (e.g., budgets and any other plans) are consistent with the strategic plan. If there are material inconsistencies, determine the root cause and whether the inconsistencies pose material financial risk.

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<sup>34</sup> 12 CFR 30, appendix A, II.F.

3. Assess the consistency of the bank's lending activities and practices relative to the bank's strategic and operational plans by comparing current results with those forecasted in operational plans. If results deviate materially from plans, determine the root cause and whether the deviations pose material financial risk. Refer to the "[Strategic Planning](#)" section of this booklet for discussion of potential root causes.
4. Assess the adequacy of risk management for new lending activities. Refer to the "[Corporate and Risk Governance](#)" booklet of the *Comptroller's Handbook* for examination procedures covering risk management of new activities. Consider whether risk management is commensurate with the quantity of associated risks.

## Credit Underwriting

**Objective:** To determine the adequacy of the bank's credit underwriting processes and practices. Other booklets in the "Asset Quality" category of the *Comptroller's Handbook's Safety and Soundness* series provide comprehensive information related to credit underwriting for specific types of loans.

1. Determine whether the bank has established and maintained prudent credit underwriting practices in accordance with 12 CFR 30, appendix A, "Interagency Guidelines Establishing Standards for Safety and Soundness." Specifically, determine whether the bank's credit underwriting practices<sup>35</sup>
  - are commensurate with the types of loans the bank will make and consider the terms and conditions under which they will be made.
  - consider the nature of the markets in which loans will be made.
  - provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed.
  - are appropriate for the size of the bank and the nature and scope of its activities.
2. Evaluate the bank's underwriting policies. Determine the nature and extent of any changes since the last credit underwriting examination. Consider
  - how underwriting policies and criteria have changed since the prior supervisory cycle or examination along with
    - reasons for the changes.
    - potential effects of the changes on underwriting and credit risk exposure.
  - whether the appropriate parties reviewed and approved underwriting policy changes.
  - whether underwriting policies are commensurate with the bank's credit risk appetite and product offerings.
  - whether underwriting criteria reflect conservative, moderate, or liberal underwriting in relation to safe and sound banking practices.

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<sup>35</sup> 12 CFR 30, appendix A, II.D.

- the reasonableness of definitions that guide credit policy, underwriting, and documentation exceptions.
  - the reasonableness of guidelines for approving and reporting exceptions and overrides.
  - whether underwriting criteria reflect differences in risk between acquisition channels (e.g., direct, through third parties such as fintech partners, mobile, internet, direct mail).
  - the extent to which underwriter authorities and accountabilities are defined, in line with skills, and commensurate with risks associated with loan characteristics.
  - the reasonableness of compensation policies and whether policies appropriately balance risk and reward.
  - whether policies provide appropriate standards for the use of credit scoring models.
  - whether policies address applicable laws and regulations.
3. Determine whether the bank has established and maintained loan documentation practices consistent with 12 CFR 30, appendix A, “Interagency Guidelines Establishing Standards for Safety and Soundness.” Specifically, determine whether loan documentation practices<sup>36</sup>
- enable the bank to make an informed lending decision and to assess risk, as necessary, on an ongoing basis.
  - identify the purpose of a loan and the source of repayment and assess the ability of the borrower to repay the indebtedness in a timely manner.
  - ensure that any claim against a borrower is legally enforceable.
  - demonstrate appropriate administration and monitoring of a loan.
  - take account of the size and complexity of a loan.
4. Assess the consistency of the bank’s underwriting practices with policy parameters. Examiners may leverage bank reports (e.g., underwriting or exception reports), leverage results of credit risk review and audit reviews, or analyze bank-provided data when this information is available and reliable. Testing can validate the adequacy of risk management practices, reliability of bank reporting, and effectiveness of credit risk review and internal audit. Consider
- the nature and extent of deviations from the bank’s credit underwriting policies and sound underwriting practices.
  - whether credit underwriting exceptions and overrides are appropriately captured in bank reporting.
  - the volume, composition, trend, and performance of loans with credit underwriting exceptions and overrides.
  - trends in loan origination metrics (e.g., DSCR, FCC, credit score, DTI, PTI, LTV) and the extent of risk layering.
  - for automated underwriting, changes in the bank’s scoring models and adequacy of model risk management practices. Models used for credit underwriting and

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<sup>36</sup> 12 CFR 30, appendix A, II.C.

decisioning should be subject to sound model risk management. Refer to OCC Bulletin 2026-13, “[Model Risk Management: Revised Guidance](#),” for more information about model risk management. Other “Asset Quality” category booklets of the *Safety and Soundness* series of the *Comptroller’s Handbook* provide more information about credit scoring models specifically. For community banks, refer also to OCC Bulletin 2025-26, “[Model Risk Management: Clarification for Community Banks](#).”

**Objective:** To conduct loan-level transaction testing of credit underwriting. Underwriting transaction testing may be combined with transaction testing for other purposes, as appropriate. Additionally, testing does not necessarily entail comprehensive loan-level transaction testing in every case. For example, examiners may use transaction testing to verify the accuracy of bank reports, validate the results of credit risk reviews, or form conclusions about underwriting when bank sources are not reliable. [Appendix D](#) of this booklet, the “[Sampling Methodologies](#)” booklet, and product-specific booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller’s Handbook* provide more detailed information about selecting samples.

Examiners may use the job aids in appendixes [F](#) and [G](#) of this booklet when assessing commercial and retail credit underwriting.

1. Assess the extent to which new loans are underwritten within the parameters of the bank’s lending policies and determine whether exceptions to policy were appropriately identified and approved. Consider whether exceptions were identified in the loan approval documentation along with mitigants that justify the decision to approve the loan.
2. For commercial loans, assess the following:
  - Structure and sources of repayment: The loan’s structure and repayment terms, adequacy of repayment sources, and guarantor support.
  - Collateral: The type of collateral, LTV ratios and advance rates, and adequacy of the collateral valuation.
  - Controls: Controls that are included in the loan documents. Specifically, this category focuses on financial reporting requirements, collateral inspection opportunities, and covenants. Credit administration weaknesses, such as the failure to analyze borrower-provided information in a timely manner, are not considered in credit underwriting conclusions. Rather, examiners should consider those as part of credit administration.
3. For retail loans, assess the following:
  - Structure and sources of repayment: The loan’s structure and repayment terms, adequacy of repayment sources, and guarantor support.
  - Collateral: The type of collateral, LTV ratios and advance rates, and adequacy of the collateral valuation.

4. Assess the quality of the loan approval package and determine whether the approval package or approval processes
  - provide credit decision makers with a thorough analysis of the borrowers' and guarantors' sources of repayment.
  - include information about previous and related transactions and performance, if applicable.
  - contain a comprehensive analysis of key credit risks and mitigating factors.
  - provide appropriate support for the credit approval, risk-rating, and accrual treatment.
5. Assess loan pricing and determine whether loans are priced to provide reasonable returns commensurate with the risks taken.
6. Assess loan-level stress testing. Consider the reasonableness of assumptions and projections.
7. Determine whether conditions of closing were satisfied, documentation exceptions were resolved in a timely manner, and liens are properly perfected.

## Loan Purchase Activities

**Objective:** To determine the quantity of risk associated with loan purchase activities.

1. Assess the quantity of risks associated with the bank's loan purchase activities. Consider the following:
  - Volume of loans purchased.
  - Types of loans purchased.
  - Level and trends in weighted average risk ratings and delinquencies in the purchased loans compared with the originated portfolio.
  - The level and trend of policy exceptions in purchased loans compared with originated loans.
  - The volume of loans purchased from each seller, including any concentrations in loans purchased from a single seller.

**Objective:** To determine the quality of risk management of loan purchase activities. Refer to OCC Bulletin 2020-81, "[Credit Risk: Risk Management of Loan Purchase Activities](#)," for more information about risk management of loan purchase activities.

1. Determine whether loan purchase activities are consistent with the bank's strategic plan and risk appetite. Consider whether management has evaluated how loan purchase activities could affect credit, strategic, interest rate, liquidity, compliance, and operational risks.
2. Assess the adequacy of policies and procedures governing loan purchase activities. Consider whether policies are consistent with the bank's strategic plan and risk appetite

and whether procedures support effective processes for engaging in loan purchase activities. Determine whether policies address

- approval limits and personnel authorized to engage in loan purchases.
  - acceptable credit types and portfolio characteristics (e.g., loan types, credit grade or risk rating, acceptable credit score range, collateralization, collateral characteristics, credit concentrations, and loan structures).<sup>37</sup>
  - acceptable sources from which to purchase loans, including standards for selecting sellers and concentration limits for seller volume.
  - requirements for purchase agreements, including rights and obligations concerning repurchase or recourse arrangements.
  - expectations regarding the level of due diligence to be performed in assessing the potential purchase of loans, such as standards for
    - pre-purchase documentation.
    - independent credit and underwriting analysis.
    - determining the collateral value and confirming the lien status.
  - requirements for obtaining ongoing financial and nonfinancial information for the term of the loan. Nonfinancial information for commercial loans may include the borrower’s business plans and objectives, experience of senior managers of the borrowing entity, changes in business structure, or other information that may affect the borrower’s ability to repay the loan. Nonfinancial information for retail borrowers may include time in residence, employment status and history, homeownership, and other information that may affect the borrower’s ability to repay the loan.
  - credit administration requirements, including post-purchase management, risk rating, credit scoring, ACLs, and problem loan management.
3. Assess the adequacy of due diligence for loan purchases. Examiners may use this procedure to assess the bank’s procedures or when conducting loan-level transaction testing. Determine whether
- the nature and extent of due diligence are consistent with
    - the transaction’s complexity.
    - the transaction’s size relative to the bank’s existing loan portfolio, concentrations, and capital levels.
    - experience of the bank’s personnel with the type of loan purchased.
  - due diligence includes
    - credit analysis independent of the seller that includes assessing whether the loan meets the bank’s underwriting standards and other lending policy criteria.
    - assessing the quality of the collateral and the appropriateness of collateral valuation methods.
    - analyzing the purchasing bank’s history with the seller and the seller’s experience with the lending product and financial capacity.
    - risk assessment of all applicable risks.

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<sup>37</sup> If the bank uses its internal underwriting criteria for in-house originations to define acceptable loan purchases, it is not necessary in all cases to separately define purchase characteristics in a stand-alone document.

- thorough assessment and legal review of the purchase contract, including recourse and risk-sharing arrangements, loan administration, and collateral controls.
  - assessing accounting implications, such as sales treatment and allowances for credit losses.
  - an analysis to determine the applicability of the legal lending limit for loans purchased from a single seller. Examiners should consult with OCC legal counsel when potential legal lending limit issues are identified. Refer to OCC Bulletin 2023-27, “[Loan Purchase Activities: Legal Lending Limit Guidance](#),” for more information about the applicability of the legal lending limit to purchased loans.
  - for loans purchased with recourse, assessing the seller’s ability to meet recourse and repurchase obligations.
4. Assess the adequacy of due diligence for loan portfolio and pool purchases. Consider whether the bank’s due diligence includes an assessment of
- credit agreements and supporting legal documentation.
  - loan portfolio metrics and performance data.
  - the adequacy of loan sampling criteria used to evaluate the pool or portfolio.
  - the originating institution’s underwriting of loans in the pool or portfolio.
  - characteristics governing the use of credit scoring by the seller (if applicable).
  - collateral description, value, lien status, and method of asset valuation for loans in the pool or portfolio.
  - portfolio credit characteristics (e.g., credit scores or risk ratings, DTI, DSCR, and LTV).
  - any outstanding legal and compliance concerns related to the pool or portfolio.
  - the quality of loan servicing and account management activities.
5. Assess the adequacy of credit administration of purchased loans. Consider whether credit administration includes
- monitoring the seller’s compliance with the terms of the contract.
  - engaging with the seller to monitor credit quality and borrower compliance with loan covenants.
  - monitoring and reporting of seller performance and concentration limits.
  - processes for verifying the assignment of notes and perfection of interests in collateral.
  - internal controls and physical security to safeguard personal information and the transfer of notes from the seller to the purchaser.
  - processes for evaluating the quality of original due diligence based on ongoing performance.
  - appropriate legal and accounting expertise to review and validate transactions.
  - obtaining credit and other pertinent information (e.g., financial performance, payment history, and credit scores) to monitor performance, determine risk ratings and accrual status, and appropriately make provisions for loan-loss allowances.

- effective management and board reports specific to loan purchase activities. Specifically, determine whether reports
  - provide bank management the ability to monitor performance and conduct appropriate post-purchase management.
  - compare performance between purchased loans and those the bank originated. Such reports can provide management with key information to make future loan purchase-related decisions.

## Credit Administration

**Objective:** To determine the adequacy of the bank’s credit administration practices, including loan administration and portfolio management. Other booklets in the “Asset Quality” category of the *Comptroller’s Handbook’s Safety and Soundness* series provide more detailed examination procedures related to credit administration practices for specific types of loans.

1. Evaluate the adequacy of the bank’s pre-closing review processes. Consider whether pre-closing reviews
  - confirm the accuracy of credit underwriting information and key underwriting metrics (e.g., DTI, PTI, DSCR, LTV).
  - check for consistency with bank policies.
  - verify that loan documents are appropriate for the loan type and consistent with approved terms and conditions.
  - check compliance with laws and regulations.
  - include legal review of loan documents, as warranted based on the loan type (e.g., for complex or non-standard loan documentation).
2. Evaluate the adequacy of loan closing and booking processes. Consider the adequacy of internal controls to ensure information is properly recorded in the bank’s systems, liens are properly perfected, and exceptions and ongoing monitoring requirements are appropriately captured.
3. Evaluate the adequacy of post-closing processes. Consider whether post-closing processes
  - verify that documents are complete and properly executed.
  - verify that liens are attached and perfected.
  - track and verify resolution of any missing, incomplete, or improperly executed items.
  - confirm that loan information has been accurately entered into the bank’s systems.
4. Evaluate the adequacy of the bank’s loan servicing and monitoring processes. Consider the adequacy of processes for
  - processing of draws and revolving credit advances.
  - interest rate adjustments for variable rate loans, including commercial loans with performance-based pricing.

- periodic loan billing.
  - escrow administration.
  - monitoring flood, property and casualty, and liability insurance (e.g., policy changes, terminations) and force placing coverage when a borrower fails to provide evidence of insurance.
  - payment processing and balancing of appropriate general ledgers.
  - processing participation loan payments.
  - loan maturity monitoring.
  - monitoring trailing document exceptions.
  - lien perfection monitoring for recorded mortgages or deeds of trust and recorded UCC filings, which generally have a five-year expiration from the filing date.
  - monitoring the status of required periodic borrower financial statements and loan covenant testing.
  - monitoring the status of periodic commercial loan reviews (e.g., annual analysis and risk-rating reviews).
  - processing loan payoffs and lien releases.
5. Evaluate the effectiveness of the bank's exception processes. Consider
- whether bank reports appropriately capture underwriting, financial, and credit administration exceptions.
  - whether bank reports contain aggregated exception levels, trends, and performance analysis.
  - the adequacy of processes for identifying, approving, and tracking exceptions.
  - the extent of exceptions identified by credit risk review, audit, or examiners that bank staff failed to identify at the appropriate point in the lending or credit administration process.
  - the timeliness of follow-up on exceptions requiring corrective action.
6. Assess the adequacy of concentration risk management practices. Refer to the [“Concentrations of Credit”](#) booklet of the *Comptroller's Handbook* for expanded examination procedures regarding concentrations of credit.
7. Assess the adequacy of management and board reports. Determine whether reports are appropriate for the size, complexity, and risk profile of the bank's lending activities. Evaluate the effectiveness of reports in promoting prompt detection of emerging risks and changes in portfolio quality. Consider
- whether reports are tailored to the target audience (e.g., staff, first-line managers, senior management, and the board).
  - the timeliness of information and reporting.
8. Perform testing to assess the accuracy of reporting. (If internal controls are satisfactory or if the bank's internal audit function tested the accuracy of reports, examiner testing may be unnecessary.)

**Objective:** To determine the adequacy of the bank’s stress testing processes.

1. Evaluate the quality of portfolio stress testing. Consider whether stress testing
  - is appropriate to the complexity of the loan portfolio.
  - asks plausible “what if” questions about key vulnerabilities.
  - makes a reasonable determination of how much impact the stress event or factor might have on earnings and capital.
  - incorporates the resulting analysis into the bank’s overall risk management processes.
2. Evaluate the effectiveness of loan-level stress testing. Determine whether stress testing analyzes the impact of changing economic conditions on the borrower’s ability to service debt. Consider whether
  - variables are tailored to the borrower’s risk characteristics.
  - income (e.g., rents, sales prices) and expenses (e.g., marketing costs, insurance costs, energy costs, costs of materials, interest) are stressed.
  - collateral values and capitalization rates are stressed.
  - management compares actual borrower financial performance with planned performance or updates loan-level stress tests if the borrower’s operations change or there are changes in the industry, market conditions, or economic conditions.

## Problem Loan Management

**Objective:** To determine the adequacy of the bank’s collections processes.

1. Determine whether the bank has established appropriate policies and procedures for collections activities.
2. Determine if the criteria for transfer of loans from lenders to collectors are consistently applied. Evaluate whether transition practices appropriately balance relationship management with early involvement of specialists.
3. Determine whether staffing levels, skills, and experience are consistent with the volume and complexity of loans in collection status; the products offered; and the bank’s size, complexity, and risk profile.
4. Review the process for modifying loans to borrowers experiencing financial difficulty.<sup>38</sup> Evaluate the oversight provided by the bank’s accounting, legal, and audit departments. Determine if loans modified to borrowers experiencing financial difficulty are appropriately recognized and reported.

