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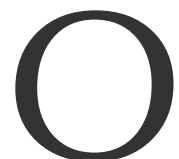
Comptroller of the Currency  
Administrator of National Banks

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# Country Risk Management

Comptroller's Handbook

October 2001



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## Overview

In recent years, the international exposures of the U.S. banking system have become increasingly concentrated in a relatively small number of banking institutions. These institutions, which are the most susceptible to the effects of country risk, can be divided into three main groups:

- A very small number of very large money center banks operating as truly multinational financial institutions and providing a full range of banking products and services through an international network of branches and affiliates.
- A number of other (many of them relatively large) banks and federal branches of foreign banks whose foreign exposures are primarily a reflection of the international financing needs of their domestic, corporate clients.
- Relatively small institutions, which make up the largest number of U.S. banks and federal branches of foreign banks with international exposures. Many of them have close ties to (and focus their efforts on) a particular geographic area, such as Latin America, Asia, or the Middle East.

This booklet discusses the basic elements of the country risk management process and provides risk-focused examination procedures for evaluating the adequacy of that process in internationally active banks. However, because the population of banks that are affected by country risk is so diverse, examiners must use judgment in applying these procedures to a particular bank, and should calibrate their expectations for the country risk management process to the size of the bank, as well as the volume and complexity of its international activities.

## Risks Associated with International Activities

Under the OCC's supervision by risk philosophy, risk is the potential that events, expected or unexpected, may have an adverse impact on a bank's earnings or capital. The OCC has defined nine categories of risk for bank

supervision purposes: *credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation* risk. These nine risks, which are discussed in detail in other booklets of the *Comptroller's Handbook*, are not mutually exclusive; any product or service provided either domestically or internationally may expose the bank to multiple risks.

Along with the risks present in their domestic operations, banks engaged in international activities are exposed to “country risk” — the risk that economic, social, and political conditions and events in a foreign country will adversely affect an institution’s financial interests. In addition to the adverse effect that deteriorating economic conditions and political and social unrest may have on the rate of default by obligors in a country, country risk includes the possibility of nationalization or expropriation of assets, government repudiation of external indebtedness, exchange controls,<sup>1</sup> and currency depreciation or devaluation.

Country risk has an overarching effect on a bank’s international activities and should explicitly be taken into account in the risk assessment of all exposures (including off-balance-sheet exposures) to all public- and private-sector foreign-domiciled counterparties. The risk associated with even the strongest counterparties in a country will increase if, for example, political or macroeconomic conditions cause the exchange rate to depreciate and the cost of servicing external debt to rise.

Country risk is not necessarily limited to a bank’s exposures to foreign-domiciled counterparties. Although it may not be feasible to incorporate the potential effect of country risk on domestic counterparties into the bank’s formal country risk management process, country risk factors should nevertheless be taken into account, where appropriate, when assessing the creditworthiness of domestic counterparties. Country risk would be pertinent to exposures to U.S.-domiciled counterparties if the creditworthiness of the borrower or of a guarantor (or the value of the collateral) is significantly

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<sup>1</sup> Exchange controls are an example of transfer risk, which is a facet of country risk. Transfer risk is the possibility that an asset cannot be serviced in the currency of payment because the obligor’s country lacks the necessary foreign exchange or has put restraints on its availability. The Interagency Country Exposure Review Committee (ICERC) assigns ratings to foreign exposures based on its evaluation of the level of transfer risk associated with a country. See the *Guide to the Interagency Country Exposure Review Committee Process*, which was issued in November 1999, for a comprehensive discussion of the operations of the ICERC.

affected by events in a foreign country. For example, a domestic borrower's credit risk might increase because of significant export receivables from a foreign country or because of the transfer-pricing of imports from a foreign affiliate. Country risk considerations would also be pertinent when one of the determinants of a transaction's value is a foreign country's foreign exchange or interest rate environment, as would be the case in an interest rate swap in which one rate is derived from a foreign country's yield curve.

Country risk is not limited solely to credit transactions. Investments in foreign subsidiaries, electronic banking agreements, and EDP servicing and other outsourcing arrangements with foreign providers all carry with them the risk that policies or conditions in a foreign country may have adverse consequences for the bank.

