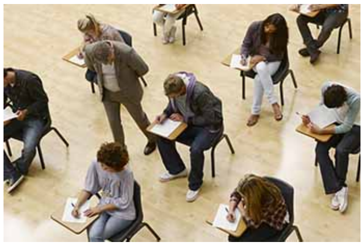

OCC Operating Plan Is a "Cheat Sheet" for CFIs

regulatory credit credit risk

Summary: The Bank Supervision Operating Plan, published annually by the Office of the Comptroller of the Currency, can serve as a "cheat sheet" to help CFIs focus their compliance efforts in the right areas. Among the 13 areas identified by the 2023 operating plan, two are related directly to credit quality.

Did you ever have a teacher who told you what questions would be on a test before administering it? Knowing the test questions ahead of time makes it easier to prepare and make a good grade.

Community financial institutions (CFIs) have access to a similar "cheat sheet." Each year, the Office of the Comptroller of the Currency's (OCC) Committee on Bank Supervision (CBS) publishes a document that gives CFIs a heads up about what the committee's supervision priority objectives will be for the upcoming year.

On Oct. 6, the CBS released its Bank Supervision Operating Plan for fiscal year 2023. By reviewing this plan, you can get a peek at which areas the OCC will be concentrating on in the upcoming year and focus your compliance efforts accordingly. The operating plan highlights 13 areas of heightened focus for the agency, and two areas in particular are related directly to credit quality. We believe these two credit-related objectives will be critical for CFIs to prioritize over the next year.

Credit Risk Management

The agency points out that credit losses are now at historic lows, particularly as the government has injected a tremendous amount of support into the economy these past few years. The credit risk environment is quickly changing due to volatile market conditions, such as rising interest rates, geopolitical instability, and ongoing supply chain disruptions. Continued weakness in commercial real estate (e.g., offices, hotels, retail) is also a concern.

According to the operating plan, bank supervisory efforts will focus on risk management functions to determine whether there is *"appropriate credible challenge."* Bank examiners will also evaluate how CFIs are stress testing *"adverse economic scenarios"* and their implications. This might include the elevated impacts on retail and commercial borrowers who have borne the brunt of supply chain disruptions and other pandemic-related impacts. These two key borrowers may be facing higher operating and borrowing costs.

There is also a sense of higher standards for stress testing this upcoming fiscal year, particularly in light of inflation and higher borrowing costs.

Allowances for Credit Losses (ACL)

Bank examiners will focus on ACL adequacy, which will include the provisions required to build the ACL. As CFIs finalize current expected credit losses (CECL) accounting standard adoption, examiners will assess the effectiveness of that implementation and ACL methodology when it comes to estimating lifetime expected losses.

As part of the assessment, examiners will determine whether assumptions and key policy decisions — such as a forecast period that is both sensible and supportable, materiality exceptions, and discretionary elections — are consistent in a CFI's policies and procedures. The operating plan stresses that each reporting period should include an ACL reevaluation that is thoroughly documented, as well as subject to appropriate governance activities. This includes noting when third-party modeling techniques are used in ACL processes.

It's clear that the agency's emphasis here is on the transition to CECL. The agency also emphasizes scrutiny of the supporting data used in modeling, including the forward-look component of the CECL model and qualitative factors.

PCBB is transitioning to CECL right alongside other CFIs, so we recognize the challenges involved in this endeavor. We have created a solution to help our fellow CFI lenders make the transition smoothly and successfully.

Preparing for the CECL transition and adapting stronger credit risk management practices are two key ways that CFIs can ensure that their compliance efforts will meet, and even exceed, the OCC's expectations. These preventative, forward-thinking measures will help you feel as ready to meet these supervisory strategies as any student would be who reviewed and studied the test questions well ahead of time.

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ECONOMY & RATES

Rates As Of: 12/21/2022 10:04AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	4.35	-0.02	4.29
6M	4.70	0.00	4.51
1Y	4.59	-0.12	4.20
2Y	4.22	-0.09	3.48
5Y	3.78	0.04	2.52
10Y	3.69	0.08	2.17
30Y	3.75	0.01	1.85

FF Market	FF Disc	IORB
4.33	4.50	4.40
SOFR	**Prime**	**OBFR**
4.30	7.50	4.32