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<sup>38</sup> Refer to call report instructions and Accounting Standards Update (ASU) 2022-02, “Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,” for more information.

**Objective:** To determine the adequacy of loan workout processes and whether loan workout processes are appropriate for the complexity and nature of the bank's lending activities, consistent with safe and sound lending practices, and in compliance with laws and regulations.

1. Determine whether the bank has established appropriate policies and procedures for loan workout activities.
2. Determine whether loan workout processes are supported by adequate management infrastructure to identify and manage the volume and complexity of workout activity.
3. Determine whether the bank's loan workout processes include internal controls, systems, and reports to identify and track loan performance and risk.
4. Assess the adequacy of the bank's organizational structure and staffing for loan workout activities. Determine whether staffing levels, skills, and experience are consistent with the volume and complexity of loan workouts; the products offered; and the bank's size, complexity, and risk profile.
5. Assess the bank's loan workout plans. Consider whether workout plans include
  - a summary and analysis of the root cause of the credit deterioration.
  - a decision to rehabilitate or exit the relationship.
  - updated and comprehensive financial information on the borrower and guarantor(s).
  - current valuations of the collateral supporting the loan and workout plan.
  - analysis and determination of appropriate loan structure (e.g., term and amortization schedule), curtailment, covenants, or re-margining requirements.
  - an estimation of any expected loss
  - appropriate legal documentation for any changes to loan terms.
  - actions and time frames to be taken by the bank and borrower.
  - triggers for risk-rating changes (upgrades and downgrades) and accrual treatment.
6. Assess the adequacy of the bank's processes to periodically assess the effectiveness of the bank's workout strategies.

**Objective:** To determine the adequacy of third-party risk management for third parties used for collection and workout activities.

1. Assess the bank's risk management of third parties used in the collections and workout process. Consider whether
  - bank policies address use of third-party collections and workout providers.
  - management has assigned responsibility and authority for day-to-day oversight to an individual or group.
  - a defined process has been established for the transfer of accounts between the bank and the third party.

- third-party providers and reporting are subject to periodic review by an independent control function (e.g., credit risk review, audit, quality assurance, quality control).

Refer to OCC Bulletin 2023-17, “[Third-Party Relationships: Interagency Guidance on Risk Management](#),” for additional information about risk management of third parties.

## Independent Credit Risk Review

**Objective:** To determine adequacy of independent credit risk review. These procedures are designed to be used to assess credit risk reviews independent of the bank’s loan officers, regardless of whether reviews are performed in-house or outsourced to a third party. Refer to OCC Bulletin 2020-50, “[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#),” for more information about credit risk review.

- Determine whether independent credit risk reviews are performed by personnel who do not have control over the loan and are not part of the loan approval process or influenced by individuals associated with the loan approval process.
1. Assess the appropriateness of the frequency of independent credit risk reviews. Determine the cause of reviews that are behind schedule, have been postponed, or were canceled.
  2. Evaluate the staff of independent credit risk review. Consider
    - the adequacy of staffing levels based on the size, complexity, and risk profile of the loan portfolio.
    - the level of staff turnover.
    - education, experience, and formal credit training of credit risk review staff and whether these are consistent with the risk and complexity of the bank’s lending activities.
    - credit risk review staff’s knowledge of sound lending practices; the bank’s internal policies and procedures; and relevant laws, regulations and supervisory guidance.
  3. Assess the adequacy of independent credit risk review’s scope. Determine whether independent credit risk review covers all segments of the loan portfolio that pose significant credit risk or concentrations, and other loans that meet other bank-specific criteria. Consider whether the scope includes
    - loans over a predetermined size.
    - a sufficient sample of smaller loans, new loans, and new loan products.
    - loans with higher risk indicators (e.g., low credit scores, high LTVs)
    - loans approved as exceptions to policy.
    - segments of loan portfolios, including retail, with similar risk characteristics, such as those related to borrower risk (e.g., credit history), transaction risk (e.g., product or collateral type), or other risk factors as appropriate.
    - segments of the loan portfolio experiencing rapid growth.

- exposures from nonlending activities that also pose credit risk.
  - past-due, nonaccrual, renewed, and restructured loans.
  - low-grade pass loans.
  - special mention and classified loans.
  - recently upgraded loans.
  - loans to insiders, affiliates, or related parties
  - loans constituting concentrations of credit and other loans affected by common repayment factors.
4. Assess the adequacy of the depth of credit risk reviews. Consider if loans and portfolios are evaluated for
- credit quality, soundness of underwriting and risk identification, borrower performance, and adequacy of the sources of repayment. (When applicable, this evaluation includes the appropriateness of automated underwriting and credit scoring, including prudent use of overrides, as well as the effectiveness of account management strategies, collections, and portfolio management activities in managing credit risk.)
  - reasonableness of assumptions.
  - creditworthiness of guarantors or sponsors.
  - sufficiency of credit and collateral documentation.
  - proper lien perfection.
  - proper approvals consistent with internal policies.
  - adherence to loan agreement covenants.
  - adequacy of, and compliance with, internal policies and procedures (such as those related to nonaccrual and classification or risk-rating policies), laws, and regulations.
  - the appropriateness of credit loss estimation for those loans with significant weaknesses, including the reasonableness of assumptions used and the timeliness of charge-offs.
  - the accuracy of risk ratings and the appropriateness and timeliness of the identification of problem loans by loan officers.
5. Evaluate the effectiveness of the process to address risk-rating differences and criticisms or deficiencies that require corrective action. Consider whether processes include
- an appeal or review process by an independent party if credit risk review and loan officers cannot come to agreement on a rating.
  - an agreed-upon plan of corrective action and time frame for completion.
  - escalation to senior management and the board if actions remain unresolved at the end of the agreed-upon time frame.

6. Evaluate the timeliness and effectiveness of credit risk review reporting. Determine whether credit risk review reports
  - are reported to board (or appropriate committee) on a timely basis, typically quarterly.
  - compare trends that identify significant changes in the overall quality of the loan portfolio.
  - include an assessment of the adequacy of, and adherence to, internal policies and procedures.
  - include an assessment of the quality of underwriting and risk identification.
  - include an assessment of compliance with laws and regulations.
  - include management's response to substantive criticisms or recommendations.

## Model Risk Management

**Objective:** To determine the adequacy of the model risk management for models used in lending and credit risk management processes. Examiners should consider model risk management conclusions from the supervisory cycle when performing this objective. Examiners may select a sample of models to complete this objective. Models used for credit underwriting and decisioning should be subject to sound model risk management. Refer to OCC Bulletin 2026-13, "[Model Risk Management: Revised Guidance](#)," for more information about model risk management. For community banks, refer also to OCC Bulletin 2025-26, "[Model Risk Management: Clarification for Community Banks](#)."

1. Verify that model documentation includes information supporting decisions related to model selection, testing, governance, development, internal controls, and third-party risk management.
2. Determine whether the bank implemented appropriate controls before putting a model or related technology into production.
3. Determine whether the bank maintains a record of model change history.
4. Evaluate whether data and information used in the model are suitable for the model's purpose.
5. Assess the adequacy of model validation.

## Third-Party Risk Management

**Objective:** To determine the adequacy of third-party risk management over lending-related third parties.

1. If the bank has third-party relationships that support critical activities related to lending, assess the adequacy of the bank's third-party risk management. Refer to OCC Bulletin 2023-17, "[Third-Party Relationships: Interagency Guidance on Risk Management](#)." Examiners may use examination procedures in OCC Bulletin 2017-7, "[Third-Party](#)

[Relationships: Supplemental Examination Procedures](#),” as appropriate. Consider reviewing a sample of due diligence and ongoing monitoring documentation for lending-related third parties. Refer to the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook* for more information about sampling. In general, a judgmental sample focusing on third parties supporting critical lending activities would be appropriate for this procedure.

## Internal and External Audit

**Objective:** To determine the adequacy of internal and external audit activities related to lending. Refer to the “[Internal and External Audits](#)” booklet of the *Comptroller’s Handbook* for expanded procedures as appropriate.

1. Assess the adequacy of lending-related internal audits. Consider whether audits focus on the adequacy of
  - policies and procedures.
  - internal controls.
  - underwriting.
  - collateral valuation processes.
  - disbursement.
  - credit administration.
  - collections and workout activities.
  - ACL methodologies and processes.
  - credit risk review.
2. Assess the adequacy of external audit activities related to lending. Consider whether external audit tests internal controls for significant lending-related financial reporting activities (e.g., ACL).

## Conclusions

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**Conclusion:** The aggregate level of each associated risk is (low, moderate, or high).  
The direction of each associated risk is (increasing, stable, or decreasing).

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**Objective:** To determine, document, and communicate overall findings and conclusions.

1. Determine preliminary examination findings and conclusions and discuss with the examiner-in-charge (EIC). Discussions should include
  - effect on the core assessment of asset quality and management.
  - quantity of associated risks.
  - quality of risk management.
  - aggregate level and direction of associated risks.
  - overall risk in lending activities.
  - violations of laws and regulations.
  - matters requiring attention (MRA).
2. If substantive safety and soundness concerns remain unresolved that may have a material adverse effect on the bank, consider further expanding the scope of the examination. The examination scope may be further expanded by completing additional objectives or procedures within the expanded procedures in this booklet, expanded procedures from other *Comptroller's Handbook* booklets, or verification procedures, as appropriate.
3. Discuss examination findings with management, including violations, MRAs, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.
4. Compose conclusion comments, highlighting any issues that should be included in the ROE or supervisory letter. Include conclusions, as applicable, for
  - the level of risks, with heightened focus on material financial risks.
  - the portfolio's asset quality.
  - observations from any transaction testing performed.
  - the quality of risk management and whether it is commensurate with the quantity of risks undertaken. Examiners should place more emphasis on areas presenting material financial risks.
  - effectiveness of credit administration.
  - reliability and timeliness of internal loan risk ratings.
  - effectiveness of audit and credit risk review.
  - the extent to which lending activities and credit risk management practices affect interrelated risks such as interest rate risk, liquidity risk, operational risk, compliance

- risk, and strategic risk. Examiners should place more emphasis on areas presenting material financial risks.
- compliance with applicable laws and regulations.
5. If necessary, compose MRAs and violation write-ups.
  6. Update the OCC's supervisory information systems and any applicable report of examination schedules or tables.
  7. Document recommendations for the supervisory strategy (e.g., what the OCC should do in the future to effectively supervise lending activities in the bank, including time periods, staffing, and workdays required). Consider the aggregate level of each risk associated with lending when making supervisory strategy recommendations.
  8. Update, organize, and reference work papers in accordance with OCC policy. Appropriately dispose of or secure any paper or electronic media that contain sensitive bank or customer information.

## Internal Control Questionnaire

An internal control questionnaire (ICQ) is a tool designed to help an examiner assess a bank's internal controls. ICQs address common controls that provide day-to-day protection of bank assets and financial records. "No" answers indicate potential control weaknesses; however, examiners should focus on whether internal controls are sufficient based on the bank's specific operations and circumstances (e.g., additional controls or other mitigating factors may be present). Examiners should also consider the bank's size and complexity when assessing internal controls.

1. Does the bank have processes and control systems to monitor compliance with lending policies and applicable laws and regulations?
2. Does the bank have internal controls to prevent loans originated outside of an individual or committee's lending authority? Does the bank have detective controls to identify instances in which preventive controls fail?
3. Are reports submitted to the board periodically reviewed for integrity?
4. Are new loans, payments, and payoffs processed through the bank's processing system?
5. Are liens for paid notes released in a timely manner?
6. Does the bank have controls to prevent and detect errors and misconduct?
7. Does the bank have pre-closing controls?
8. Does the bank have post-closing controls?
9. Is there appropriate segregation of duties between lending personnel (e.g., loan officers) and back-office functions?
10. Are written and signed applications required for all loan types offered by the bank?<sup>39</sup>
11. Does the bank have a system to monitor the timely submission of commercial borrower and guarantor financial statements and other items required in the bank's loan agreements?
12. Are commercial lines of credit reviewed annually, as applicable?
13. Does the bank complete annual reviews of commercial loans in a timely manner?
14. Does the bank monitor market conditions for the geographies in which it operates?

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<sup>39</sup> "Written" may include electronic submissions that are kept in accordance with record-keeping laws and bank policy.

15. Is the bank's classified asset report current?
16. Is a systematic and progressively stronger follow-up notice procedure utilized for delinquent loans?
17. Does credit risk review maintain a list of loans reviewed, indicating the date of the review and the loan's risk rating?
18. Are models used in the bank's lending and credit risk management processes incorporated into the bank's model risk management processes?
19. Are third parties used in the bank's lending and credit risk management processes incorporated into the bank's third-party risk management processes?

## Verification Procedures

Verification procedures are used to verify the existence of assets and liabilities or test the reliability of financial records. Examiners generally do not perform verification procedures as part of a typical examination. Rather, verification procedures are performed when substantive safety and soundness concerns are identified that are not mitigated by the bank's risk management systems and internal controls.

1. Reconcile the trial balance to the general ledger. Include loan commitments and other contingent liabilities in the testing.
  
2. Using an appropriate sampling technique, select loans from the trial balance and
  - prepare and mail confirmation forms to borrowers. (Loans serviced by other institutions, either whole loans or participations, should be confirmed only with the servicing institution. Loans serviced for other institutions, either whole loans or participations, should be confirmed with the other institution and the borrower. Confirmation forms should include the borrower's name, loan number, original amount, interest rate, current loan balance, contingency and escrow account balance, and a brief description of the collateral.)
    - After a reasonable time, mail second requests.
    - Follow up on any no-replies or exceptions and resolve differences.
  - examine notes for completeness and reconcile date, amount, and terms to trial balance.
    - In the event any notes are not held at the bank, request confirmation with the holder.
    - Verify that required initials of approving officer are on the note.
    - Verify that the note is signed, appears to be genuine, and is negotiable.
  - compare collateral descriptions on loan documents. List and investigate all collateral discrepancies.
  - determine whether the bank's lien on the collateral has been properly perfected.
  - determine whether any collateral is held by an outside custodian or has been temporarily removed for any reason. Request confirmation for any collateral held outside the bank.
  - determine whether each file contains documentation supporting guarantees and subordination agreements, when appropriate.
  - determine whether any required insurance coverage is adequate and that the bank is named as loss payee.
  - review participation agreements for participations purchased to verify the seller's compliance with contractual terms (e.g., fees, treatment of late payments, and remittance requirements).
  - review participation agreements for participations sold to verify the bank's compliance with contractual terms (e.g., borrower and collateral monitoring, fee collection, payment collection, and remittance requirements).
  - review disbursement ledgers and authorizations and determine whether authorizations are signed in accordance with the terms of the loan agreement.

- determine whether information in the processing system (e.g., committed amount, unfunded amount, maturity date, interest rate) is accurate.
3. Review the accrued interest accounts, and
    - review procedures for accounting for accrued interest and handling of adjustments.
    - scan accrued interest and income accounts for any unusual entries and follow up on any unusual items by tracing to initial and supporting records.
  4. Obtain or prepare a schedule showing the amount of monthly interest income and the loan portfolio balance at the end of each month since the last examination, and
    - calculate or check yield.
    - investigate significant fluctuations or trends.
  5. Using a list of loans on nonaccrual, check loan accrual records to determine whether interest income is not being accrued.

# Appendixes

## Appendix A: Quantity of Credit Risk Indicators

This appendix includes examples of risk indicators that examiners may consider when assessing the effect of lending activities on the quantity of credit risk. Examiners may also use this matrix when assessing the quantity of credit risk for a specific type of lending. Other booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller’s Handbook* include supplemental risk indicators for specific types of lending.

Low	Moderate	High
The level of loans outstanding is low relative to total assets and equity capital.	The level of loans outstanding is moderate relative to total assets and equity capital.	The level of loans outstanding is high relative to total assets and equity capital.
Growth rates are supported by local, regional, or national economic and demographic trends and level of competition. Growth (including off-balance-sheet activities) has been planned for and appears consistent with management and staff expertise, the bank’s operational capabilities, and the bank’s strategic plan.	Growth rates are mostly supported by local, regional, or national economic and demographic trends and level of competition. Some growth (including off-balance-sheet activities) has not been planned for or exceeds planned levels and may test management and staff expertise or operational capabilities. Minor inconsistencies relative to the bank’s strategic plan may exist.	Growth rates exceed local, regional, or national economic and demographic trends and level of competition. Growth (including off-balance-sheet activities) was not planned for or exceeds planned levels. Growth stretches management and staff expertise or the bank’s operational capabilities.
The bank has well-diversified income, and dependence on interest and fees from loans and leases is commensurate with asset mix. Risks and returns are well balanced.	The bank is dependent on interest and fees from loans for the majority of its income, but income sources within the loan portfolio are diversified. Imbalances between risk and return may exist but are not significant.	The bank is highly dependent on interest and fees from loans and leases. The bank may target higher-risk loan products for their earnings potential. Loan income is highly vulnerable to cyclical trends. Loan yields reflect an imbalance between risk and return, or risk is disproportionately high relative to return.
Reliance on third parties for lending-related activities is low.	Reliance on third parties for lending-related activities is moderate.	Reliance on third parties for lending-related activities is high.
The bank’s portfolio is well diversified with no single large concentrations or a few moderate concentrations. Concentrations are well within internal limits.	The bank has one or two material concentrations. Concentrations are within internal limits but may be approaching the limits.	The bank has one or more large concentrations. Concentrations may have exceeded internal limits.
Extensions of credit reflect conservative underwriting and risk-selection standards.	Extensions of credit generally reflect conservative to moderate underwriting and risk-selection standards.	Extensions of credit reflect liberal underwriting and risk-selection standards.