## **Elements of an Effective Country Risk Management Process**

To effectively control the level of risk associated with their international activities, banks must have a risk management process that focuses on the broadly defined concept of country risk. A sound country risk management process includes:

- Effective oversight by the board of directors,
- Adequate risk management policies and procedures,
- An accurate system for reporting country exposures,
- An effective process for analyzing country risk,
- A country risk rating system,
- Established country exposure limits,
- Regular monitoring of country conditions,
- Periodic stress testing of foreign exposures, and
- Adequate internal controls and audit function.

Although the details and complexity of the country risk management process will vary from one bank to the next, such management must be commensurate with the volume and complexity of the bank's international activities. Supervisory expectations will also take into consideration the bank's size and technological capabilities.

## **Oversight by the Board of Directors**

If country risk is to be managed properly, the board of directors must oversee the process effectively. The board is responsible for periodically reviewing and approving policies governing the bank's international activities to ensure that they are consistent with the bank's strategic plans and goals. The board is also responsible for reviewing and approving limits on country exposure and ensuring that management is effectively controlling the risks. When evaluating the adequacy of the bank's capital and allowance for loan and lease losses (ALLL), the board should also take into account the volume of foreign exposures and the ratings of the countries to which the bank is exposed.

## **Policies and Procedures for Managing Country Risk**

Bank management is responsible for implementing sound, well-defined policies and procedures for managing country risk that:

- Establish risk tolerance limits;
- Delineate clear lines of responsibility and accountability for country risk management decisions;
- Specify authorized activities, investments, and instruments; and
- Identify both desirable and undesirable types of business.

Management should also ensure that country risk management policies, standards, and practices are clearly communicated to the affected offices and staff.

## Country Exposure Reporting System

To effectively manage country risk, the bank must have a reliable system for capturing and categorizing the volume and nature of foreign exposures. The reporting system should cover all aspects of the bank's operations, whether conducted through paper transactions or electronically. An accurate country exposure reporting system is also necessary to support the regulatory reporting of foreign exposures on the quarterly FFIEC 009 Country Exposure Report.

The board of directors should regularly receive reports on the level of foreign exposures. If the level of foreign exposures in a bank is significant,<sup>2</sup> or if a country to which the bank is exposed is considered to be high risk, exposures should be reported to the board at least quarterly. More frequent reporting is appropriate when a deterioration in foreign exposures would threaten the soundness of the bank.

## Country Risk Analysis Process

Although the nature of the country risk analysis process and the level of resources devoted to it will vary from bank to bank, depending on the size and sophistication of the bank's international operations, a number of considerations are relevant to evaluating the process in all banks:

- Is there a quantitative and qualitative assessment of the risk associated with each country in which the bank is conducting or planning to conduct business?
- Is a formal analysis of country risk conducted at least annually, and does the bank have an effective system for monitoring developments in the interim?
- Does the analysis take into account all aspects of the broadly defined concept of country risk, as well as any special risks associated with

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<sup>2</sup> For purposes of this guidance, concentrations of exposure to individual countries that exceed 25 percent of the bank's Tier 1 capital plus the ALLL are considered to be significant; however, in the case of particularly troubled countries, lesser degrees of exposure may also be considered to be significant.

specific groups of counterparties the bank may have targeted in its business strategy?

- Is the analysis adequately documented, and are conclusions concerning the level of risk communicated in a way that provides decision makers with a reasonable basis for determining the nature and level of the bank's exposures in a country?
- Given the size and sophistication of the bank's international activities, are the resources devoted to the country risk analysis process adequate?
- As a final check of the process, are the bank's conclusions concerning a country reasonable in light of information available from other sources, including external research and rating services and the Interagency Country Exposure Review Committee (ICERC)?

Conclusions about the level of country risk reflect an evaluation of the effect of prevailing (and possible future) economic, political, and social conditions on a country's ability to sustain external debt service, as well as the impact of these conditions on the credit risk of individual counterparties located in the country. The appendix to this handbook section provides a more detailed description of these factors.

## **Country Risk Ratings**

Country risk ratings summarize the conclusions of the country risk analysis process. The ratings are an important component of country risk management because they provide a framework for establishing country exposure limits that reflect the bank's tolerance for risk.

Because some counterparties may be more exposed to local country conditions than others, it is a common and acceptable practice for banks to distinguish between different types of exposures when assigning their country risk ratings. For example, trade-related and banking sector exposures typically receive better risk ratings than other categories of exposure because the importance of these types of transactions to a country's economy has usually moved governments to give them preferential treatment for repayment.