Low	Moderate	High
Collateral requirements are conservative. Collateral valuations are timely and well supported.	Collateral requirements are acceptable. Bank practices result in moderate deviations from policy. A moderate number of collateral valuations are not well supported or reflect inadequate protection. Soft (intangible) collateral is sometimes used in lieu of hard (tangible) collateral.	Collateral requirements are liberal, or if policies incorporate conservative requirements, there are substantial deviations. Collateral valuations are not always obtained, are frequently unsupported, and/or reflect inadequate protection. Soft (intangible) collateral is frequently used rather than hard (tangible) collateral.
The level of credit administration exceptions is low and has minimal impact on risk of loss.	The level of credit administration exceptions is moderate, but exceptions are corrected in a timely manner and generally do not expose the bank to risk of loss.	The level of credit administration exceptions is high. Exceptions are outstanding for inordinate periods, and the bank may be exposed to heightened risk of loss.
Distribution across pass categories is consistent with a conservative risk appetite. Migration trends within the pass category are balanced or favor the higher or less risky ratings. Indicators such as past dues and nonaccruals are low.	Distribution across pass categories is consistent with a moderate risk appetite. Migration trends within the pass category are starting to favor the lower or riskier pass ratings. Indicators such as past dues and nonaccruals are moderate.	Distribution across pass categories is heavily skewed toward the lower or riskier pass ratings. Downgrades dominate rating changes within the pass category. Indicators such as past dues and nonaccruals are moderate or high.
Classified and special mention loans represent a low percentage of loans and capital and are not skewed to the more severe categories (doubtful or loss).	Classified and special mention loans represent a moderate percentage of loans and capital and are not skewed to the more severe categories (doubtful or loss).	Classified and special mention loans represent a high percentage of loans and capital or a moderate percentage of loans and capital and are growing or are skewed to the more severe categories (doubtful or loss).
Re-aging, extension, renewal, and refinancing practices raise little or no concern about the accuracy/transparency of reported problem loan, past due, nonperforming, and loss numbers.	Re-aging, extension, renewal, and refinancing practices raise some concern about the accuracy/transparency of reported problem loan, past due, nonperforming, and loss numbers.	Re-aging, extension, renewal, and refinancing practices raise substantial concern about the accuracy/transparency of reported problem loan, past due, nonperforming, and loss numbers.
Loan losses to total loans are low. ACL coverage of problem and noncurrent loans and loan losses is high. Provision expense is stable.	Loan losses to total loans are moderate. ACL coverage of problem and noncurrent loans is moderate, but provision expense may need to be increased.	Loan losses to total loans are high. ACL coverage of problem and noncurrent loans is low. Special provisions may be needed to maintain acceptable coverage.

## Appendix B: Quality of Credit Risk Management Indicators

This appendix includes examples of risk indicators that examiners may consider when assessing the effect of lending activities on the quality of credit risk management.

<b>Strong</b>	<b>Satisfactory</b>	<b>Insufficient</b>	<b>Weak</b>
There is a clear, sound credit culture with a clear risk appetite.	The credit culture is generally sound but may vary by product line or business unit. Risk appetite is generally clear.	There are weaknesses in the bank's credit culture. Risk appetite may be inconsistent with strategic goals or not uniformly communicated throughout the bank.	Credit culture is absent or is materially flawed. Risk appetite is materially unclear or inconsistent with strategic goals.
Lending policies are consistent with the bank's strategic direction and risk appetite. Policies are comprehensive and communicate portfolio objectives, risk appetite, and loan-underwriting and risk-selection standards.	Lending policies are generally consistent with the bank's strategic direction and risk appetite. Policies are fundamentally adequate. Enhancements can be achieved in one or more areas but are generally not critical. Specificity of risk appetite or loan-underwriting and risk-selection standards may need improvement to fully communicate policy requirements.	Lending policies include some inconsistencies with the bank's strategic direction and risk appetite. Policies may not be sufficiently clear or are too general to adequately communicate portfolio objectives, risk appetite, or loan-underwriting and risk-selection standards. Policies may be outdated.	Lending policies are inconsistent with the bank's strategic direction and risk appetite. Policies are deficient in one or more ways and require significant improvement in several areas. Key policies may be absent or lack basic credit guidance on loan-underwriting criteria, risk appetite, or risk-selection standards.
Strategic and operational plans are consistent with risk appetite and promote an appropriate balance between risk-taking and growth and earnings objectives. New lending activities <sup>40</sup> are undertaken with strong risk management.	Strategic and operational plans are consistent with risk appetite. Anxiety for income may lead to some higher-risk transactions. Generally, there is an appropriate balance between risk-taking and growth and earnings objectives. New lending activities are undertaken with satisfactory risk management.	Strategic and operational plans are not fully consistent with risk appetite. Anxiety for income may lead to some higher-risk transactions that may not be well understood. There are concerns with risk-taking and growth and earnings objectives. New lending activities may not be subject to satisfactory risk management.	Strategic and operational plans are inconsistent with risk appetite or may encourage taking on excessive levels of risk. Anxiety for income dominates planning activities. New lending activities are undertaken without satisfactory risk management.

<sup>40</sup> "New activities" refers collectively to new, modified, or expanded products or services. For more information, refer to OCC Bulletin 2017-43, "[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#)."

<b>Strong</b>	<b>Satisfactory</b>	<b>Insufficient</b>	<b>Weak</b>
<p>Management is effective. Lending and credit administration personnel possess extensive expertise to effectively administer the risk assumed. Responsibilities and accountability are clear and appropriate, and timely remedial or corrective action is taken when they are breached.</p>	<p>Management is adequate to administer assumed risk, but improvements may be needed in one or more areas. Lending and credit administration personnel generally possess the expertise required to effectively administer assumed risks, but additional expertise may be required in one or more areas. Responsibilities and accountability may require some clarification. Generally, appropriate remedial or corrective action is taken to address the root causes of problems.</p>	<p>Management requires strengthening in one or more key areas. Responsibilities and accountability likely require some clarification or do not reflect the bank's current structure. Management may take remedial or corrective actions to address root causes of problems, but these actions are not always effective or timely.</p>	<p>Management is deficient. Lending and credit administration personnel may not possess sufficient expertise and/or experience, or otherwise may demonstrate an unwillingness to effectively administer the risk assumed. Responsibilities and accountability are not clear. Remedial or corrective actions are lacking or do not address root causes of problems.</p>
<p>Diversification management is active and effective. Concentration limits are set at reasonable levels. The bank identifies and reports concentrated exposures and initiates actions to limit, reduce or otherwise mitigate their risk. Management identifies and controls correlated risk exposures.</p>	<p>Diversification management is adequate. Concentrated exposures are identified and reported. Management has set reasonable concentration limits, but these limits may require minor enhancements or further stratification. Management generally takes action to limit, reduce, or otherwise mitigate risk. Correlated exposures are understood but may not be formally discussed or well documented.</p>	<p>Diversification management needs improvement. Management has set concentration limits, but these limits may not be reasonable, are outdated, or may not adequately address the primary exposures at the bank. Management may identify when the bank exceeds these limits but does not always take appropriate or timely actions to reduce or mitigate risk when limits are exceeded. Correlated exposures are not well understood or clearly identified.</p>	<p>Diversification management is deficient or altogether absent. The bank takes little or no action to limit, reduce, or mitigate risk. Management does not identify and control correlated exposures. Concentration limits, if any, may be exceeded or are raised frequently.</p>
<p>Compensation structures provide appropriate balance among loan/revenue production, loan quality, and portfolio administration, including risk identification.</p>	<p>Compensation structures provide reasonable balance among loan/revenue production, loan quality, and portfolio administration.</p>	<p>Compensation structures may be skewed toward loan/revenue production. There may be inadequate incentives or accountability for loan quality and portfolio administration.</p>	<p>Compensation structures are skewed to loan/revenue production. There is little evidence of substantive incentives and/or accountability for loan quality and portfolio administration.</p>

<b>Strong</b>	<b>Satisfactory</b>	<b>Insufficient</b>	<b>Weak</b>
<p>Staffing levels and expertise are robust for the size and complexity of the loan portfolio. Staff turnover is reasonable and allows for the orderly transfer of responsibilities. Training programs facilitate ongoing staff development.</p>	<p>Staffing levels and expertise are generally adequate for the size and complexity of the loan portfolio. Staff turnover is moderate, but management addresses gaps in portfolio management in a timely manner. Training initiatives are effective but may need minor enhancements.</p>	<p>Staffing levels need improvement. High turnover may result in significant gaps in some areas. Management and the board do not respond to these needs in a timely manner. Training initiatives may be present but are likely inconsistent.</p>	<p>Staffing levels are inadequate in numbers or skill level. Turnover is high, and management and the board are ineffective at addressing staffing gaps or shortfalls. Training is lacking or wholly insufficient.</p>
<p>Bank thoroughly identifies, approves, tracks, and reports exceptions individually and in aggregate, including risk exposures associated with off-balance-sheet activities.</p> <p>Management conducts appropriate aggregation and trend analysis to assess the effect of exceptions on portfolio quality.</p>	<p>Bank identifies, approves, and reports significant policy, underwriting, and risk-selection exceptions on a loan-by-loan basis, including risk exposures associated with off-balance-sheet activities.</p> <p>Management conducts adequate analysis of the effect of exceptions on portfolio quality.</p>	<p>Bank approves exceptions on a loan-by-loan basis. Exception identification, tracking, and aggregate reporting may need improvement. Risk exposures associated with off-balance-sheet activities may not be considered.</p> <p>Management may not analyze the effect of exceptions on portfolio quality.</p>	<p>Exception identification, approval, tracking, or reporting need material improvement. Exceptions may not be properly identified or may not receive appropriate approval, significant policy and pricing exceptions may be approved but not reported individually or in aggregate, or their effect on portfolio quality is not analyzed. Risk exposures associated with off-balance-sheet activities are not considered.</p>
<p>Credit analysis is thorough and timely both at underwriting and periodically thereafter.</p>	<p>Credit analysis appropriately identifies key risks and is conducted within reasonable time frames. Analysis after underwriting is effective but may need minor enhancements.</p>	<p>Credit analysis needs improvement. Moderate errors may be evident, key risks may be overlooked, or analysis may not be consistently timely. Further employee training or assistance is likely required.</p>	<p>Credit analysis is deficient. Analysis is not timely, accurate, or complete and cannot be relied on for underwriting or risk-rating decisions. Employees lack basic knowledge or understanding of how to complete these analyses.</p>

<b>Strong</b>	<b>Satisfactory</b>	<b>Insufficient</b>	<b>Weak</b>
<p>Risk-rating and problem loan identification processes are accurate and timely. They effectively stratify credit risk in both problem and pass-rated credits. They serve as an effective early warning tool and support risk-based pricing, ACL, and capital allocation processes.</p>	<p>Risk-rating and problem loan identification processes are mostly accurate and timely. Examiners may have identified a small number of inaccurate or untimely risk ratings that are isolated or explainable. The graduation of pass ratings may need to be expanded to facilitate early warning, risk-based pricing, or capital allocation.</p>	<p>Risk-rating and problem loan identification processes are insufficient and do not consistently produce accurate or timely risk ratings. Problem credits may be identified, but not in a timely manner. The graduation of pass ratings is insufficient to stratify risk in pass credits for early warning or other purposes (loan pricing, ACL, capital allocation).</p>	<p>Risk-rating and problem loan identification systems need substantial improvement. The bank does not have an effective system to identify problem credits accurately or in a timely manner; as a result, portfolio risk is significantly misstated.</p>
<p>Independent credit risk review is comprehensive, timely, and effective.</p> <p>Credit risk review identifies underwriting, financial, and collateral exceptions and also evaluates the adequacy of overall credit risk management. When there are risk-rating changes, they are consistently accurate and timely.</p> <p>Credit risk review management and personnel are qualified, experienced, and independent, and report directly to the board or its designated committee.</p> <p>Identified issues are resolved effectively and in a timely manner.</p> <p>Work papers fully support conclusions.</p>	<p>Independent credit risk review is adequate in scope, timely, and generally effective. Minor weaknesses that do not compromise overall effectiveness may be evident.</p> <p>Credit risk review identifies underwriting, financial, and collateral exceptions but may not evaluate the overall credit risk management function. Risk-rating conclusions are generally accurate and timely.</p> <p>Credit risk review management and personnel are qualified, experienced, and independent (whenever possible), and report directly to the board or its designated committee.</p> <p>Identified issues are generally resolved effectively and in a timely manner.</p> <p>Work papers adequately support conclusions.</p>	<p>The scope of independent credit risk review may require some expansion to be sufficient, or reviews may not always be timely.</p> <p>Reviews may not consistently identify underwriting, financial, and collateral exceptions and likely do not include an evaluation of overall credit risk management. Risk-rating conclusions are not consistently accurate or timely.</p> <p>Credit risk review management or personnel may lack extensive experience, require further training, or may not be fully independent. Reporting to the board or a designated committee may be indirect.</p> <p>Identified issues may not be resolved effectively or in a timely manner.</p> <p>Work papers may not fully support all findings.</p>	<p>Independent credit risk review is ineffective due to weaknesses in scope, timing, coverage, staffing, or expertise.</p> <p>Reviews do not consistently identify underwriting, financial, and collateral exceptions. Risk-rating conclusions are not accurate or timely.</p> <p>Credit risk review management and personnel lack experience and competence, or independence may be in question. Key issues are not properly reported to the board or designated committee.</p> <p>Identified issues are not resolved effectively or in a timely manner.</p> <p>Work papers are inadequate to support findings.</p>
<p>Special mention ratings do not indicate any management problems administering the loan portfolio.</p>	<p>Special mention ratings generally do not indicate management problems administering the loan portfolio.</p>	<p>Special mention ratings may indicate management problems administering the loan portfolio.</p>	<p>Special mention ratings clearly indicate management is not properly administering the loan portfolio.</p>

<b>Strong</b>	<b>Satisfactory</b>	<b>Insufficient</b>	<b>Weak</b>
<p>MIS provide accurate, timely, and complete portfolio information, including information on significant portfolio segments.</p> <p>Management and the board receive thorough reports on the bank's lending activities and loan portfolio.</p> <p>Reports promote strong decision making and proactive risk management.</p>	<p>MIS are satisfactory and generally provide accurate, timely, and complete portfolio information.</p> <p>Management and the board generally receive appropriate reports on the bank's lending activities. Reports promote sound decision making but may not consistently enable proactive risk management.</p>	<p>MIS provide insufficient portfolio information.</p> <p>Reports may be incomplete, inaccurate, or inconsistently produced in a timely fashion.</p> <p>Management and the board may not receive appropriate reports on the bank's lending activities.</p> <p>Reports do not promote fully informed decision making or risk management.</p>	<p>MIS are deficient.</p> <p>Reports are materially incomplete, inaccurate, or untimely.</p> <p>Management and the board do not receive sufficient information on the bank's lending activities.</p> <p>Reports are either non-existent or inadequate to support decision making.</p>
<p>Audit coverage of lending activities is comprehensive, timely, and supported by a comprehensive risk assessment.</p>	<p>Audit coverage of lending activities is adequate, timely, and supported by an adequate risk assessment.</p>	<p>Audit coverage of lending activities is insufficient or lending audits may not be timely. There may be weaknesses in the risk assessment.</p>	<p>Audit coverage of lending is deficient in scope or frequency. Audits may have failed to identify significant weaknesses.</p>

## Appendix C: Sample Request List

This appendix is provided as a guide and should be tailored to the scope of the supervisory activity and the bank's specific activities and business model. The request letter should indicate which items need to be provided before the start of the supervisory activity and which will be reviewed during the supervisory activity.

1. Lending- and credit-related organizational charts and a list of primary contacts for examiners.
2. For each board and management committee that provides credit-related oversight, please provide
  - a. meeting minutes for the last 12 months [examiners may customize date range as needed].
  - b. a copy of the standard report package distributed at, or in advance of, each meeting. (Please provide for the most recent meeting. Examiners will request packages from additional meetings as needed).
3. Strategic and operational plans for lending. Include projections, budgets, and assumptions. If there are multiple plans (e.g., by product or line of business), please provide a list and examiners will request the ones needed.
4. Risk appetite statements related to lending.
5. Lending-related risk assessments.
6. A high-level summary of the bank's loan products and services. For each product offered, please include, as applicable
  - a. a brief description of the product, including its basic characteristics and terms.
  - b. summary tables of the dollars outstanding, number of accounts, and volume of unfunded commitments.
  - c. descriptions of marketing or acquisition channels used (e.g., direct, internet, mail, and third parties).
  - d. descriptions of any new or expanded features, market segments, or marketing initiatives since the last examination or planned for the near future. Please include any product proposals and projections for new, modified, or expanded products introduced within the last 18 months.
  - e. analyses or proposals for any retail product or product segment discontinued or significantly curtailed within the last 18 months.
  - f. descriptions of any portfolios acquired since the last examination.
  - g. a brief summary and description of any securitization, loan purchases or sales, credit derivatives, or other concentration or liquidity management activities related to lending products or portfolios.

7. A list of third-party relationships used in the lending process (e.g., third-party loan origination, credit risk review, appraisal review, account management, collections). Examiners may request a sample of due diligence or ongoing monitoring reviews.
8. A list and brief description of models used in the lending process (include models used for credit originations, account management, collections, or portfolio management). Examiners may request a sample of model documentation or reviews.
9. A brief description of litigation, either filed or anticipated, associated with the bank's lending activities.
10. Customer complaint logs for the last 12 months [examiners may customize time frame] (logs should be filtered or sorted to include only lending-related complaints to the extent practical).

*Examiners should include either 11 or 12 depending on the bank's size and complexity.*

11. Lending and credit administration policies and procedures.
12. A list of the bank's lending and credit administration policies and procedures. Examiners may request specific policies and procedures from the list.
13. Loan commitment reports showing commitments and undisbursed funds.
14. Loan trial balance and code descriptions.
15. Lists of watch, special mention, classified, past-due, and nonaccrual loans.
16. Workout plans or problem loan status reports for classified loans.
17. Concentration and portfolio diversification reports.
18. Exception reports.
19. Commercial loan credit administration reports, such as financial statement tracking, covenant tracking, and the status of annual reviews.
20. Results of the most recent loan portfolio stress tests and a list of any stress tests of significant products or portfolios. Include presentations or analysis of loan portfolio stress test results and follow-up actions. Examiners may request additional information based on the list of stress tests of significant products or portfolios.
21. Loans on which interest has been capitalized subsequent to initial underwriting.
22. Over-disbursed loans or over-limit lines of credit.

23. Loan purchase and sale reports.
24. Most recent internal and external audit reports covering lending and management's responses.
25. Internal and external audit reports covering lending, loan portfolio risk management, and credit risk management since [date].
26. Independent credit risk review reports since [date].
27. Most recent open-item monitoring/issue-tracking reports (e.g., for internal and external audit issues, independent risk management issues, and management self-identified issues).

## Appendix D: Loan Sampling

This appendix includes guidance for examiners on loan sampling and should be used in conjunction with the “[Sampling Methodologies](#)” and other booklets of the *Comptroller’s Handbook*. This appendix also includes hypothetical examples designed to illustrate various aspects of statistical and judgmental sampling methodologies.

### Loan Sampling Overview

The OCC does not prescribe a specific loan sampling methodology. The “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook* describes judgmental and statistical sampling in the context of the OCC’s bank supervision. Examiners have flexibility to choose a judgmental or statistical sampling methodology.

**Excerpt from the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook***

**Judgmental sampling**, which is not statistically based, includes gathering a selection of items for testing based on examiners’ professional judgment, expertise, and knowledge. Examiners may use information from judgmental sampling to inform supervisory activity conclusions, but they cannot make an inference about the entire population.

**Statistical sampling** allows examiners to use a sample’s results to make inferences about the entire population under review. Items for a statistical sample must be selected randomly from the population.

Judgmental sampling is commonly used in lending examinations, particularly when focusing on commercial lending activities. The homogenous nature of retail loans, however, lends itself well to statistical sampling methodologies and portfolio-level assessments, but judgmental sampling may also be used for retail lending examinations.

The methodology used to select samples should be consistent with the supervisory strategy and examination objectives. Common examples of lending-related sampling objectives include the following:

- Assessing the level of reliance that can be placed on the bank’s credit risk review.
- Assessing the adequacy of a bank’s internal controls.
- Assessing a bank’s adherence to its policies.
- Identifying information about the bank’s practices that might not be ascertained from a review of bank policies.
- Testing a bank’s compliance with laws and regulations.

## Judgmental Sampling

**Excerpt from the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook***

Judgmental (i.e., nonstatistical) sampling includes gathering a selection of items for testing based on examiners’ professional judgment, expertise, and knowledge to target known or probable areas of risk. Judgmental sampling is an appropriate sampling methodology in the context of bank supervision, particularly when examiners do not need to draw inferences about the population under review.

The key limitation with judgmental sampling is that the resulting conclusions cannot be extrapolated statistically to the population. For example, examiners cannot use judgmental sampling to estimate the rate of exceptions in a population. Examiners can, however, identify specific issues, such as violations, loan risk rating downgrades, bank policy exceptions, risk management weaknesses, or other characteristics that are considered in the assessment of the area under review. Examiners can also use judgmental sampling to identify specific risks or areas with elevated risk.

### Determine Population, Areas of Focus, and Sample Size

**Excerpt from the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook***

Appropriately defining the population and areas of focus promotes targeted, risk-based, and efficient sampling. Areas of focus are the specific segments or attributes of a population that examiners sample. Since judgmental sampling does not result in an inference about the population, the sample sizes are not derived mathematically. Examiners use their professional judgment, expertise, and knowledge to support the population, areas of focus, specific items sampled, and sample size. Examiners consider the supervisory activity’s scope and objectives as well as the characteristics of the bank and population when determining areas of focus and a judgmental sample’s size, which often occur simultaneously.

The OCC does not require examiners to test a specific percentage of loan portfolios or outstanding balances. Rather, examiners have flexibility to determine the appropriate size of judgmental samples to meet supervisory objectives. Examiners should consider the following when selecting a judgmental sample:

- New large loans
- New loan products
- Loans originated under new or changed underwriting standards
- Purchased loans
- Loans originated through third-party relationships
- Loans originated in new markets or by new lenders
- Loans with exceptions
- Loans near a loan officer or committee’s lending authority
- Growth areas
- Higher-risk or specialized portfolios
- Loans outside the bank’s geographic market
- Loans to insiders or affiliates

- Commercial lines of credit that have not been drawn upon
- Lowest-rated pass credits (e.g., watch-list loans)
- Recently upgraded loans
- Loans identified for review by examiners in charge of other lending areas
- Loans flagged for re-review at previous examinations
- Loans from portfolios that represent greater than 25 percent of capital
- Loans with high numbers of modifications, renewals, or extensions
- Special mention and classified loans
- Loans with multiple delinquencies
- Loans to borrowers with significant overdrafts
- Loans on nonaccrual
- Loans reviewed by credit risk review or audit

Examiners should use their knowledge of the bank's lending activities and the unique characteristics of the loan portfolio to select a risk-based sample. What constitutes an appropriate risk-based sample depends on the circumstances. For example, while the bank's largest loans pose risk to earnings and capital in terms of dollar amount, selecting a sample that primarily includes the bank's largest borrowers may not be the best risk-based sample, particularly if these are seasoned loans that examiners have reviewed in prior exams and the bank's risk-rating practices have historically been satisfactory. Conversely, selecting the largest loans could be a good risk-based sample if, for example, the OCC has concerns with the bank's risk-rating practices or if there are other risk factors in addition to the loans' size (e.g., have characteristics of potentially elevated risk other than size).

### Judgmental Sampling – Example 1

An examination objective is testing the adequacy of a bank's process for placing commercial loans on nonaccrual status. Examiners sample classified commercial loans that remain on accrual status and commercial loans over 90 days past due and still accruing. The breakdown of this population is shown in table 3.

**Table 3: Example 1's Population Characteristics**

<b>Population characteristics</b>	<b>Number of commercial loans (population)</b>
Over 90 days past due and on accrual status (but not classified)	50
Substandard and on accrual status	46
Doubtful and on accrual status	2
Classified, over 90 days past due, and on accrual status	2
<b>Total</b>	<b>100</b>

Examiners considered the risks associated with this population and selected a sample of 24 loans:

- Two loans that are classified, over 90 days past due, but still on accrual status
- Two loans rated doubtful but still on accrual status
- 10 loans that are substandard and still accruing
- 10 loans that are over 90 days past due and still accruing

Examiners selected all of the loans in the categories with the highest risk of inaccurate accrual status, while still testing a sample of loans from other categories.

### **Judgmental Sampling – Example 2**

An examination objective is to assess the accuracy of commercial loan risk ratings and the adequacy of the bank's credit risk identification practices. Examiners review the characteristics of the bank's portfolio and decide to focus on loans on the bank's watch list and loans rated special mention. They choose more watch list and special mention loans than loans already rated substandard. The selections reflect the objective of determining whether the bank is appropriately classifying loans and identifying credit risk.

### **Judgmental Sampling – Example 3**

Examiners are conducting a target examination of a bank's hotel lending. The primary examination objectives are to assess the quality of underwriting, adequacy of credit risk-rating practices, adequacy of credit administration practices, and compliance with the bank's lending policies. Based on the characteristics of the bank's hotel lending activities, examiners select a sample of new and seasoned hotel loans of various dollar amounts, geographies, hotel chains, and lenders.

## Evaluating a Judgmental Sample

### Excerpt from the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook*

Although examiners cannot make inferences regarding the entire population based on the results of a judgmental sample, they can identify specific exceptions, such as violations, loan risk rating downgrades, policy exceptions, risk management weaknesses, or other characteristics that are considered in the assessment of the area under review. In evaluating the sample, examiners should

1. consider the nature and severity of exceptions, and the risk to the bank or its customers.
2. investigate and identify the root cause, including whether exceptions have a common attribute or result from a deficient practice.<sup>41</sup>
3. consider whether the results of the review warrant stopping the sample early or expanding the sample.<sup>42</sup>
4. develop recommendations for the supervisory strategy (e.g., what the OCC should do in the future to effectively supervise the area under review).

The results of the loan sample, when used in conjunction with topics and procedures in this booklet, assist the examiner in determining the bank’s level of credit risk, direction of credit risk, and quality of credit risk management.

Examiners should consider all relevant facts and circumstances when using a judgmental sample to draw conclusions. In some cases, it will be prudent for examiners to expand the sample. Expanding the sample can be prudent when examiners need more information. For example, if the examiner selected a small sample of five loans, it would generally not be appropriate to conclude that the bank’s risk-rating processes need to improve because examiners downgraded one loan (20 percent of the sample). Rather, examiners would need to consider more information and might need to expand the sample before concluding. In other cases, such as when examiners identify potentially significant weaknesses in bank processes or other potentially systemic deficiencies, examiners may consider stopping sample evaluation early. Examiners may pause sample evaluation and should give management an opportunity to review the identified exceptions, respond regarding the factual accuracy of the examiners’ assessment, and determine the root cause. If management confirms the exceptions and identifies a deficient practice, especially if the exceptions are potentially systemic, examiners may consider stopping statistical sampling and concluding the review based on the specific facts obtained from the sample, discussions with bank management, and information

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<sup>41</sup> Footnote 24 in the “Sampling Methodologies” booklet of the *Comptroller’s Handbook* states, “In some cases, examiners should direct management to perform a root cause analysis. Refer to the ‘Bank Supervision Process’ booklet of the *Comptroller’s Handbook* for more information.”

<sup>42</sup> Footnote 25 in the “Sampling Methodologies” booklet of the *Comptroller’s Handbook* states, “Once examiners have identified a deficiency and its potential cause, the bank should use its resources to determine the extent of the deficiency. Examiners should not take on actions or burdens that are the bank’s responsibility. In some cases, examiners may perform more in-depth evaluations or investigations of a bank’s deficiencies. Refer to the ‘Bank Supervision Process’ booklet of the *Comptroller’s Handbook*, and the ‘Stopping a Judgmental Sample Early’ and ‘Expanding a Judgmental Sample’ sections of [the ‘Sampling Methodologies’ booklet].”

obtained from other sources. The “Sampling Methodologies” booklet of the *Comptroller’s Handbook* discusses in more detail evaluating judgmental samples and stopping a judgmental sample early.

### Judgmental Sampling – Example 4

Following the same scenario as example 1, examiners identify five loans that should have been placed on nonaccrual status. The following table summarizes the results of the review.

**Table 4: Example 4’s Population Characteristics**

Population characteristics	Number of commercial loans (population)	Sampled loans	Loans with incorrect accrual status
Over 90 days past due and on accrual status (but not classified)	50	10	1
Substandard and on accrual status	46	10	0
Doubtful and on accrual status	2	2	2
Classified, over 90 days past due, and on accrual status	2	2	2
<b>Total</b>	<b>100</b>	<b>24</b>	<b>5</b>

Examiners discuss each item with bank management and investigate the root cause. Depending on the root cause identified, examiners could stop the testing or could consider expanding the sample to test more loans in the “over 90 days past due and still accruing (but not classified)” category. Examiners must not use the sample results to draw an inference about the population, such as estimating the percentage of the loan portfolio that could have an incorrect accrual status – statistical sampling must be used to make such an inference. Examiners’ conclusions may, however, include a statement such as, “Examiners sampled 24 loans and identified five that should have been placed on nonaccrual status.”

### Judgmental Sampling – Example 5

Examiners reviewed a sample of new installment loans and identified exceptions to the bank’s underwriting policies that were not approved by the appropriate bank officer. Examiners reviewed the bank’s audit and independent loan review findings, neither of which identified concerns about unapproved exceptions. Examiners then met with bank management and determined that the bank’s pre-funding controls were insufficient to identify unapproved underwriting policy exceptions. Examiners also identified the reasons for independent loan review and internal audit failing to identify the exceptions and pre-funding control weaknesses.

## Statistical Sampling

**Excerpt from the “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook***

The viability of statistical sampling relies on a well-defined population. If the population is not appropriately specified, the resulting inference based on a sample from that population could be flawed. Key considerations when defining populations include the following:

- Scope and objectives of the supervisory activity.<sup>43</sup>
- Characteristics of the population, and whether the population is homogeneous with respect to factors relevant to the supervisory activity and objectives.
- Relevant time period. Sample results only apply to the time period that defines the population, when applicable.
- The type(s) of exceptions for which examiners are testing.

Examiners may test multiple populations during a supervisory activity, particularly when examiners need separate statistical results about different groups of items. For example, rather than treating the bank’s commercial loan portfolio as one population, examiners might identify three separate populations, such as commercial real estate, agriculture, and asset-based loans.

Statistical sampling is typically used for high-volume portfolio or segment reviews that are inherent to retail or small business lending. Statistical sampling helps examiners conclude on the quantity of credit risk in the broader portfolio or targeted segment under review. For the purposes of loan sampling, a “population” as defined in the “Sampling Methodologies” booklet does not mean the bank’s entire loan portfolio. The “Sampling Methodologies” booklet explains how populations can be more narrowly focused. Statistical sampling can be used to analyze particular credit characteristics (e.g., credit scores, credit lines, utilization, or delinquency) for a particular product and vintage (e.g., all branded credit card originations during a 12-month period). A statistically valid sample varies based on the number of loans in a portfolio or segment, the confidence level chosen and the acceptable margin of error rate. Items for a statistical sample must be selected randomly and must *not* be selected using examiner judgment.

The “[Sampling Methodologies](#)” booklet of the *Comptroller’s Handbook* includes several lending-related examples in the “Statistical Sampling” section as well as a statistical sampling job aid.

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<sup>43</sup> Footnote 13 in the “Sampling Methodologies” booklet of the *Comptroller’s Handbook* states, “Examiners should confirm that the scope and objectives for activities with sampling have considered information from an OCC operating plan, internal OCC procedures, and directives from OCC senior management, as applicable.”

## Appendix E: Assessing Credit Underwriting

This appendix supplements the introductory information in the “[Credit Underwriting Reviews](#)” and “[Credit Underwriting](#)” sections of this booklet.

### Scope of Credit Underwriting Reviews

The “[Bank Supervision Process](#)” booklet of the *Comptroller’s Handbook* states, “the OCC employs an ongoing risk-based supervision approach focused on evaluating risk, identifying material and emerging concerns, and requiring banks to take timely corrective action before deficiencies compromise their safety and soundness.” Consistent with this approach, credit underwriting reviews should be tailored to the associated risks and quality of risk management. In general, for areas of low risk with minimal or no changes, credit underwriting reviews should focus on the work necessary to draw conclusions under the core assessment and RAS.

The “Bank Supervision Process” booklet of the *Comptroller’s Handbook* also indicates that examiners should conduct periodic baseline transaction testing to validate key control functions and systems even for areas that are low risk, but the booklet does not prescribe a specific methodology or frequency for this testing. The “Assessing Underwriting Policies,” “Assessing Underwriting Practices,” and “Loan-Level Transaction Testing” sections of this appendix provide more information on periodic testing.

Examiners should consider the following when determining whether review beyond the core assessment is necessary and when developing the scope and depth of credit underwriting reviews:

- Prior underwriting, asset quality, and credit RAS conclusions.
- Outstanding supervisory concerns related to credit underwriting.
- Loan growth and concentration trends.
- The volume and trend of new originations, including refinance activity.<sup>44</sup>
- The nature and extent of new, modified, or expanded loan products or services, including those offered through third-party relationships.<sup>45</sup>
- New acquisition channels or entry into new markets.
- The volume, composition, trend, and performance of underwriting exceptions and overrides.
- Findings from quality control, quality assurance, credit risk review, and internal audit functions, as long as these functions are reliable. Examiners should also consider the

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<sup>44</sup> Loan origination reports can help examiners isolate the volume of new underwriting in low-growth periods. Banks experiencing a significant volume of refinance activity could reflect low growth metrics on the call report and UBPR but still have a high origination volume.

<sup>45</sup> For more information about risks associated with new activities and third-party relationships, refer to OCC Bulletin 2017-43, “[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#),” and OCC Bulletin 2023-17, “[Third-Party Relationships: Interagency Guidance on Risk Management](#).”

extent of changes to these functions and whether management implements corrective actions in a timely manner.

- Actual or planned changes in
  - the bank’s lending strategy or credit risk appetite.
  - underwriting policies or practices.
  - lending staff.
  - governance and oversight of credit underwriting (e.g., loan committee).
- Changes in the banking industry and competitive landscape (e.g., industry-wide loosening or tightening of underwriting standards).
- The level of automation in credit underwriting and types of models used.
- Staff expertise in relation to the bank’s lending activities.