The risk rating systems of some banks may also differentiate between public sector and private sector exposures. And in some banks, a country's private sector credits cannot be rated less severely than its public sector credits (*i.e.*, the bank imposes a "sovereign ceiling" on the rating for all exposures in a country). Both are acceptable practices.

A bank's country risk ratings may differ from the ICERC-assigned transfer risk ratings because the two ratings differ in purpose and scope. A bank's internally assigned ratings help it to decide whether to extend additional credit, as well as how to manage existing exposures. Such ratings should, therefore, have a forward-looking and broad country risk focus. The ICERC's more narrowly focused transfer risk ratings are primarily a supervisory tool to identify countries where concentrations of transfer risk might warrant greater scrutiny and to determine whether some minimum level of reserves against transfer risk should be established.

## Country Exposure Limits

As part of their country risk management process, internationally active banks should adopt a system of country exposure limits. Because the limit setting process often involves divergent interests within the bank (such as the country managers, the bank's overall country risk manager, and the country risk committee), country risk limits will usually reflect a balancing of several considerations, including:

- The overall strategy guiding the bank's international activities;
- The country's risk rating and the bank's appetite for risk;
- Perceived business opportunities in the country; and
- The desire to support the international business needs of domestic customers.

Country exposure limits should be approved by the board of directors, or a committee thereof, and communicated to all affected departments and staff. Exposure limits should be reviewed and approved at least annually — more frequently when concerns about a particular country arise.

A bank should consider whether its international operations are such that it should supplement its aggregate exposure limits with more discrete controls. Such controls might take the form of limits on the different lines of business in the country, limits by type of counterparty, or limits by type or tenor of exposure. A bank might also limit its exposure to local currencies. Banks that have both substantial capital market exposures and credit-related exposures typically set separate aggregate exposure limits for each because exposures to the two lines of business are usually measured differently.

Although country-by-country exposure limits are customary, banks should also consider limiting (or at least monitoring) exposures on a broader (e.g., regional) basis. A troubled country's problems often affect its neighbors, and the adverse effects may also extend to geographically distant countries with close ties through trade or investment. By monitoring and controlling exposures on a regional basis, banks are in a better position to respond if the adverse effects of a country's problems begin to spread.

For banks that are engaged primarily in direct lending activities, monthly monitoring of compliance with country exposure limits is adequate. However, banks with more volatile portfolios, including those with significant trading accounts, should monitor compliance with approved limits more frequently. Exceptions to approved country exposure limits should be reported to an appropriate level of management or the board so it can consider corrective measures.

## **Monitoring Country Conditions**

The bank should have a system in place to monitor current conditions in each of the countries where it has significant exposure. The level of resources devoted to monitoring conditions within a country should be proportionate to the bank's level of exposure and the perceived level of risk. If the bank maintains an in-country office, reports from the local staff are an obviously valuable resource for monitoring country conditions. In addition, periodic country visits by the regional or country manager are important to properly monitor individual exposures and conditions in a country. The bank may also draw on information from rating agencies and other external sources.

There should also be regular, on-going communication between senior management and the responsible country managers. The bank should not

rely solely on informal lines of communication and *ad hoc* decision-making in times of crisis. Established procedures should be in place for dealing with exposures in troubled countries, including contingency plans for reducing risk and, if necessary, exiting the country.

## **Stress Testing**

Banks should periodically stress-test their foreign exposures and report the results to the board of directors and senior management. As used here, stress testing does not necessarily refer to the use of sophisticated financial modeling tools but rather to the need for all banks to evaluate in some way the potential impact of different scenarios on their country risk profiles. The level of resources devoted to this effort should be commensurate with the significance of foreign exposures in the bank's overall operations.

## **Internal Controls and Audit**

Banks should ensure that their country risk management process includes adequate internal controls, and that there is an audit mechanism to ensure the integrity of the information used by senior management and the board to monitor compliance with country risk policies and exposure limits. The system of internal controls should, for example, ensure that the responsibilities of marketing and lending personnel are properly segregated from the responsibilities of personnel who analyze country risk, rate country risk, and set country limits.

# Appendix

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## Factors Affecting Country Risk

The debt crises experienced by a number of lesser-developed and emerging market countries over the past 20 years have focused attention on a number of factors that are particularly relevant to the analysis of country risk.

### Macroeconomic Factors

The first of these factors is the size and structure of the country's external debt in relation to its economy. More specifically:

- The current level of short-term debt and the potential effect that a liquidity crisis would have on the ability of otherwise creditworthy borrowers in the country to continue servicing their obligations.
- To the extent the external debt is owed by the public sector, the ability of the government to generate sufficient revenues, from taxes and other sources, to service its obligations.