## Assessing Underwriting Policies

Evaluating banks’ credit underwriting policies and changes to these policies is part of the core assessment and is an important consideration when determining the scope of credit underwriting reviews. Assessing a bank’s credit underwriting standards as documented in the bank’s lending policies provides examiners with an understanding of the bank’s expected credit underwriting practices and credit risk appetite. Lending policies are the primary means by which senior management and the board guide lending activities. Lending policies provide a framework for achieving asset quality and earnings objectives, operating within risk tolerance levels, and conducting lending activities in a manner that is consistent with the bank’s strategic direction and risk appetite and in compliance with laws and regulations.

Examiners should consider the following when reviewing credit underwriting policies:

- How underwriting policies and criteria have changed since the prior supervisory cycle or examination along with
  - reasons for the changes.
  - potential effects of the changes on underwriting and credit risk exposure.
- Whether the appropriate parties reviewed and approved underwriting policy changes.
- Whether underwriting policies are commensurate with the bank’s credit risk appetite and product offerings.
- Whether underwriting criteria reflect conservative, moderate, or liberal underwriting in relation to safe and sound banking practices.
- The reasonableness of definitions that guide credit policy, underwriting, and documentation exceptions.
- The reasonableness of guidelines for approving and reporting exceptions and overrides.
- Whether underwriting criteria reflect differences in risk between acquisition channels (e.g., direct, through third parties such as fintech partners, mobile, internet, direct mail).
- The extent to which underwriter authorities and accountabilities are defined, in line with skills, and commensurate with risks associated with loan characteristics.
- The reasonableness of compensation policies and whether policies appropriately balance risk and reward.

- Whether policies provide appropriate standards for the use of credit scoring models.
- Whether policies address applicable laws and regulations.

Examiners may use the job aids in appendixes F, “[Commercial Credit Underwriting Assessment Job Aid](#),” and G, “[Retail Credit Underwriting Assessment Job Aid](#),” when assessing a bank’s credit underwriting policies.

## Assessing Underwriting Practices

Examiners should periodically assess the consistency of a bank’s credit underwriting practices with policy parameters. Examiners may leverage bank reports (e.g., underwriting or exception reports), rely on credit risk review and audit results,<sup>46</sup> or analyze bank-provided data when this information is available and reliable. Testing can validate the adequacy of risk management practices, reliability of bank reporting, and effectiveness of credit risk review and internal audit. The following are considerations for assessing the consistency of a bank’s credit underwriting practices with policy parameters:

- The nature and extent of deviations from the bank’s credit underwriting policies and sound underwriting practices.
- Whether credit underwriting exceptions and overrides are appropriately captured in bank reporting.
- The volume, composition, trend, and performance of loans with credit underwriting exceptions and overrides.
- Trends in loan origination metrics (e.g., DSCR, FCC, credit scores, DTI, PTI, and LTV) and the extent of risk layering.<sup>47</sup>
- For automated underwriting, changes in the bank’s scoring models and adequacy of model risk management practices.<sup>48</sup>

Examiners should assess the bank’s underwriting in relation to safe and sound banking practices. Easing underwriting standards can reflect changing market conditions. Increasingly liberal underwriting can be a response to increased competition among banks for loans or an increase in risk appetite. If the bank is underwriting similarly to other entities (e.g., other banks, nonbanks, government-sponsored enterprises) for competitive reasons, it does not inherently mean the bank’s underwriting practices are moderate.

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<sup>46</sup> For more information about assessing the adequacy of credit risk review and internal audit, refer to the “[Independent Credit Risk Review](#)” section of this booklet, OCC Bulletin 2020-50, “[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#),” the “[Internal and External Audit](#)” section of this booklet, and the “[Internal and External Audits](#)” booklet of the *Comptroller’s Handbook*.

<sup>47</sup> Refer to the “[Risk Layering](#)” section of this booklet for information about risk layering.

<sup>48</sup> Models used for credit underwriting and decisioning should be subject to sound model risk management. Refer to OCC Bulletin 2026-13, “[Model Risk Management: Revised Guidance](#),” for more information about model risk management. For community banks, refer also to OCC Bulletin 2025-26, “[Model Risk Management: Clarification for Community Banks](#).”

Booklets in the “Asset Quality” category of the *Comptroller’s Handbook’s Safety and Soundness* series provide comprehensive information related to credit underwriting for specific types of loans. Examiners may use the job aids in appendixes [F](#) and [G](#) of this booklet as a tool when assessing commercial and retail credit underwriting practices, respectively.

## Portfolio-Level Analysis

When available, loan portfolio reporting and metrics can provide examiners with valuable information on the quality of underwriting and underwriting trends. For retail lending, data downloads of credit underwriting attributes can be sorted and analyzed to quantify credit underwriting risks often more efficiently than loan-level transaction testing. The following are examples of sources examiners can use when conducting portfolio analysis: loan trial balance, loan committee packages, concentration reporting, loan pipeline reporting, loan origination reporting, lending policy exception and override reporting, and credit risk review reports. Examples of key metrics for retail credit portfolios include credit bureau and other scores,<sup>49</sup> DTI, PTI, and LTV ratios. Examples of metrics for commercial portfolios include DSCR, LTV, FCC, leverage ratios, and weighted average risk ratings.

## Loan-Level Transaction Testing

Transaction testing should be tailored to the purpose of the review. Testing does not necessarily entail comprehensive loan-level transaction testing in every case. For example, examiners may use transaction testing to verify the accuracy of bank reports, validate the results of credit risk reviews, or form conclusions about underwriting when bank sources are not reliable. [Appendix D](#) of this booklet, the “Sampling Methodologies” booklet of the *Comptroller’s Handbook*, and product-specific booklets in the “Asset Quality” category of the *Safety and Soundness* series of the *Comptroller’s Handbook* provide more information about selecting samples for transaction testing. The “Sampling Methodologies” booklet provides examiner guidance on judgmental and statistical sampling.

Examiners may use the job aids in appendixes [F](#) and [G](#) of this booklet when transaction testing commercial or retail credit underwriting, respectively. The job aids focus on examples of criteria that are generally most material in assessing whether underwriting of a particular loan or portfolio is conservative, moderate, or liberal.

The following are items that, in addition to the criteria in appendixes F and G, examiners should consider when conducting transaction testing of underwriting. Weaknesses these areas could be indicative of risk management or internal control concerns.

**Compliance with lending policies:** Examiners should assess the extent to which new loans are underwritten within the parameters of the bank’s lending policies and should determine whether exceptions to policy were appropriately identified and approved. For retail loans, examiners should consider score overrides and whether the bank identifies, tracks, and

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<sup>49</sup> Refer to the [“Retail Lending,”](#) [“Installment Lending,”](#) [“Credit Card Lending,”](#) and [“Residential Real Estate Lending”](#) booklets of the *Comptroller’s Handbook* for more information about credit bureau and other scores.

reports high-side (i.e., denials above cutoff) and low-side (i.e., approvals below cutoff) overrides. Examiners should expect to see exceptions clearly identified in the loan approval documentation along with mitigants that justify the decision to approve the loan.

Underwriting that is consistent with a bank's policies does not automatically equate to moderate credit underwriting. It is important for examiners to understand whether the bank's policy standards reflect conservative, moderate, or liberal underwriting. For example, a loan with no exceptions to a conservative lending policy would generally be assessed as conservative underwriting.

**Approval package:** Examiners should consider the quality of the loan approval package and determine whether the approval package or approval processes

- provide credit decision makers with a thorough analysis of the borrowers' and guarantors' sources of repayment.
- include information about previous and related transactions and performance, if applicable.
- contain a comprehensive analysis of key credit risks and mitigating factors.
- provide appropriate support for the credit approval, risk rating, and accrual treatment.

**Loan pricing:** Pricing provides the bank with a return, risk premium, and margin to cover the cost of funds. Individual credits and portfolio segments should be priced to provide reasonable returns commensurate with the risks taken while maintaining adequate capital and allowance levels. Pricing may be adjusted for other criteria, such as having a borrower with strong and sustainable performance; having rapid amortization, low LTV ratios, or low advance rates; and having a borrower with an existing relationship with the bank or who can access capital markets to obtain funds at reasonable rates. Nevertheless, receiving a high yield on a loan with otherwise liberal underwriting is generally not a sufficient mitigating factor to result in a conclusion of moderate underwriting practices for that credit (i.e., the expectation is for the bank to be compensated for the higher level of risk taken rather than the pricing serving as a mitigant).

**Stress testing and projections:** Stress testing at underwriting is a risk management tool that provides benefits to the bank regardless of the sophistication of stress testing methods. Examiners should consider the reasonableness of assumptions and projections.

**Conditions of closing, documentation exceptions, and proper lien perfection:** Examiners should consider whether conditions of closing were satisfied, documentation exceptions are resolved in a timely manner, and liens are properly perfected. A bank's failure to take these actions could indicate potential internal control or risk management weaknesses.

## Addressing Liberal Underwriting Practices

The existence of limited or infrequent liberal underwriting would generally not be a supervisory concern. Examiners should consider all relevant facts and circumstances when

determining the extent of concern posed by liberal underwriting practices. The following are examples of factors examiners should consider:

- The significance of liberal underwriting practices (e.g., the volume compared with the bank’s loan portfolio, portfolio segment, strategic plan, or capital position)
- The potential effect on the bank’s safety and soundness and risk profile, with heightened emphasis on material financial risks
- Whether the bank has appropriate processes to identify, measure, monitor, and control associated risks

## Report of Examination and Supervisory Letter Considerations

Examiners should be familiar with the structural weakness elements in the “[Rating Credit Risk](#)” booklet of the *Comptroller’s Handbook*. A summary of structural weakness elements is provided in the “[Structural Weaknesses](#)” section of this booklet.

Examiners should consider using the “Credit Underwriting Weaknesses” section of the ROE or supervisory letters when there are weaknesses in a bank’s credit underwriting or credit administration practices that warrant communication to bank management or the board. The underwriting and credit administration weaknesses table in the “Credit Underwriting Weaknesses” ROE section is a useful tool to concisely highlight for bank management and the board the severity and extent of weaknesses identified by the OCC. Refer to the “Bank Supervision Process” booklet of the *Comptroller’s Handbook* for more information about the “Credit Underwriting Weaknesses” section of the ROE. Examiners may also use this presentation format in supervisory letters.

## Appendix F: Commercial Credit Underwriting Assessment Job Aid

This job aid provides examiners with examples of information to consider when assessing credit underwriting for individual loans or portfolios. Examiners may also use this job aid when assessing a bank's policies.

Each loan and loan portfolio has unique characteristics. Not every criterion is applicable to every loan or portfolio. Additionally, one criterion alone should not unduly influence the overall conclusion. Examiners should use sound judgment when reaching credit underwriting conclusions and consider the aggregate effects of criteria, as appropriate. For example, a single loan with liberal underwriting would generally not be as significant as an entire portfolio with liberal underwriting.

Commercial credit underwriting assessments focus on three broad categories:

- **Structure and sources of repayment:** This category addresses the loan's structure and repayment terms, adequacy of repayment sources, and guarantor support.
- **Collateral:** This category addresses the type of collateral, LTV ratios and advance rates, and adequacy of the collateral valuation.
- **Controls:** This category addresses controls that are included in the loan documents. Specifically, this category focuses on financial reporting requirements, collateral inspection opportunities, and covenants. Credit administration weaknesses, such as the failure to analyze borrower-provided information in a timely manner, are not considered in credit underwriting conclusions. Rather, examiners should consider those as part of credit administration.

### Commercial Credit Structure and Sources of Repayment

Criteria	Conservative	Moderate	Liberal
<b>Purpose and sources of repayment</b>	<p>Loan purpose is clearly consistent with the primary source of repayment.</p> <p>Primary source of repayment is strong and sustainable.</p> <p>Stress testing results reflect an ample margin should any deterioration occur, or mitigants exist to offset potential deterioration.</p>	<p>Loan purpose is generally consistent with the primary source of repayment.</p> <p>Primary source of repayment is adequate.</p> <p>Appropriately mitigated structural weaknesses related to sources of repayment may be present.</p> <p>Stress testing results reflect a reasonable margin should any deterioration occur, or mitigants exist to offset potential deterioration.</p>	<p>Loan purpose is inconsistent with the primary source of repayment.</p> <p>Primary source of repayment is marginal.</p> <p>Structural weaknesses related to sources of repayment are not appropriately mitigated.</p> <p>Stress testing results do not reflect a reasonable margin should any deterioration occur, or no mitigants exist to offset potential deterioration.</p>

Criteria	Conservative	Moderate	Liberal
<b>Tenor and amortization</b>	<p>Tenor is short compared with the loan purpose. Tenor provides the bank with ample opportunities to manage the credit at renewal or maturity to address existing or emerging risks.</p> <p>Amortization period is short relative to the loan type, purpose, and collateral.</p>	<p>Tenor is appropriate for the loan purpose. Tenor provides the bank with adequate opportunities to manage the credit at renewal or maturity to address existing or emerging risks.</p> <p>Repayment terms are consistent with a normal repayment schedule for the loan type, purpose, and collateral. Long amortization or interest-only periods are mitigated by conservative LTV ratios, advance rates, or other criteria.</p>	<p>Tenor is long and may not support the loan purpose. Tenor does not provide the bank with adequate opportunities to manage the credit at renewal or maturity to address existing or emerging risks.</p> <p>Repayment terms provide for slower repayment than sound lending standards when considering the loan type, purpose, and any collateral. Repayment terms may provide for extended amortization or interest-only payments without strong mitigants.</p>
<b>Guarantee</b>	Guarantee provides substantial support.	Guarantee provides adequate support.	Guarantee provides inadequate support.

## Commercial Credit Collateral

Criteria	Conservative	Moderate	Liberal
<b>Type</b>	Collateral is clearly consistent with the loan purpose.	Collateral is somewhat commensurate with the loan purpose.	Collateral is inconsistent with the loan purpose, or the loan is unsecured, without appropriate support or mitigants.
<b>Coverage</b>	Low LTV, low advance rates, or high collateral coverage provide strong support and ample capacity to withstand significant deterioration in performance, economic conditions, or the competitive environment.	Acceptable LTV, advance rates, or collateral coverage provide adequate support and capacity to withstand moderate deterioration in performance, economic conditions, or the competitive environment.	High LTV, high advance rates, or low collateral coverage provide inadequate support and capacity to withstand modest deterioration in performance, economic conditions, or the competitive environment. Examples include a secondary lien with an elevated combined LTV or an assignment of equity that cannot be readily liquidated in the normal course of business.
<b>Valuation</b>	Collateral valuation(s) are independent and thoroughly documented and supported (includes appraisal/evaluation reviews).	Collateral valuation(s) are independent and adequately documented and supported (includes appraisal/evaluation reviews).	Collateral valuation(s) are not independent or are inadequately documented and supported (includes appraisal/evaluation reviews). Collateral valuation(s) may be of questionable quality, inflated or stale, or performed by an unqualified party.

## Commercial Credit Controls

<b>Criteria</b>	<b>Conservative</b>	<b>Moderate</b>	<b>Liberal</b>
<b>Reporting and monitoring requirements</b>	Several requirements exist that provide the lender with multiple opportunities to closely monitor the credit or portfolio and support strong underwriting decisions. Examples include regularly required borrower certificates of compliance, financial statements, borrowing base certificates, and the bank's right to conduct regular collateral inspections.	Some requirements exist that provide the lender with occasional opportunities to monitor the credit or portfolio and make informed underwriting decisions. Examples include periodically receiving borrower certificates of compliance, financial statements, and borrowing base certificates as well as the right to conduct periodic collateral inspections.	Very few requirements exist that provide the lender with opportunities to monitor the credit or portfolio. Examples include infrequent borrower certificates of compliance, financial statements, borrowing base certificates, and collateral inspections.
<b>Financial covenants</b>	Financial covenants are strong, well established, and within acceptable parameters to manage risks. Covenants allow the bank to renegotiate loan terms to reflect emerging weaknesses in a timely manner before credit deterioration.	Financial covenants are adequate and generally well established but may lead to heightened risk exposure. Covenants permit the bank to renegotiate loan terms to reflect emerging weaknesses before significant credit deterioration.	Financial covenants are inadequate, inappropriately established, or nonexistent, and may permit significant deterioration in borrower performance or collateral position before a covenant violation or an event of default is triggered. Covenants do not allow the bank to renegotiate loan terms to reflect emerging weaknesses in a timely manner.

## Appendix G: Retail Credit Underwriting Assessment Job Aid

This job aid provides examiners with examples of information to consider when assessing credit underwriting for individual loans or portfolios. Examiners may also use this job aid when assessing a bank's policies.

Each loan and loan portfolio has unique characteristics. Not every criterion is applicable to every loan or portfolio. Additionally, one criterion alone should not unduly influence the overall conclusion. Examiners should use sound judgment when reaching credit underwriting conclusions and consider the aggregate effects of criteria, as appropriate. For example, a single loan with liberal underwriting would generally not be as significant as an entire portfolio with liberal underwriting.

The homogenous nature of retail loans lends itself well to portfolio assessments and statistical sampling methodologies. Examiners may use statistical or judgmental sampling for retail loan portfolio reviews. Statistical sampling allows examiners to use a sample's results to make inferences about the population under review. Items for a statistical sample must be selected randomly. Judgmental sampling is not statistically based. Examiners may use information from judgmental sampling to inform supervisory activity conclusions, but they cannot make an inference about the entire population. For more information about statistical and judgmental sampling, refer to the "[Sampling Methodologies](#)" booklet of the *Comptroller's Handbook*.

This job aid is not designed for assessments of compliance with consumer protection-related laws and regulations. Examiners should be alert to practices that could present violations of consumer protection-related laws and regulations and discuss these practices with examiners reviewing consumer compliance. Refer to booklets in the *Consumer Compliance* series of the *Comptroller's Handbook* for more information about consumer protection-related laws and regulations.

Retail credit underwriting assessments focus on two broad categories:

- **Structure and sources of repayment:** This category addresses the loan's structure, repayment terms, and adequacy of repayment sources.
- **Collateral:** This category addresses the type of collateral, LTV ratios and advance rates, and adequacy of the collateral valuation.

Some items are core to retail lending and should weigh heavily in examiners' assessments:

- **Credit bureau, application, or custom scores,**<sup>50</sup> which represent a borrower's probability of default, with higher scores typically considered more conservative.

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<sup>50</sup> Application or custom scores are bank-generated scores from proprietary models used in conjunction with credit bureau scores to decision loans. The bank determines whether a low or high application score is better. Refer to the "[Retail Lending](#)," "[Installment Lending](#)," "[Credit Card Lending](#)," and "[Residential Real Estate Lending](#)" booklets of the *Comptroller's Handbook* for more information.

- **Ability to repay and DTI calculations**, which quantify the affordability of the new loans based on disposable or available funds. Low DTI ratios and well-established limits for DTI are considered conservative, as is the practice of verifying income, which strengthens the accuracy of DTI calculations.
- **Collateral valuation and LTV calculations**, which establish support for the loan amount and provide security in case of default. Consistent collateral valuation processes with strong control and review functions are more conservative. Accurate LTV calculations consider all fees, add-on products, and other expenses.

## Retail Credit Structure and Sources of Repayment

Criteria	Conservative	Moderate	Liberal
<b>Purpose</b>	Loan purpose is clearly defined and matches a product offering.	Loan purpose is reasonably clear and seems to match a product offering.	Loan purpose is inadequately defined and may not appropriately match a product offering.
<b>Loan amount or line assignment</b>	Loan amounts or line assignments are well supported by credit scores, income, ability to repay, and collateral. Loan amounts or line assignments are consistently related to borrower affordability and probability for successful repayment.	Loan amounts or line assignments are reasonably supported by credit scores, income, ability to repay, and collateral. Loan amounts or line assignments are reasonably related to borrower affordability and probability for successful repayment.	Loan amounts or line assignments are not supported by credit scores, income, ability to repay, or collateral. Loan amounts or line assignments are inconsistent with borrower affordability and probability of successful repayment.
<b>Score cutoffs (credit bureau and other scores, as applicable)</b>	Score cutoffs are well developed and are based on periodic analyses of anticipated approval rates and bad loan rates. Analyses are updated periodically. Cutoffs reflect a low probability of default or credit scores at the high end of the credit spectrum (generally referred to as super prime).  Joint applicant scores are used to help mitigate the risk of the primary applicant but not substituted for the primary applicant, and both applicants must have a score above the cutoff.	Score cutoffs are based on an initial analysis of anticipated approval rates and bad loan rates. Analysis is not updated periodically. Cutoffs reflect a moderate probability of default or credit scores in the middle range of the credit spectrum (generally referred to as prime or near prime).  Joint applicant scores are considered and may be used in lieu of a lower cutoff score from the primary applicant for approval of a transaction.	Score cutoffs are not based on an appropriate analysis of anticipated approval rates and bad loan rates. Cutoffs reflect a high probability of default or credit scores at the low end of the credit spectrum (generally referred to as nonprime or subprime).  Joint applicant scores are always used if it is the higher score and above the cutoff regardless of the primary applicant's score.

<b>Criteria</b>	<b>Conservative</b>	<b>Moderate</b>	<b>Liberal</b>
<b>Repayment terms and ability to repay</b>	<p>Repayment terms are appropriately related to purpose and emphasize amortization.</p> <p>Repayment terms are sufficient for the borrower to demonstrate a strong ongoing capacity to repay the full loan balance over the stated loan term. Rarely use interest-only structures or deferral periods.</p> <p>Ability-to-repay evaluation is robust and assesses housing expenses and other obligations,<sup>51</sup> if necessary, to determine a DTI ratio or monthly net disposable income amount after payment of obligations.</p> <p>Co-signers or co-borrowers are used to help mitigate the risk of the primary applicant but are not substituted for the primary applicant.</p>	<p>Repayment terms are reasonably related to purpose and typically emphasize amortization.</p> <p>Repayment terms are adequate for the borrower to demonstrate an ongoing capacity to repay the full loan balance over the stated term. Occasionally use interest-only structures or deferral periods.</p> <p>Ability-to-repay evaluation is satisfactory and includes at least all reported obligations to determine a DTI ratio, PTI ratio, or monthly net disposable income amount after payment of obligations.</p> <p>There may be some reliance on support provided by co-signers or co-borrowers.</p>	<p>Repayment terms may be unrelated to purpose or do not emphasize amortization.</p> <p>Repayment terms are typically inadequate for the borrower to demonstrate an ongoing capacity to repay the full loan balance over the stated term. Frequently use interest-only structures or deferral periods.</p> <p>Ability-to-repay evaluation is marginal and includes most reported obligations to determine a DTI ratio or only a PTI ratio.</p> <p>Credit approval materially relies on support from a co-signer or co-borrower.</p>
<b>Income verification</b>	Income information is obtained from verifiable and documented sources.	Income information is stated and may be tested for reasonableness or verified and documented.	Income information is stated and typically not evaluated for reasonableness or otherwise verified or documented.
<b>Liquid reserves</b>  (For residential real estate-secured or other large long-term loans)	Reserves are sufficient to continue servicing loan payments over an intermediate or longer time frame should the borrower face financial hardship.	Reserves are sufficient to continue servicing loan payments over a short time frame should the borrower face financial hardship.	Reserves may not be sufficient for continued debt service should the borrower face financial hardship.
<b>Ancillary products and fees</b>	Ancillary products and fees are not present or are minimal in amount(s), reflect full awareness of potential fair lending issues, and are consistently monitored through internal controls and periodic compliance audits.	Ancillary products and fees are present and are material in amount(s), reflect an awareness of potential fair lending issues, and are subjected to periodic compliance audits.	Ancillary products and fees are present and are significant in amount(s) in relation to total loan amount. The use of ancillary products and fees does not reflect an awareness of potential fair lending issues and/or is not subjected to periodic compliance audits.

<sup>51</sup> “Obligations” include loans with no current payments required (such as student loans in deferment) or open lines of credit with low utilization at origination.

## Retail Credit Collateral

<b>Criteria</b>	<b>Conservative</b>	<b>Moderate</b>	<b>Liberal</b>
<b>Type</b>	Collateral is clearly consistent with the loan purpose.	Collateral is somewhat commensurate with the loan purpose.	Collateral is inconsistent with the loan purpose, or the loan is unsecured, without appropriate support or mitigants.
<b>Valuation</b>	Collateral valuation(s) are independent and thoroughly documented and supported (includes appraisal/evaluation reviews).	Collateral valuation(s) are independent and adequately documented and supported (includes appraisal/evaluation reviews).	Collateral valuation(s) are not independent or are inadequately documented and supported (includes appraisal/evaluation reviews). Collateral valuations may be of questionable quality, inflated or stale, or performed by an unqualified party.
<b>Coverage</b>	Low LTV, low advance rates, or high collateral coverage provide strong support and ample capacity to withstand significant deterioration in performance, economic conditions, or the competitive environment.	Acceptable LTV, advance rates, or collateral coverage provide adequate support and capacity to withstand moderate deterioration in performance, economic conditions, or the competitive environment.	High LTV, high advance rates, or low collateral coverage provide inadequate support and capacity to withstand modest deterioration in performance, economic conditions, or the competitive environment.

## Appendix H: Loan Purchase Review Job Aid

Examiners may use this job aid when assessing a bank's due diligence for purchased loan(s). This job aid is designed to be used as a guide and is not a checklist of requirements. There are many ways banks may conduct elements of due diligence. As such, examiners should consider all relevant facts and circumstances when drawing conclusions about a bank's risk management of loan purchase activities.

**Bank:**

**Charter number:**

**Borrower:**

**Loan number:**

**Examiner:**

Question	Y/N/NA	Comments (as applicable)
1. Are the nature and extent of due diligence consistent with the transaction's complexity?	[y/n/na]	[comment as applicable]
2. Are the nature and extent of due diligence consistent with the transaction's size relative to the bank's existing loan portfolio, concentrations, and capital levels?	[y/n/na]	[comment as applicable]
3. Are the nature and extent of due diligence consistent with the level of experience the bank's personnel have with the type of loan purchased?	[y/n/na]	[comment as applicable]
4. Does due diligence include credit analysis independent of the seller that includes assessing whether the loan meets the bank's underwriting standards or other policy criteria?	[y/n/na]	[comment as applicable]
5. Does due diligence include assessing the quality of the collateral and the appropriateness of collateral valuation methods?	[y/n/na]	[comment as applicable]
6. Does due diligence include analyzing the purchasing bank's history with the seller and the seller's experience with the lending product and financial capacity?	[y/n/na]	[comment as applicable]
7. Does due diligence include risk assessment of all applicable risks?	[y/n/na]	[comment as applicable]
8. Does due diligence include thorough assessment and legal review of the purchase contract, including recourse and risk-sharing arrangements, loan administration, and collateral controls?	[y/n/na]	[comment as applicable]
9. Does due diligence include assessing accounting implications, such as sales treatment and allowances for credit losses?	[y/n/na]	[comment as applicable]

Question	Y/N/NA	Comments (as applicable)
10. Does due diligence include an analysis to determine compliance with the applicability of the legal lending limit for loans purchased from a single seller? (Refer to OCC Bulletin 2023-27, " <a href="#">Loan Purchase Activities: Legal Lending Limit Guidance</a> ," for more information.)	[y/n/na]	[comment as applicable]
11. For loans purchased with recourse, does due diligence include assessing the seller's ability to meet recourse and repurchase obligation?	[y/n/na]	[comment as applicable]

## Appendix I: Examples of Lending-Related Laws and Regulations

This appendix lists examples of commonly applicable lending-related laws and regulations.

- 12 CFR 22, “Loans in Areas Having Special Flood Hazards”
- 12 CFR 30, appendix A, “Interagency Guidelines for Establishing Standards for Safety and Soundness”
- 12 CFR 32, “Lending Limits”
- 12 CFR 34, subpart C, “Appraisals”
- 12 CFR 34, subpart D, “Real Estate Lending Standards” (national banks)
- 12 CFR 160.100-101, “Real Estate Lending Standards” (FSAs)
- 12 CFR 215, “Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation O)”
- 12 CFR 221, “Credit by Banks and Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock (Regulation U)”
- 12 CFR 223, “Transactions Between Member Banks and Their Affiliates (Regulation W)”
- 12 CFR 1002, “Equal Credit Opportunity Act (Regulation B)”
- 12 CFR 1006, “Debt Collection Practices (Regulation F)”
- 12 CFR 1022, “Fair Credit Reporting (Regulation V)”
- 12 CFR 1026, “Truth in Lending (Regulation Z)”
- 12 USC 1464(c), “Loans and Investments” (FSAs)
- 32 CFR 232, “Limitations on Terms of Consumer Credit Extended to Service Members and Dependents” (implements the Military Lending Act)
- 42 USC 3601 et seq., “Fair Housing Act”
- 50 USC 3901 et seq., “Servicemembers Civil Relief Act”
- Laws prohibiting unfair, deceptive, or abusive acts or practices<sup>52</sup>
- Laws and regulations governing the maximum interest on loans. Refer to [appendix J](#) of this booklet for more information.
- Anti-tying laws (12 USC 1972(1) (national banks) and 12 USC 1464(q) (FSAs))

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<sup>52</sup> Section 5 of the Federal Trade Commission Act, 15 USC 45(a)(1), prohibits unfair or deceptive acts or practices (UDAP) in or affecting commerce. Sections 1031 and 1036 of the Dodd–Frank Wall Street Reform and Consumer Protection Act prohibit unfair, deceptive, or abusive acts or practices (UDAAP). For more information, refer to the “[Unfair or Deceptive Acts or Practices and Unfair, Deceptive, or Abusive Acts or Practices](#)” booklet of the *Comptroller’s Handbook*.

## Appendix J: Interest on Loans

12 USC 85 (national banks) and 12 USC 1463(g) (FSAs) and their implementing regulations, 12 CFR 7.4001 (national banks) and 12 CFR 160.110 (FSAs), generally govern the maximum rate of interest that banks may charge on loans.<sup>53</sup> National banks or FSAs that charge a higher rate may trigger the penalties for usury described in 12 USC 86 (national banks) and 12 USC 1463(g)(2) (FSAs). Other laws and regulations, such as 12 USC 1735f-7a and 12 CFR 190, may also be relevant to determining the interest a national bank or FSA may charge on certain loans.

### Definitions for 12 CFR 7.4001 (National Banks) and 12 CFR 160.110 (FSAs)

**Interest:** Interest includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, certain not sufficient funds (NSF) fees, over limit fees, annual fees, cash advance fees, and membership fees.<sup>54</sup> The OCC has determined that certain other fees are included in interest, such as account opening fees and prepayment fees.<sup>55</sup>

The definition of interest for purposes of 12 CFR 7.4001 (national banks) and 12 CFR 160.110 (FSAs) does not change how interest is defined by the individual states (nor how the state definition of interest is used) solely for purposes of state law. For example, if late fees are not “interest” under state law where a bank is located but state law permits late fees, then a bank located in that state may charge late fees to its intrastate customers. The bank may also charge late fees to its interstate customers because the fees are interest under the federal definition of interest and an allowable charge under state law where the national bank is located. However, the late fees would not be treated as interest for purposes of evaluating compliance with state usury limitations because state law excludes late fees when calculating the maximum interest that lending institutions may charge under those limitations.<sup>56</sup>

**Located:** 12 CFR 7.4001 and 12 CFR 160.110 do not define “located.” In general, a bank is located in the state where its main or home office is located and in any state where it has a branch.<sup>57</sup>

<sup>53</sup> Congress modeled 12 USC 1463(g) on 12 USC 85 to place FSAs on equal footing with their national bank competitors. Therefore, 12 USC 1463(g) is generally interpreted coextensively with 12 USC 85.

<sup>54</sup> 12 CFR 7.4001(a) (national banks) and 12 CFR 160.110(a) (FSAs).

<sup>55</sup> Refer to OCC Interpretive Letters [803](#) and [744](#).

<sup>56</sup> 12 CFR 7.4001(c) (national banks) and 12 CFR 160.110(c) (FSAs).

<sup>57</sup> Refer to OCC Interpretive Letters [822](#) and [1171](#) (national banks) and Office of Thrift Supervision Letter P-2004-8 (FSAs) for additional information on the framework applicable to a bank located in more than one state.

## Maximum Interest Rates

A bank located in a state may charge the maximum rate of interest permitted by that state's law for any state-chartered or state-licensed lending institution. This is commonly referred to as "most favored lender" status. If state law permits different interest charges on a specified class of loans, the bank making such loans is subject only to the provisions of state law relating to that class of loans that are material to the determination of the permitted interest.<sup>58</sup> For example, when a state law allows finance companies to charge 20 percent on certain loans, but limits state banks to 16 percent, banks may charge 20 percent. However, the bank would be limited to charging the higher rate only on the same size and type of loans that finance companies are allowed to make. For example, if state law allowed 20 percent on the first \$500 on open-end credit accounts and 18 percent thereafter, a bank lending \$800 could charge no more than 20 percent for the first \$500 and no more than 18 percent on the remaining \$300.<sup>59</sup>

12 USC 85 (national banks) and 12 USC 1463(g)(1) (FSAs) also provide that banks may charge 1 percent more than the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district in which the bank is located. For example, if the discount rate is 7 percent, national banks may charge 8 percent, discounted in advance, without regard to state usury laws.<sup>60</sup>

## Exportation of Interest Rates

12 USC 85 (national banks) and 12 USC 1463(g) (FSAs) permit banks to charge interest rates as permitted by a state in which the bank is located, even when the borrower is located in a different state. This is referred to as interest rate exportation.

For example, banks frequently issue credit cards to consumers who live in a state other than where the bank is located. In these situations, a consumer living in a state that limits the applicable rate to 18 percent can be obligated to pay 24 percent if the bank is located in a state that permits such a rate.<sup>61</sup>

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<sup>58</sup> 12 CFR 7.4001(b) (national banks) and 12 CFR 160.110(b) (FSAs).

<sup>59</sup> 12 CFR 7.4001(d) also specifically clarifies that a national bank located in a state whose law denies the defense of usury to a corporate borrower may charge a corporate borrower any rate agreed upon.

<sup>60</sup> When no rate is set by the state (other than when state lenders may make loans without interest rate limitations as described above), a national bank may not charge more than 1 percent more than the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the district in which the bank is located, or 7 percent, whichever is greater. However, this law generally will not apply, because courts have found that this provision does not apply if the state law merely states that the parties can agree on the interest rate or when a state law providing a maximum interest rate is nonexistent.

<sup>61</sup> *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978).

In addition, when a bank sells, assigns, or otherwise transfers a loan, the interest permissible under 12 USC 85 (national banks) or 12 USC 1463(g) (FSAs) before the transfer continues to be permissible after the transfer.<sup>62</sup>

## Preemption of State Usury Laws

12 USC 1735f-7a and its implementing regulation, 12 CFR 190, preempt state laws expressly limiting the rate or amount of interest, discount points, finance charges, or other charges that may be imposed on any federally related loan made after March 31, 1980, and secured by a first lien on one of the following:

- Residential real property.
- Stock in a residential cooperative housing corporation when the loan is used to finance the acquisition of such stock.
- A residential manufactured home, provided that the loan contains the consumer safeguards required in 12 CFR 190.4.