The condition and vulnerability of the country's current account is also an important consideration, including:

- The level of international reserves, including forward market positions of the country's monetary authority (especially when the exchange rate is fixed).
- The level of import coverage provided by the country's international reserves.
- The importance of commodity exports as a source of revenue, the existence of any price stabilization mechanisms, and the country's vulnerability to a downturn in either its export markets or the price of an exported commodity.

- The potential for sharp movements in exchange rates and the effect on the relative price of the country's imports and exports.

The role of foreign sources of capital in meeting the country's financing needs is another important consideration in the analysis of country risk, including:

- The country's access to international financial markets and the potential effects of a loss of market liquidity.
- The country's relationships with private sector creditors, including the existence of loan commitments and the attitude among bankers toward further lending to borrowers in the country.
- The country's current standing with multilateral and official creditors, including the ability of the country to qualify for and sustain an International Monetary Fund (IMF) or other suitable economic adjustment program.
- The trend in foreign investments and the country's ability to attract foreign investment in the future.
- The opportunities for privatization of government-owned entities.

Past experience has highlighted the importance of a number of other important macroeconomic considerations, including:

- The degree to which the economy of the country may be adversely affected through the contagion of problems in other countries.
- The size and condition of the country's banking system, including the adequacy of the country's system for bank supervision and any potential burden of contingent liabilities that a weak banking system might place on the government.
- The extent to which state-directed lending or other government intervention may have adversely affected the soundness of the country's banking system, or the structure and competitiveness of the favored industries or companies.

- For both in-country and cross-border exposures, the degree to which macroeconomic conditions and trends may have adversely affected the credit risk associated with counterparties in the country.

## **Social, Political, and Legal Climate**

The analysis of country risk should also take into consideration the country's social, political, and legal climate including:

- The country's natural and human resource potential.
- The willingness and ability of the government to recognize economic or budgetary problems and implement appropriate remedial action.
- The degree to which political or regional factionalism or armed conflicts are adversely affecting government of the country.
- Any trends toward government-imposed price, interest rate, or exchange controls.
- The degree to which the country's legal system can be relied upon to fairly protect the interests of foreign creditors and investors.
- The accounting standards in the country and the reliability and transparency of financial information.
- The extent to which the country's laws and government policies protect parties in electronic transactions and promote the development of technology in a safe and sound manner.
- The extent to which government policies promote the effective management of the institution's exposures.
- The level of adherence to international legal and business practice standards.

## Institution-Specific Factors

Finally, an institution's analysis of country risk should take into consideration factors relating to the nature of its actual (or approved) exposures in the country including, for example:

- The institution's business strategy and its exposure management plans for the country.
- The mix of exposures and commitments, including the types of investments and borrowers, the distribution of maturities, the types and quality of collateral, the existence of guarantees, whether exposures are held for trading or investment, and any other distinguishing characteristics of the portfolio.
- The economic outlook for any specifically targeted industries within the country.
- The degree to which political or economic developments in a country are likely to affect the institution's chosen lines of business in the country. For instance, the unemployment rate or changes in local bankruptcy laws may affect certain activities more than others.
- For an institution involved in capital markets, its susceptibility to changes in value based on market movements. As the market value of claims against a foreign counterparty rise, the counterparty may become less financially sound, thus increasing the risk of nonpayment. This is especially true with regard to over-the-counter derivative instruments.
- The degree to which political or economic developments are likely to affect the credit risk of individual counterparties in the country. For example, foreign counterparties with healthy export markets or whose business is tied closely to supplying manufacturing entities in developed countries may have significantly less exposure to the local country's economic disruptions than do other counterparties in the country.
- The institution's ability to effectively manage its exposures in a country through in-country or regional representation, or by some other

arrangement that ensures the timely reporting of, and response to, any problems.



# Examination Procedures

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## General Procedures

These procedures are intended to determine the adequacy of the bank's policies, procedures, and internal controls as they relate to country risk management. The extent of testing and procedures performed should be based upon the examiner's assessment of risk. This assessment should include consideration of work performed by other regulatory agencies, internal and external auditors, internal compliance review units, formalized policies and procedures, and the effectiveness of internal controls and management information systems.

**Objective:** Determine the scope of the examination of the bank's country risk management process and identify examination activities necessary to meet the needs of the supervisory strategy for the bank.

1. Review the following documents for any previously identified problems that require follow-up:
  - Supervisory strategy.
  - EIC's scope memorandum.
  - Previous Report of Examination.
  - Working papers from the previous examination.
  - Internal and external audit reports and, if necessary, work papers.
  - Correspondence.
2. Review the bank's recent FFIEC 009 Country Exposure Reports and relevant internal bank reports for any apparent changes, trends, or areas of concern in the bank's international activities.
3. Review the "Canary" and "International" topic pages on the OCCnet for any information that may be relevant to the bank's international activities.
4. Obtain and review the following documents to determine the amount of oversight provided for the bank's international activities:

- A list of board and executive or senior management committees that supervise the bank's international activities, including a list of members and meeting schedules. Also review copies of the minutes documenting the meetings of these groups since the last examination.
  - Reports related to the bank's international activities and country exposures that have been furnished to the board of directors, country risk management committee, or any similar committee.
5. Obtain and review policy and procedure manuals, reports, and any other tools used by management to supervise the bank's international activities, including:
- Organization chart.
  - Written policy and procedure manuals.
  - Strategic and business plans for international activities.
  - List of products, services, and business initiatives.
  - Country limit and exposure reports.
  - Country risk analysis and rating reports.
  - Concentration reports.
  - Exception reports.
  - Reports on the results of any financial modeling tools that may have been applied to the bank's international portfolio.
  - ALLL analysis.
6. Based on the material reviewed in the previous steps and discussions with management, identify any areas of significant change or possible concern in the bank's international activities, including:
- Any significant changes in policies, procedures, or personnel.
  - Any significant changes in the products offered, size of exposures, or market focus.
  - The level and trend in delinquencies and losses.
  - Any significant changes in the level of concentrations or the number of exceptions granted to established limits.
  - Any internal or external factors that could affect the level of risk associated with the bank's international activities, including:

- Changes in country exposure limits.
  - Economic conditions in the countries and regions in which the bank has exposure.
7. Using the information obtained while performing these procedures and from discussions with the bank EIC, determine the scope of this examination and its objectives.

**Select steps necessary to meet objectives from the following examination procedures. Seldom will every step be required.**

# Quantity of Risk

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

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**Objective:** To determine the level of country risk associated with the bank's international activities.

1. Analyze the volume and distribution of the bank's international activities, including commitments and other off-balance-sheet exposures, noting any changes since the previous examination. Determine the implications for risk of the following:
  - Significant country or regional concentrations of exposure.
  - Serious economic or other problems in countries in which the bank has significant exposures.
  - Significant growth in exposures to residents of a particular country.
  - Significant growth in exposures to a particular economic sector within a country (e.g., banking, commodity producers, manufacturing, or the public sector).
  - Significant growth in exposures to a geographic region (e.g., Asia, Latin America, or Eastern Europe).
2. Analyze the nature of the bank's international activities, noting any changes since the previous examination. Determine the implications for risk of the following:
  - Significant growth in any existing products or activities.
  - Any new or planned products or activities.
3. If the bank has acquired any significant new foreign affiliates since the previous examination, analyze the effect of these acquisitions on the risk profile of the bank. Consider:
  - The nature and volume of the affiliate's activities.
  - The affiliate's potential for adversely affecting the bank's reputation.

4. Review the business and/or strategic plan for the bank's international activities. Consider:
  - Growth goals and exposure limits — for individual countries and for regions.
  - New and planned products and business lines.
5. Review and discuss with management any internally prepared risk assessments of the bank's international activities.

# Quality of Risk Management

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

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## Policy

**Conclusion:** The board (has/has not) established effective policies to manage the level of country risk associated with the bank's international activities.

**Objective:** To determine whether the bank has established and effectively communicated the policies, standards, and procedures necessary to manage the country risk associated with its international activities.

1. Evaluate relevant policies to determine whether they provide appropriate guidance for the bank's international activities. Consider:
  - Country risk tolerance, *i.e.*, the maximum acceptable country risk rating.
  - Authorized lines of business.
  - Approved instruments and tenors.
  - Desirable and undesirable types of business.
2. Review the process used to establish country exposure limits. Consider:
  - The role of the country risk management committee, the chief country risk management officer, country managers, and marketing staff in setting country exposure limits.
  - The process for reviewing and approving country exposure limits.
  - The process for approving exceptions to country exposure limits.
3. Determine whether country exposure limits are well-defined and reasonable. Consider:

- The way limits are measured. (For example, is capital or some other standard used to define the exposure limit?)
  - The relationship between assigned ratings and the bank's system for establishing country exposure limits.
  - The use of sub-limits for different types and tenors of exposure within a country.
  - The use of regional limits as a tool for limiting the effects of a contagion of problems between countries.
  - The impact on the bank if the country exposure limit is reached.
4. Evaluate the policy review and country exposure limit approval processes to ensure that the policy and/or exposure limits can be adjusted in response to changes in the level of country risk.
  5. Determine whether the board of directors has approved the current policies and country exposure limits.
  6. While performing the remaining procedures, evaluate whether country risk management policies and exposure limits have been clearly communicated to affected staff.

## **Processes**

**Conclusion:** The bank (does/does not) have systems in place to provide accurate and timely assessments of the country risk associated with its international activities.

**Objective:** To determine whether the bank has systems in place to provide accurate and timely assessments of the country risk associated with its international activities.

1. Review the bank's definition of country risk to determine the scope of its analyses. Is the scope based on a broadly defined concept of country risk?
2. In light of the size and sophistication of the bank's international activities, evaluate the adequacy of the bank's country risk analysis process. Consider:

- Does the bank assess the level of risk associated with each country in which it is currently conducting or planning to do business?
  - Is a formal analysis of country risk conducted at least annually, and does the bank have an effective system for monitoring developments in the interim?
  - Does the bank's analysis take into account all aspects of the broadly defined concept of country risk, as well as any special risks associated with specific groups of counterparties the bank may have targeted in its business strategy?
  - Is the bank's analysis adequately documented and are its conclusions concerning the level of risk communicated in a way that provides decision makers with a reasonable basis for determining the nature and level of the bank's exposures in a country?
  - Are the resources devoted to the country risk analysis process, including the number and expertise of staff, considered adequate?
  - Do the bank's conclusions concerning a country appear to be reasonable in light of information available from other sources?
3. Evaluate the adequacy of the documentation supporting the bank's country risk management decisions. Consider:
- Whether the bank's country risk files include (at a minimum) a recent analysis of country risk, the bank-assigned rating of country risk, authorized types of activities, and approved limits on exposure.
  - Why the bank has waived the analysis of any countries in which it is exposed (if it has done so).
4. Evaluate the bank's system for assigning country risk ratings. Consider:
- The rating category definitions used.
  - Whether ratings differentiate among types of exposures (e.g., trade vs. non-trade).
  - Independence (*i.e.*, the persons involved in the rating process do not have conflicting interests).
  - What triggers rating changes.
  - The rating review and approval process.



- The reasonableness of the assigned ratings in light of information available from other sources, including external rating agencies and the ICERC.
  - The consistency of application across countries.
5. Determine how the bank factors country risk ratings into its assessment of counterparty credit risk.

## **Personnel**

**Conclusion:** Management (does/does not) have the knowledge and experience necessary to effectively manage the risks associated with the bank's international activities.

**Objective:** To determine management's ability to engage in international activities in a safe and sound manner.

1. Through discussions with management, ascertain its knowledge of current policies for managing the country risk associated with the bank's international activities.
2. Review the bank's organization chart in conjunction with management resumes to assess the overall structure and experience of personnel responsible for managing the bank's international activities. If no chart is available, discuss structure and experience with department management.
3. Evaluate whether reporting lines encourage open communication and limit the chances of conflicts of interest.
4. Determine whether the span of control for managing the bank's international activities is reasonable.
5. Evaluate the level of staff turnover and its effect on country risk management.

## Control Systems

**Conclusion:** The bank (does/does not) have systems in place to effectively monitor the level of country risk associated with its international activities.

**Objective:** To determine whether the bank has systems in place to effectively monitor the level of country risk associated with its international activities.

1. Determine how compliance with country risk limits is monitored and reported to senior management and the board of directors.
2. Assess the level of review for country exposures nearing their risk limits. Is there sufficient reporting to senior management, and is oversight heightened?
3. Evaluate the adequacy of the system for monitoring current conditions in countries in which the bank has significant exposures. Consider:
  - The volume of exposure and the perceived level of risk in a country.
  - The types of resources used including, for example, in-country staff, periodic country visits, internal research, and external research and rating services.
4. Evaluate the adequacy of the bank's procedures for dealing with country risk problems. Consider whether the bank has contingency plans addressing the possibility of a serious deterioration of political or economic conditions in countries where the bank has significant exposures.
5. Evaluate the adequacy of the management information system (MIS) for the bank's international activities. All evaluations of MIS should assess timeliness, accuracy, level of detail, clarity of report format, and distribution channels. Consider:
  - Capital and earnings-at-risk measurements.
  - Past-due and accrual status.
  - Profitability data.

- Trend analysis.
  - Commitments, including type, amount, and level of expected usage.
  - Maturity distribution.
  - Liquidity information.
  - Exceptions to policy and country risk limits.
  - Distribution of exposures across country risk rating categories.
  - Distribution of exposures by currency.
  - Distribution of exposures by line of business.
6. Test the accuracy of the country exposure reports received by management and the quarterly FFIEC 009 Country Exposure Report to determine whether the information received by both management and supervisors is accurate and complete.
7. Evaluate the adequacy and flexibility of the MIS for the bank's international activities. Consider:
- The distribution of MIS reports.
  - The amount and suitability of information provided to each layer of management.
  - The timeliness of MIS reports.
  - Whether the reports are generated off a database that allows reporting flexibility. Can country exposure information be reported a number of ways (for example, by sector, by product, or by in-country obligor)?
  - Whether management can design its own reports so it can access the type of information about country exposure that it wants.
  - Whether reports can be developed quickly to respond to a specific need.
8. Determine whether control functions are independent. Consider:
- Reporting lines.
  - Budget oversight.
  - Performance evaluation.
  - Compensation plans.
  - Access to the board.

9. Evaluate the effectiveness of the audit function in testing the bank's system for managing country risk. Consider:
  - Scope and coverage of reviews.
  - Frequency of reviews.
  - Qualifications and independence of audit personnel.
  - Comprehensiveness and accuracy of findings.
  - Adequacy and timeliness of follow-up.
  
9. If the bank uses financial modeling tools in the management of its country risk, assess the following:
  - The reasonableness of the assumptions used in the modeled scenarios.
  - How management uses the results of the modeling.
  
10. Confer with the examiner analyzing the allowance for loan and lease losses (ALLL) to determine:
  - Whether required allocated transfer risk reserves have been provided.
  - Whether transfer and/or country risk has been considered and appropriately provided for in the ALLL.

# Conclusion Procedures

**Objective:** To communicate findings and initiate corrective action when policies, practices, procedures, or internal controls are deficient or when violations of law, rulings, or regulations occur.

1. Prepare a summary memorandum to the EIC detailing the results of the evaluation of the bank's country risk management process. Draft conclusions on:

- The extent to which the bank's international operations affect the aggregate level of risk in the bank.
- The quality of the bank's country risk management process.

Also address in the summary memorandum:

- Any concerns about the level and/or trend in the direction of country risk in countries in which the bank has significant exposure.
  - Appropriateness of strategic and business plans for the bank's international activities.
  - Adequacy of adherence to policies and country exposure limits.
  - Adequacy of systems for analyzing country risk and assigning risk-ratings.
  - Adequacy of country risk control functions, including MIS and audit.
  - Compliance with applicable laws, rules, and regulations.
  - Recommended corrective action for deficient policies, procedures, practices, or other concerns.
  - Other matters of significance.
2. For any issues of concern identified when performing the country risk management procedures, determine their impact on the bank's aggregate risk and the direction of its risks. Examiners should refer to guidance provided under the OCC's large and community bank risk assessment programs.

3. Discuss examination findings and conclusions with the EIC. If necessary, compose “Matters Requiring Attention” (MRA) for the country risk management examination. MRAs should cover practices that:
  - Deviate from sound, fundamental principles and are likely to result in financial deterioration or increased risk if not addressed.
  - Result in substantive noncompliance with laws.

MRAs should discuss:

- Causes of the problem.
  - Consequences of inaction.
  - Management’s commitment to corrective action.
  - The time frame for corrective action and person(s) responsible for meeting that time frame.
4. Discuss findings with bank management, including conclusions about risks. If necessary, obtain commitment for corrective action.
  5. Write a memorandum specifically setting out what the OCC should do in the future to effectively supervise country risk management practices in the bank, including time frames, staffing, and workdays required.
  6. Update the OCC’s electronic information system and any applicable report of examination schedules or tables.
  7. Update the examination work papers in accordance with OCC guidance.