For purposes of 12 CFR 190, in general, **federally related loans** include any loan<sup>63</sup>

- made by a lender whose deposits or accounts are insured by any agency of the federal government.
- made by any lender regulated by any agency of the federal government.
- made by any lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act.
- made in whole or in part by the Secretary of Housing and Urban Development; insured, guaranteed, supplemented, or assisted in any way by the Secretary or any officer or agency of the federal government, or made under or in connection with a housing or urban development program administered by the Secretary; or a housing or related program administered by any other such officer or agency.
- eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or made by any financial institution from which the loan could be purchased by the Federal Home Loan Mortgage Corporation.
- made in whole or in part by any entity that
  - regularly extends, or arranges for the extension of, credit payable by agreement in more than four installments or for which the payment of a finance charge is or may be required; and
  - makes or invests in residential real property loans, including loans secured by first liens on residential manufactured homes that aggregate more than \$1,000,000 per year; except that the latter requirement shall not apply to such an entity selling residential manufactured homes and providing financing for such sales through loans or credit sales secured by first liens on residential manufactured homes, if the entity

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<sup>62</sup> 12 CFR 7.4001(e) (national banks) and 12 CFR 160.110(d) (FSAs).

<sup>63</sup> 12 CFR 190.2(b).

has an arrangement to sell such loans or credit sales in whole or in part, or where such loans or credit sales are sold in whole or in part, to a lender or other institution otherwise included in 12 CFR 190.2.

Based on these criteria, all loans made by OCC-supervised banks are federally related loans.

Under 12 USC 1735f-7a, states were generally given a limited window to opt out of the preemption under this section for covered loans made in that state, though states continue to have the ability to adopt limitations on discount points or such other charges. Any state opt-out may be relevant to banks seeking to rely on the preemption in 12 USC 1735f-7a. Nothing in 12 USC 1735f-7a or 12 CFR 190 preempts state laws limiting prepayment charges, attorneys' fees, late charges, or other provisions designed to protect borrowers.

12 USC 1735f-7 preempts state law limits on interest, discount points, or other charges that may be imposed on any loan, mortgage, or advance insured under subchapter I or II of the National Housing Act (under 12 USC 1702 through 1706f and 12 USC 1707 through 1715z-25). However, states may override this provision and impose limits on interest, discount points, or other charges on such insured loans. Any state opt-out could be relevant to banks seeking to rely on the preemption in 12 USC 1735f-7.

## Appendix K: Investment Limitations Under the Home Owners' Loan Act (FSAs)

This appendix is substantively similar to Office of Thrift Supervision Thrift Bulletin (TB) 78a, "Investment Limitations under the Home Owners' Loan Act." Certain information, such as law or regulation citations, references, and outdated information, was updated for purposes of this appendix. TB 78a was rescinded with publication of this booklet.

### Background

HOLA authorizes FSAs to make various types of loans and investments. It limits some types of loans and investments to a percentage of assets or capital. For example, FSAs may invest up to 20 percent of their assets in commercial loans, 400 percent of their capital in nonresidential real estate loans, 10 percent of their assets in leases secured by personal property, and 35 percent of their assets in consumer loans.<sup>64</sup>

When the OTS issued TB 78a, it indicated OTS received several questions from FSAs and examiners on exactly how flexible OTS would be in enforcing these statutory investment limitations and whether the FSA should use thrift-only<sup>65</sup> assets or consolidated assets when calculating the HOLA limits. While recognizing OTS's responsibility to enforce HOLA's investment limitations, OTS believed that, in passing various amendments to HOLA over the years, Congress had demonstrated its intent to provide thrifts with the flexibility to structure their portfolios in a way that will allow them to best serve their communities.

### HOLA Classifications

12 CFR 160.31 states that, "If a loan or other investment as authorized under more than one section of HOLA, as amended, or this part, the federal savings association may designate under which section the loan or investment has been made. Such a loan or investment may be apportioned among appropriate categories, and may be moved, in whole or in part, from one category to another." This rule highlights the flexibility that FSAs have in satisfying the HOLA investment limitations.

It should be noted that each authority under HOLA is separate and distinct. Therefore, investments of the same type that are made under one HOLA authority do not have to be aggregated with such investments made under other HOLA authorities.

It is management's responsibility to appropriately classify loans to determine that the savings association's loans and investments are within HOLA's limitations. Examiners will then

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<sup>64</sup> Refer to 12 CFR 160.30, "General lending and investment powers of federal savings associations," for a more complete listing.

<sup>65</sup> TB 78a defined "thrift-only" for purposes of that bulletin to include any operating subsidiaries of the savings association. Refer to 12 CFR 5.38(e)(4) for more information.

determine if the classification is appropriate given the regulatory and statutory requirements for such classification.

## Commercial Lending

FSA's are authorized to invest up to 20 percent of their assets in commercial loans, provided that amounts in excess of 10 percent of total assets may be used only for small business loans. FSA's may also invest up to 400 percent of their total capital in nonresidential real estate loans, which, by definition, include CRE loans. When an FSA makes a loan secured by commercial real estate, it may classify that loan as a commercial loan, as authorized under 12 USC 1464(c)(2)(A), or as a nonresidential real estate loan authorized under 12 USC 1464(c)(2)(B). The statutory requirement under the authority for a commercial loan is that the loan, whether secured or unsecured, be "for commercial, corporate, business, or agricultural purposes." Under the second authority, the only requirement is that the loan be "secured by a lien on nonresidential property." If an FSA makes a loan secured by CRE, either of the statutory requirements would be met, so the institution could select under which authority it made the loan. Conversely, if a commercial loan is made without real estate collateral, it can only be classified as a commercial loan, unless it also meets the requirements of another HOLA category.

## Leases

Under 12 CFR 160.41, FSA's are authorized to engage in leasing activities. The regulation permits two separate leasing activities, financing leases and general leases. Financing leases are the functional equivalent of loans and are authorized under an FSA's respective lending authorities under HOLA. For example, an FSA may make commercial and consumer leases, as it would make consumer and commercial loans. Such leases must be aggregated with the institution's commercial and consumer loans for purposes of determining compliance with HOLA's lending limits. General leases are allowed under a separate HOLA authority. A federal savings association may invest up to 10 percent of its assets in tangible personal property for purposes of rental or sale, including leasing. Leases made under this authority do not have to be the functional equivalent of loans and, since they are authorized under a separate authority, do not have to be aggregated with the FSA's loans for purposes of HOLA's investment limits. For example, when an FSA makes commercial leases on tangible commercial property, such leases do not have to be aggregated with its commercial loans. Similarly, when an FSA makes consumer leases, under its general leasing authority, such leases do not have to be aggregated with its consumer loans. Since the only restriction for general leases is that they must be leases on personal property (in contrast to real property), an FSA may structure a lease with similar terms as a full payout lease, and yet, still classify it as a general lease, which would not have to be aggregated with other similar loans. Refer to the "[Lease Financing](#)" booklet of the *Comptroller's Handbook* for more detailed discussion.

## Loans to Facilitate Consumer Lending

FSA's may also classify certain "commercial type" loans as consumer loans for purposes of HOLA's investment limitations if such loans are reasonably incidental to providing credit for

personal, family or household purposes. The OTS determined that floor plan loans are reasonably incidental to providing credit for consumer loans when an FSA grants floor plan loans to dealers to facilitate their consumer lending activities. Such floor plan loans may be classified as consumer loans for purposes of determining compliance with HOLA. Other commercial type loans may also be classified as consumer loans. For example, if a merchant obtains the line of credit from an FSA secured by the merchant's installment loans to its customers, the line of credit could be classified as a consumer loan for purposes of the HOLA investment limitations.

## Loans Secured By Real Estate

TB 78a also indicated that questions had also been asked regarding whether an FSA could classify a loan as a real estate loan if it were only partially secured by real estate. The answer to that depends on the level of security of the loan. 12 CFR 160.3 defines a real estate loan for purposes of HOLA investment classifications.

Therefore, to classify a loan as a real estate loan under HOLA, the loan would have to meet that definition. Home equity loans may also be classified as real estate loans or consumer loans for HOLA purposes; however, such loans are real estate loans for purposes of meeting the requirements of 12 CFR 160.100-101, "Real Estate Lending Standards," and appended interagency real estate lending guidelines in the appendix to 12 CFR 160.101.

## Underwriting

Allowing a loan to be classified under various categories for purposes of the HOLA limitations does not reduce the FSA's responsibility to underwrite the loan in a safe and sound manner<sup>66</sup> and ensure proper portfolio diversification.

## Questions and Answers

The following questions and answers address several related issues that arise when loans and investments may be assigned different categories for purposes of the HOLA investment limitations.

**Question:** When an institution classifies a loan for purposes of HOLA, must the classification carry through to other regulatory classifications?

**Answer:** No. Each regulation has its own requirements as to which loans are covered and what the consequences are. For example, if an FSA classifies a small business loan secured by real estate as a CRE loan for HOLA investment limitation purposes, that would not preclude the FSA from classifying it as a small business loan for QTL purposes, provided it meets both definitional requirements. Furthermore, accounting standards, call report categorization, and expected underwriting standards do not necessarily have to be the

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<sup>66</sup> 12 CFR 30, appendix A, II.C and II.D, address safety and soundness standards for loan documentation and credit underwriting.

determining factors for HOLA classification purposes. Refer to the “[Qualified Thrift Lender](#)” booklet of the *Comptroller’s Handbook* for more information about QTL compliance.

**Question:** If a loan is secured by CRE, but the FSA elects to treat it as a commercial loan for purposes of HOLA, does the loan have to have an appraisal?

**Answer:** Appraisals are governed by 12 CFR 34, subpart C, not HOLA. Loans secured by real estate must have an appraisal or evaluation when required by 12 CFR 34.43, depending on the size of a loan and whether an exception under the regulation applies. Refer to OCC Bulletin 2010-42, “[Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines](#),” for more information about real estate appraisals and evaluations.

**Question:** If a commercial loan is well secured by both nonresidential real estate and commercial property, and may be split into a real estate secured part and a commercial part for purposes of categorizing it under HOLA, could the loan be split into a real estate secured part and non-real estate secured part for purposes of the 12 CFR 160.100-101?

**Answer:** Yes; however, the guidelines under 12 CFR 160.100-101 still apply.

**Question:** If the same commercial loan is only 50 percent secured by real estate and 50 percent is unsecured, could the loan be split into a real estate secured part and an unsecured part for purposes of 12 CFR 160.100-101?

**Answer:** No. The entire loan is subject to 12 CFR 160.101, regardless of how the FSA categorizes it for purposes of HOLA.

## Appendix L: Internal Revenue Service Express Determination Letters

This appendix outlines the OCC’s process for issuing an express determination letter in connection with the Internal Revenue Service (IRS) regulations relating to bank-initiated charge-offs.

IRS regulations cover deductibility of loan charge-offs by banks for tax purposes. 26 CFR 1.166-2(d)(4)(i) generally defines the term “bank,” in part, as: (i) a bank or trust company incorporated and doing business under U.S. law, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks, and which is subject by law to supervision and examination by the OCC; and (ii) any corporation that would be a bank under (i) except for the fact that it is a foreign corporation, but the IRS regulation applies only with respect to loans where the interest is connected with banking business conducted in the United States. The term “bank” also generally includes federal savings associations.<sup>67</sup>

Under IRS regulations, banks may elect to align their tax accounting for bad debts with their regulatory accounting. Banks that make this election are automatically allowed to deduct charge-offs of loss assets for federal income tax purposes in the same year the charge-offs are taken for regulatory purposes.

IRS regulations require a bank to maintain and apply loan loss classification standards that are consistent with the standards established for loan charge-offs by its primary federal supervisory agency. If the bank meets these requirements, its loan charge-offs are conclusively presumed worthless for federal income tax purposes.<sup>68</sup>

### Election and Eligibility Requirements

To be eligible, a bank must file a conformity election with its federal tax return.<sup>69</sup> Additionally, in connection with its most recent examination involving the bank’s loan review process, the OCC must have made an express determination that the bank maintains and applies loan loss classification standards that are consistent with the OCC’s regulatory standards.<sup>70</sup>

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<sup>67</sup> Refer also to 26 USC 581.

<sup>68</sup> 26 CFR 1.166-2(d)(3).

<sup>69</sup> 26 CFR 1.166-2(d)(3)(iii)(C).

<sup>70</sup> 26 CFR 1.166-2(d)(3)(iii)(D).

## Process

Banks desiring an express determination letter are responsible for requesting an express determination letter during each examination that covers the loan review process.

The assistant deputy comptroller (ADC) or EIC<sup>71</sup> may issue an express determination letter similar to the sample included in this appendix, provided that the bank maintains and applies loan loss classification standards that are consistent with regulatory standards.

An express determination letter should be issued only when an examination covering the bank's loan review process is completed and when the OCC has concluded that it is appropriate to issue the express determination letter. Examiners should not alter the scope or frequency of supervisory activities merely to permit a bank to use the IRS regulation.

An examination is "completed" when the report of examination or supervisory letter has been finalized and provided to the bank. Additionally, "loan review" and "credit risk review" describe the same type of process. Terminology varies from bank to bank. Refer to the OCC Bulletin 2020-50, "[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#)," for more information about credit risk review systems.

An express determination letter should be issued only when both of the following criteria are met:

- The OCC has concluded, in connection with the most recent examination involving the bank's loan review process, that the bank maintains and applies loan loss classification standards that are consistent with OCC standards regarding the identification of losses and the charge-off of loans.
- There are no material deviations from the OCC's regulatory standards for loss classification and charge-offs.

Minor weaknesses in the bank's loan review process or immaterial deviations from the OCC's regulatory standards should not preclude issuance of an express determination letter. Refer to the "[Regulatory Loss Classification Standards](#)" section of this appendix for more information about the OCC's regulatory standards for loan loss classification.

An express determination letter should not be issued when any of the following are true:

- There are outstanding material concerns with the bank's loan review processes.
- Loan charge-offs are consistently overstated or understated on call reports.
- The bank has a pattern of failing to recognize loan charge-offs in the appropriate year.

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<sup>71</sup> For banks with an ADC in the organizational structure, the ADC may issue the express determination letter. For banks without an ADC in the organizational structure, the EIC may issue the express determination letter. For banks assigned to the Special Supervision division, the Director for Special Supervision may issue the express determination letter.

The OCC provides the bank with express determination letters separately from reports of examination and supervisory letters. A copy of the express determination letter must be retained in the OCC's supervisory information systems. In general, because express determination letters are based on the bank's existing supervisory record, examiners do not need to include additional workpapers in the OCC's supervisory information systems. Specifically, examiners generally do not need to prepare additional work papers supporting the decision to issue an express determination letter when the following criteria are met:

- The supervisory record for the current supervisory cycle documents that the bank's classification and charge-off practices are satisfactory.
- There are no outstanding supervisory concerns or enforcement actions regarding asset classification or charge-offs.

## Regulatory Loss Classification Standards

The federal banking agencies have communicated longstanding risk management principles for determining charge-offs. For commercial loans and securities, the charge-off principles are described in the "Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions" conveyed by OCC Bulletin 2013-28, "[Classification of Securities: Interagency Guidance](#)." For retail loans, the charge-off principles are described in the "Uniform Retail Credit Classification and Account Management Policy" conveyed by [OCC Bulletin 2000-20](#). The "Instructions for Preparation of Consolidated Reports of Condition and Income" (call report instructions) explain requirements for the recognition of recoveries.

Interagency classification standards, including those for loss classification, are also included in the "[Rating Credit Risk](#)" booklet of the *Comptroller's Handbook*. Additionally, considerations for loss classification and charge-offs for specific loan types are included in other booklets in the "Asset Quality" category of the *Safety and Soundness* series of the *Comptroller's Handbook*.

## Revoking the Election

The bank's conformity election is revoked automatically if the OCC does not issue an express determination letter following an examination covering the loan review process. As a general matter, the election is revoked as of the beginning of the taxable year that includes the date as of which the OCC conducts the examination even if the examination is completed in the following taxable year. The OCC is not required to rescind any previously issued express determination letters.

The OCC's decision to withhold the determination letter revokes the conformity election for the current year. It does not invalidate a bank's election for any previous years. Withholding the determination letter places the burden of proof on the bank to support its tax deductions for loan charge-offs.

## Sample Express Determination Letter

Month, day, year

Chief Executive Officer

Name of Bank

Subject: Express Determination Letter for IRS Regulation 1.166-2(d)(3)

In connection with the most recent examination of [NAME OF BANK] (Bank) by the Office of the Comptroller of the Currency (OCC), the OCC reviewed the Bank's loan review processes. Based on the review, the OCC concluded that the Bank, as of [EXAMINATION CLOSE DATE], maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs.

This statement is made on the basis of a review that was conducted in accordance with the OCC's normal examination procedures and criteria. It does not in any way limit or preclude any formal or informal supervisory action or enforcement actions by the OCC relating to the Bank's loan risk management processes, the level at which the Bank maintains its allowance for credit losses, or otherwise.

Sincerely,

[NAME]

[Title]

# Glossary

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**Collections activities:** Collections activities involve bringing past-due accounts current and negotiating payment plans for charged-off accounts.

**Concentration:** The sum of direct, indirect, or contingent obligations exceeding 25 percent of the bank's tier 1 capital plus ACL.<sup>72</sup>

**Covenant:** A borrower's agreement to do (affirmative) or forbear from doing (negative) an action. Banks use covenants to establish the circumstances in which the bank can terminate a commitment to lend or accelerate a loan. An example of an affirmative covenant is the requirement to provide financial statements annually. An example of a negative covenant is the requirement that the borrower not sell any assets without prior approval from the bank. Covenants may also be financial indicators such as a minimum DSCR.

**Credit administration:** Credit administration is an important control mechanism, and it is often the operations arm of the lending function. In many banks, the credit administration function has two primary components, loan administration and portfolio management.

**Credit administration exceptions:** Administrative exceptions, such as missing or stale documentation.

**Credit culture:** A bank's credit culture refers to the corporate culture around lending activities.

**Credit risk review:** In general, credit risk review provides management and the board with an objective, independent, and timely assessment of the overall quality of the loan portfolio. Credit risk review generally performs activities related to loan-risk-rating validation, trend analysis, adherence to bank policies, compliance with laws and regulations, and financial reporting information (e.g., information for ACLs). Credit risk review is referred to using other terminology such as loan review, credit review, or asset quality review in some banks.<sup>73</sup>

**Financial exceptions:** Financial exceptions that occur during the life of a loan (i.e., after origination). Financial exceptions are generally for commercial loans.

**Fixed charge coverage (FCC) ratio:** This ratio measures a company's ability to meet fixed charges (recurring expenses that are paid regardless of sales volumes). In general, the ratio divides cash flow by fixed charges.

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<sup>72</sup> Refer to the "[Concentrations of Credit](#)" booklet of the *Comptroller's Handbook*.

<sup>73</sup> Refer to OCC Bulletin 2020-50, "[Credit Risk: Interagency Guidance on Credit Risk Review Systems](#)," and 12 CFR 30, appendix A, II.D.4.

**Independent credit risk review:** Credit risk review that is independent of loan officers and loan production staff.

**Lending authorities:** Lending authorities describe who is authorized to approve loans, make changes in terms, and grant exceptions to policy.

**Lending personnel:** Lending personnel include customer-facing front-line staff (e.g., loan officers), underwriters, credit administration staff, credit risk managers, and, in some banks, appraisers, independent credit risk review staff, and many other risk management roles.

**Loan administration:** The loan administration function often encompasses the following types of activities: pre-closing reviews, loan closing, loan booking, post-closing reviews, loan servicing and monitoring, problem loan management, and secondary marketing. The loan administration function is often referred to as back-office operations.

**Loan booking:** Loan booking includes recording loans in the bank's systems in accordance with documented loan terms as well as attaching and perfecting the bank's lien on the collateral. This also generally includes capturing exceptions to policy and ongoing monitoring requirements for tracking and reporting purposes.

**Loan closing:** Loan closing includes executing loan documents and, in most cases, disbursing funds.

**Loan-level stress testing:** Loan-level stress testing, also commonly referred to as transaction stress testing, occurs as part of initial and ongoing credit evaluation. Key operating variables are altered to gauge a borrower's ability to service debt under changing conditions.

**Loan purchase activities:** Commercial and retail loan purchase activities include purchasing whole loans, loan pools, loan portfolios, loan participations, or participations in syndicated loans from other banks or nonbank lenders.<sup>74</sup>

**Loan review:** See **credit risk review**.

**Loan servicing and monitoring:** Loan servicing and monitoring involves ongoing maintenance of each loan until payoff.

**New activities:** New, modified, or expanded products and services.<sup>75</sup>

**Nonperforming loans:** Nonaccrual loans and loans that are 90 days or more past due regardless of accrual status.

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<sup>74</sup> Refer to OCC Bulletin 2020-81, "[Credit Risk: Risk Management of Loan Purchase Activities](#)."

<sup>75</sup> Refer to OCC Bulletin 2017-43, "[New, Modified, or Expanded Bank Products and Services: Risk Management Principles](#)."

**Portfolio management:** Portfolio management is the process banks use to identify, measure, monitor, and control risks in the bank’s loan portfolio.

**Portfolio stress testing:** In portfolio stress testing, a bank alters assumptions about one or more financial or economic variables to determine the potential effects on a specific loan portfolio(s) or the bank’s entire loan portfolio. Examples of variables include unemployment rates, interest rates, and real estate values.

**Post-closing review:** Post-closing reviews are reviews that occur after a loan is closed and booked. Post-closing reviews typically verify that documents are complete and properly executed and that liens are attached and perfected.

**Pre-closing review:** Pre-closing reviews are reviews that occur before loan closing and disbursement.

**Problem loan management:** Problem loan management includes collections, workouts, and foreclosure or repossession activities.

**Refinance risk:** The risk that borrowers will not be able to replace existing debt at a future date under reasonable terms and prevailing market conditions. Refinance risk primarily affects loans with principal balances remaining at maturity and borrowers who rely on recurring debt to finance their capital structure or business operations.<sup>76</sup>

**Risk layering:** Risk layering arises when a combination of risk factors from a given borrower’s credit profile or loan terms, in aggregate, convey a higher level of risk than the individual risk factors would suggest.

**Risk management system:** The bank’s risk management system comprises its policies, processes, personnel, and control systems.<sup>77</sup>

**Secondary marketing activities:** Secondary marketing generally involves developing, pricing, and selling loan products and delivering loans to investors as well as managing price risk from loan commitments in the pipeline and warehouse as well as loans held for sale. Secondary market activities encompass many types of loan products, but the most common is mortgage loan products. For more information about secondary marketing activities, refer to the “[Mortgage Banking](#)” booklet of the *Comptroller’s Handbook*.

**Stress testing:** In stress testing, a bank alters assumptions about one or more financial, structural, or economic variables to determine the potential effect on the performance of a loan, concentration, or portfolio segment. See also loan-level stress testing and portfolio stress testing.

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<sup>76</sup> Refer to OCC Bulletin 2024-29, “[Commercial Lending: Refinance Risk](#).”

<sup>77</sup> Refer to the “[Corporate and Risk Governance](#)” booklet of the *Comptroller’s Handbook*.

**Structural weaknesses:** Underwriting deficiencies that can compromise a bank's ability to control a credit relationship if economic or other events adversely affect the borrower.<sup>78</sup>

**Transaction stress testing:** See **loan-level stress testing**.

**Underwriting exceptions:** Loans approved outside of the bank's underwriting policies or standards.

**Workouts:** Loan workouts can take many forms, such as forbearance, renewing or extending loan terms, extending additional credit, or restructuring with or without concessions.

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<sup>78</sup> Refer to the "[Rating Credit Risk](#)" booklet of the *Comptroller's Handbook*.

## Abbreviations

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ACL	allowance for credit losses
ADC	assistant deputy comptroller
AICPA	American Institute of Certified Public Accountants
AML	anti-money laundering
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BSA	Bank Secrecy Act
call report	Consolidated Report of Condition and Income
CFR	Code of Federal Regulations
CMP	civil money penalties
CRE	commercial real estate
CSA	covered savings association
CVA	credit valuation adjustments
DPC	debts previously contracted
DSCR	debt service coverage ratio
DTI	debt-to-income
EIC	examiner-in-charge
FASB	Financial Accounting Standards Board
FCC	fixed charge coverage
FFIEC	Federal Financial Institutions Examination Council
fintech	financial technology
FSA	federal savings association
GAAP	generally accepted accounting principles
HOLA	Home Owners' Loan Act
ICQ	internal control questionnaire
IRR	interest rate risk
IRS	Internal Revenue Service
LTV	loan-to-value
MIS	management information systems
MRA	matters requiring attention
MSA	mortgage servicing asset
OCC	Office of the Comptroller of the Currency
OFAC	Office of Foreign Assets Control
OREO	other real estate owned
OTS	Office of Thrift Supervision
PCD	purchased credit-deteriorated
PCI	purchased credit-impaired
PTI	payment to income
QTL	qualified thrift lender
RAS	risk assessment system
ROE	report of examination
SBA	Small Business Administration
SLTV	supervisory loan-to-value
TB	Thrift Bulletin

UBPR	Uniform Bank Performance Report
UCC	Uniform Commercial Code
UDAP	unfair or deceptive acts or practices
UDAAP	unfair, deceptive, or abusive acts or practices
USC	United States Code

## References

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Listed references apply to all OCC-supervised banks unless otherwise noted.

### Laws

- 12 USC 85, “Rate of Interest on Loans, Discounts and Purchases” (national banks)
- 12 USC 86, “Usurious Interest; Penalty for Taking” (national banks)
- 12 USC 1463(g), “Preemption of State Usury Laws” (FSAs)
- 12 USC 1464(c), “Loans and Investments” (FSAs)<sup>79</sup>
- 12 USC 1464(q), “Tying Arrangements” (FSAs)
- 12 USC 1735f-7a, “State Constitution or Laws Limiting Mortgage Interest, Discount Points, and Finance or Other Charges; Exemption for Obligations Made After March 31, 1980”
- 12 USC 1972(1) (national banks)
- 12 USC 5531 (section 1031 of the Dodd–Frank Wall Street Reform and Consumer Protection Act)
- 12 USC 5536 (section 1036 of the Dodd–Frank Wall Street Reform and Consumer Protection Act)
- 15 USC 45(1)(1) (section 5 of the Federal Trade Commission Act)
- 42 USC 3601 et seq., “Fair Housing Act”
- 50 USC 3901 et seq., “Servicemembers Civil Relief Act”

### Regulations

- 12 CFR 5.38(e)(4), “Consolidation of Figures” (FSAs)
- 12 CFR 7.4001, “Charging Interest by National Banks at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrowers” (national banks)
- 12 CFR 22, “Loans in Areas Having Special Flood Hazards”
- 12 CFR 30, appendix A, “Interagency Guidelines for Establishing Standards for Safety and Soundness”
- 12 CFR 32, “Lending Limits”
- 12 CFR 34, subpart C, “Appraisals”
- 12 CFR 34, subpart D, “Real Estate Lending Standards” (national banks)
- 12 CFR 101, “Covered Savings Associations” (CSAs)
- 12 CFR 160.100–101, “Real Estate Lending Standards” (FSAs)
- 12 CFR 160.110, “Most Favored Lender Under Usury Preemption For All Savings Associations” (FSAs)
- 12 CFR 190, “Preemption of State Usury Laws”
- 12 CFR 215, “Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation O)”
- 12 CFR 221, “Credit by Banks and Persons Other Than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock (Regulation U)”
- 12 CFR 223, “Transactions Between Member Banks and Their Affiliates (Regulation W)”

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<sup>79</sup> 12 USC 1464(c) is section 5 of HOLA.

12 CFR 363, “Annual Independent Audits and Reporting Requirements”  
12 CFR 1002, “Equal Credit Opportunity Act (Regulation B)”  
12 CFR 1006, “Debt Collection Practices (Regulation F)”  
12 CFR 1022, “Fair Credit Reporting (Regulation V)”  
12 CFR 1026, “Truth in Lending (Regulation Z)”  
26 CFR 1.166-2(d), “Banks and Other Regulated Companies”  
32 CFR 232, “Limitations on Terms of Consumer Credit Extended to Service Members and Dependents” (implements the Military Lending Act)

## Comptroller’s Handbook

### Examination Process

[“Bank Supervision Process”](#)  
[“Community Bank Supervision”](#)  
[“Federal Branches and Agencies Supervision”](#)  
[“Large Bank Supervision”](#) (regional/midsize and large banks)  
[“Problem Bank Supervision”](#)  
[“Sampling Methodologies”](#)

### Safety and Soundness, Asset Quality

[“Allowances for Credit Losses”](#)  
[“Concentrations of Credit”](#)  
[“Credit Card Lending”](#)  
[“Installment Lending”](#)  
[“Lease Financing”](#)  
[“Mortgage Banking”](#)  
[“Other Real Estate Owned”](#)  
[“Rating Credit Risk”](#)  
[“Residential Real Estate Lending”](#)  
[“Retail Lending”](#)

### Safety and Soundness, Liquidity

[“Liquidity”](#)

### Safety and Soundness, Management

[“Corporate and Risk Governance”](#)  
[“Insider Activities”](#)  
[“Internal Control”](#) (national banks)  
[“Internal and External Audits”](#)  
[“Litigation and Other Legal Matters”](#)  
[“Qualified Thrift Lender”](#) (FSAs)  
[“Regulatory Reporting”](#)  
[“Related Organizations”](#) (national banks)

### Safety and Soundness, Sensitivity to Market Risk

[“Interest Rate Risk”](#)

## Consumer Compliance

[“Fair Lending”](#)

[“Protecting Tenants at Foreclosure Act”](#)

[“Servicemembers Civil Relief Act”](#)

[“Truth in Lending Act \(Interagency\)”](#)

[“Unfair or Deceptive Acts or Practices and Unfair, Deceptive, or Abusive Acts or Practices”](#)

## Office of Thrift Supervision (FSAs)

### Examination Handbook

Section 340, [“Internal Control”](#)

Section 380, [“Transactions With Affiliates and Insiders”](#)

Section 730, [“Related Organizations”](#)

### Other OTS Issuances

Letter P-2004-8

## OCC Issuances

[\*Bank Accounting Advisory Series\*](#)

[\*Director’s Book: Role of Directors for National Banks and Federal Savings Associations\*](#)

[\*Director’s Reference Guide to Board Reports and Information\*](#)

[Examining Circular 229](#), “Guidelines for Capitalization of Interest on Loans”

[Interpretive Letter No. 744](#) (national banks)

[Interpretive Letter No. 803](#) (national banks)

[Interpretive Letter No. 822](#) (national banks)

[Interpretive Letter No. 1171](#) (national banks)

[OCC Bulletin 2000-20](#), “Uniform Retail Credit Classification and Account Management Policy: Policy Implementation”

[OCC Bulletin 2003-1](#), “Credit Card Lending: Account Management and Loss Allowance Guidance”

[OCC Bulletin 2007-14](#), “Working with Mortgage Borrowers: Interagency Statement”

[OCC Bulletin 2007-38](#), “Working with Borrowers: Statement on Residential Real Estate Loan Restructurings for Serviced Loans”

[OCC Bulletin 2010-13](#), “Liquidity: Final Interagency Policy Statement on Funding and Liquidity Risk Management”

[OCC Bulletin 2010-24](#), “Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies”

[OCC Bulletin 2010-42](#), “Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines”

[OCC Bulletin 2012-14](#), “Stress Testing: Interagency Stress Testing Guidance” (banks with over \$10 billion in assets)

[OCC Bulletin 2012-33](#), “Community Bank Stress Testing: Supervisory Guidance” (banks with less than \$10 billion in assets)  
[OCC Bulletin 2013-28](#), “Classification of Securities: Interagency Guidance”  
[OCC Bulletin 2014-5](#), “Dodd-Frank Stress Testing: Supervisory Guidance for Banking Organizations With Total Consolidated Assets of More Than \$10 Billion but Less Than \$50 Billion” (banks with over \$250 billion in assets)<sup>80</sup>  
[OCC Bulletin 2014-37](#), “Consumer Debt Sales: Risk Management Guidance”  
[OCC Bulletin 2017-7](#), “Third-Party Relationships: Supplemental Examination Procedures”  
[OCC Bulletin 2017-43](#), “New, Modified, or Expanded Bank Products and Services: Risk Management Principles”  
[OCC Bulletin 2019-31](#), “Covered Savings Associations Implementation: Covered Savings Associations”  
[OCC Bulletin 2019-37](#), “Operational Risk: Fraud Risk Management Principles”  
[OCC Bulletin 2019-47](#), “Amendments to the Stress Testing Rule for National Banks and Federal Savings Associations: Final Rule”  
[OCC Bulletin 2020-50](#), “Credit Risk: Interagency Guidance on Credit Risk Review Systems”  
[OCC Bulletin 2020-81](#), “Credit Risk: Risk Management of Loan Purchase Activities”  
[OCC Bulletin 2023-17](#), “Third-Party Relationships: Interagency Guidance on Risk Management”  
[OCC Bulletin 2023-23](#), “Credit Administration: Final Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts”  
[OCC Bulletin 2023-25](#), “Liquidity: Addendum to the Interagency Policy Statement on Funding and Liquidity Risk Management”  
[OCC Bulletin 2023-27](#), “Loan Purchase Activities: Legal Lending Limit Guidance”  
[OCC Bulletin 2024-29](#), “Commercial Lending: Refinance Risk”  
[OCC Bulletin 2025-26](#), “Model Risk Management: Clarification for Community Banks”  
[OCC Bulletin 2026-13](#), “Model Risk Management: Revised Guidance”

## Other

### **Federal Financial Institutions Examination Council**

[\*Bank Secrecy Act/Anti-Money Laundering Examination Manual\*](#)

“Instructions for Preparation of Consolidated Reports of Condition and Income” (call report instructions)<sup>81</sup>

[\*The Detection and Deterrence of Mortgage Fraud Against Financial Institutions: A White Paper\*](#)

[\*The Detection, Investigation, and Prevention of Insider Loan Fraud: A White Paper\*](#)

[\*The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: A White Paper\*](#)

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<sup>80</sup> Subsequent to issuance of OCC Bulletin 2014-5, the threshold for conducting the Dodd-Frank Act stress test was raised to \$250 billion. Refer to OCC Bulletin 2019-47.

<sup>81</sup> Instructions are available on the web page for each reporting form on the FFIEC’s website. Refer to the “Call Report Forms” section of the FFIEC’s [Reporting Forms](#) page.

**Financial Accounting Standards Board**

ASC Topic 310, “Receivables”

ASC Topic 326, “Financial Instruments–Credit Losses”

ASC Topic 948, “Financial Services–Mortgage Banking”

ASU 2022-02, “Financial Instruments–Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures”