

This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the January 2016 supplement.

SUMMARY OF CHANGES

Section 1050.2

Section 1050.2, “Guidance for the Consolidated Supervision of Regional Bank Holding Companies,” is revised (beginning at subsection 1050.2.5) to include guidance for regional banking organizations based on SR-16-4, “Relying on the Work of the Regulators of Subsidiary Insured Depository Institution(s) of Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of Less than \$50 Billion.” The letter was issued by the Federal Reserve to explain its expectations for its examiners’ reliance on the work of the regulators of insured depository institution subsidiaries of these holding companies. The letter presents a tailored supervisory approach for regional banking organizations, which are defined as companies with total consolidated assets of between \$10 billion and \$50 billion.

Section 4066.0

Section 4066.0, “Consolidated (Funding and Liquidity Risk Management),” is amended at subsection 4066.0.2 to include “Appendix B - Interagency Guidance on Funds Transfer Pricing Related to Funding and Contingent Liquidity Risks,” issued March 1, 2016. The guidance was issued to address weaknesses observed in some large financial institutions’ funds transfer pricing practices related to funding risk (including interest rate and liquidity components) and contingent liquidity risk. (Refer to SR-16-03 and to the March 1, 2016, attachment to the interagency guidance, “Illustrative Funds Transfer Pricing Methodologies.”)

Section 4070.1

Section 4070.1, “Rating...Risk Management Processes and Internal Controls of BHCs...” is partially superseded as the result of the issuance of SR-16-11, “Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than \$50 Billion.” With the issuance of SR-16-11, SR-95-51 (section 4070.1) is applicable only to bank holding companies and state member banks having \$50 billion or more in total assets.

Section 4071.0

Section 4071.0, “Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than \$50 Billion,” is a new section that reaffirms the Federal Reserve’s long-standing supervisory approach that emphasizes the importance of prudent risk management. This section’s guidance and SR-16-11, “Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less Than \$50 Billion,” outlines core risk categories and risk-management principles. This supervisory guidance reflects updates to, and partially supersedes, SR-95-51, “Rating the Adequacy of Risk Management and Internal Controls at State Member Banks and Bank Holding Companies.” The guidance in SR-16-11 provides clarifications on, and distinguishes supervisory expectations for, the roles and responsibilities of the board of directors and senior management. The risk-management expectations within this guidance are applicable to all supervised institutions with total consolidated assets of less than \$50 billion, including bank holding companies, state member banks, savings and loan holding companies, and foreign banking organizations with total combined U.S. assets of less than \$50 billion. The guidance also applies to insurance and commercial savings and loan holding companies with total consolidated assets of less than \$50 billion.

Substantive changes that are included in SR-16-11 (when compared to SR-95-51) are:

1. Certain major risk categories are modified.
 - a. Compliance risk is a separate core risk;
 - b. Reputation risk is not considered a core risk
 - c. Risk definitions that are revised:
 - i. Operational risk is the risk resulting from inadequate or failed internal processes, people, and systems or from external events.
 - ii. Market risk includes commodity prices
 - iii. Legal risk includes legal sanctions
2. The responsibilities of the board of directors versus senior management are separated across all risk-management components.
 - a. Senior management is responsible for risk identification.
 - b. Senior management is responsible for the establishment and maintenance of effective information systems.
 - c. Both the board of directors and senior management are responsible for an effective system of internal controls.
3. Additional risk-management concepts are included:
 - a. Information systems should consist of a consolidated and integrated view of risks.
 - b. The board of directors should approve significant policies to establish risk tolerances for the institution's activities.

Section 5000.0

Section 5000.0, "BHC Inspection Program (General)," is revised at subsection 5000.0.4.3.05 to provide additional guidance on the supervisory approach to be used for holding companies with total consolidated assets of \$10 billion or less. The guidance pertains to relying on the work of insured depository institution (IDI) regulators for community banking organizations. Examiners are to rely substantially on the findings of the IDI regulator in evaluating the overall condition of the holding company. Reserve Bank reviews are to evaluate the condition, performance, and prospects of a subsidiary IDI based on the conclusion of the IDI regulator and are not to duplicate the IDI regulator's work. (Refer to SR-16-4.)

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This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the July 2015 supplement.

SUMMARY OF CHANGES

Section 2060.1

Section 2060.1, “Audit (Management Information Systems),” is revised (beginning at subsection 2060.1.8) to include an Overview and Appendix A—“Interagency Advisory on External Audits of Internationally Active U. S. Financial Institutions.” The federal banking agencies¹ (the agencies) issued the advisory to communicate their support for the principles and expectations that are set forth in Parts 1 and 2, respectively, of the Basle Committee on Banking Supervision (the BCBS) March 2014 guidance on “External audits of banks.”

The agencies acknowledge that the existing standards and practices in the United States are broadly consistent with the BCBS external audit guidance. Because of the legal and regulatory framework in the United States, certain differences exist between the standards and practices followed in the United States and the principles and expectations in the BCBS external audit guidance. These differences are addressed in this advisory, which also describes the agencies’ supervisory expectations for U. S. financial institutions within the scope of the advisory for incorporating the principles and expectations in the BCBS external audit guidance into their practices. The advisory also outlines examiner responsibilities related to these supervisory expectations.

The BCBS external audit guidance is intended for “internationally active banks,” which, the agencies defined in the advisory (Refer to SR-16-2 and its attachment.)

Section 2093.0

Section 2093.0, “Control and Ownership (Shareholder Protection Arrangements)” is a new

section that discusses Federal Reserve supervisory concerns and issues regarding the establishment of arrangements by some bank and savings and loan holding companies (collectively, “holding companies”) to protect the financial investments made by shareholders (collectively, “shareholder protection arrangements”). There has been an increase in interest by some holding companies to benefit certain shareholders, enhance short-term investor returns, and/or provide a distinct disincentive for investors to acquire or increase ownership in a holding company’s common stock and other capital instruments. Such shareholder protection arrangements raise concerns because they could have negative implications on a holding company’s capital or financial position, limit a holding company’s financial flexibility and capital raising capacity, or otherwise impair a holding company’s ability to raise additional capital in the future. These arrangements impede the ability of a holding company to serve as a source of strength to its insured depository institutions subsidiaries and are considered unsafe and unsound. A holding company, regardless of its asset size, should be aware that the Federal Reserve may object to a shareholder protection arrangement based on the facts and circumstances and the features of the particular arrangement. Examples of shareholder protection arrangements that have raised supervisory issues are discussed. (Refer to SR-15-15.)

Section 4061.0

Section 4061.0, “Consolidated Capital (Capital Planning),” is revised for amendments to Regulation Y, 12 C.F.R. 225.8 “Capital Planning.” The rule was amended to limit the ability of a bank holding company with \$50 billion or more in total consolidated assets to make capital distributions under the rule if the bank holding company’s net capital issuances are less than the amount indicated in its capital plan. The tier 1 common capital ratio requirement was removed, and certain mandatory capital action assumptions were modified. (Refer to 79 *Fed. Reg.* 64040 (October 27, 2014) and 80 *Fed. Reg.* 75424 (December 2, 2015)).

1. The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Section 4060.7

Section 4060.7, Consolidated Capital (Assessing Capital Adequacy and Risk at Large Banking Organizations and Others with Complex Risk Profiles) is deleted. The section was derived from SR-99-18, superseded by SR-15-18 and SR-15-19, both issued on December 18, 2015.

Section 4063.0

Section 4063.0, “Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms,” is a new section consisting of Federal Reserve guidance that was issued to explain its expectations for capital planning at Large Institution Supervision Coordinating Committee (LISCC) firms and large and complex bank holding companies and intermediate holding companies of foreign banking organizations. This guidance is consistent with the broad supervisory expectations set forth in SR-12-17/CA-12-14, “Consolidated Supervision Framework for Large Financial Institutions.” It sets forth the Federal Reserve’s core capital planning expectations for LISCC and large and complex firms. Several appendices are included that detail supervisory expectations on a firm’s capital planning processes. The new guidance largely consolidates the Federal Reserve’s existing capital planning guidance.

The expectations for LISCC Firms and Large and Complex Firms are higher than the expectations for Large and Noncomplex Firms. Within the group of firms subject to this guidance, the Federal Reserve has significantly heightened expectations for the LISCC Firms. This guidance sets forth only minimum expectations, and LISCC Firms are consistently expected to exceed those minimum standards and have the most sophisticated, comprehensive, and robust capital planning practices for all of their portfolios and activities. Refer to SR-15-18 and its attachment.

Section 4065.0

Section 4065.0, “Federal Reserve Supervisory Assessment of Capital Planning And Positions

for Large and Noncomplex Firms,” The Federal Reserve’s guidance explains its supervisory expectations for capital planning at large and non-complex bank holding companies and intermediate holding companies of foreign banking organizations, consistent with the broad supervisory expectations set forth in SR-12-17/CA-12-14, “Consolidated Supervision Framework for Large Financial Institutions.” This guidance applies to U.S. bank holding companies and intermediate holding companies of foreign banking organizations that have total consolidated assets of at least \$50 billion but less than \$250 billion, have consolidated total on-balance sheet foreign exposure of less than \$10 billion, and are not otherwise subject to the Federal Reserve’s LISIC framework (referred to as a “Large and Non-complex Firm”). Refer to SR-15-19 and its attachment.

Section 4080.0

Section 4080.0, “Federal Reserve System Bank Holding Company Surveillance Program,” is revised to discuss the Federal Reserve’s revision of its safety-and-soundness surveillance program (the Surveillance Program) for top-tier bank holding companies and savings and loan holding companies (HCs). The revised program includes a new early warning model for HCs, the “*Holding Company Statistical Assessment of Bank Risk*” or “HC-SABR” model. It deploys risk identification algorithms (“Outlier Metrics”) and other surveillance products to process financial and economic data and generate forward-looking, actionable intelligence on HCs that will provide examiners and other supervisory staff with early signals by which to monitor risk-taking. Results are used to assess exposures, outlooks, and possible compliance shortcomings, with the goal of calibrating supervisory resources to risk. The Surveillance Program’s objectives, structure, and maintenance are discussed along with additional information on the metrics, procedures, and write-up requirements used to monitor HCs. The program also distributes surveillance results across the Federal Reserve’s supervision function. (Refer to SR-15-16 and its attachment.)

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Bank Holding Company Supervision Manual

Supplement 48—July 2015

This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the January 2015 supplement.

SUMMARY OF CHANGES

Section 2010.2

Section 2010.2, “Supervision of Subsidiaries (Loan Administration and Lending Standards),” is revised (subsection 2010.2.4.1.9) to remove a footnote reference to SR letter 02-16, “Interagency Questions and Answers on Capital Treatment of Recourse, Direct Credit Substitutes and Residual Interests in Asset Securitizations,” which is superseded by SR letter 15-6, “Interagency Frequently Asked Questions (FAQs) on the Regulatory Capital Rule.”

Section 2090.2

Section 2090.2, “Control and Ownership (BHC Formations),” has been revised to include the Board’s April 9, 2015, approval of its Small Bank Holding Company and Savings and Loan Holding Company Policy Statement (effective May 15, 2015). This policy statement expands the applicability of the former policy statement to include savings and loan holding companies (SLHCs). The policy applies to those bank holding companies (BHCs) and certain SLHCs that have consolidated assets of less than \$1 billion. Previously, the policy only applied to BHCs having consolidated assets of less than \$500 million.

Section 2128.03

Section 2128.03, “Credit-Supported and Asset-Backed Commercial Paper (Risk Management and Internal Controls) is revised (subsection

2128.03.3.3) to delete a footnote reference to SR letter 05-13 and its attachment, “Interagency Guidance on the Eligibility of Asset-Backed Commercial Paper Program Liquidity Facilities and the Resulting Risk-Based Capital Treatment,” which is superseded by SR letter 15-6 “Interagency Frequently Asked Questions on the Regulatory Capital Rule.”

Section 2500.0

This section, “Supervision of Savings and Loan Holding Companies” was revised to include a reference to SR letter 14-9, “Incorporation of Federal Reserve Policies into the Savings and Loan Holding Company Supervision Program,” which provides a listing of supervisory guidance documents (SR letters) that were issued prior to July 21, 2011. The Federal Reserve has determined that these SR letters are applicable to savings and loan holding companies.

Section 3070.3

This section, “Section 4(c)(8) of the BHC Act (Non-Traditional Mortgages—Associated Risks),” is revised to delete a footnote reference to SR letter 02-16, “Interagency Questions and Answers on Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations,” and its attachment, which is superseded by SR letter 15-6 “Interagency Frequently Asked Questions on the Regulatory Capital Rule.” Refer to subsection 3070.3.2.5. “Secondary Market Activity.”

Section 3111.0

This section, “Section 4(c)(8) of the BHC Act (Acquisition of Savings Associations)” includes (subsection 3111.0.3) reference corrections to listed Board orders that authorized the acquisition of savings associations.

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SUMMARY OF CHANGES

Sections 1050.0, 1050.1, 1050.2, 3900.0, and 4070.0

These sections have been revised to refer to SR-12-17/CA-12/14, “Consolidated Supervision Framework for Large Financial Institutions,” which superseded SR-99-15, “Risk-Focused Supervision of Large Complex Banking Organizations.”

Section 2010.2

Section 2010.2, “Supervision of Subsidiaries (Loan Administration and Lending Standards),” is revised to include a new subsection 2010.2.6, “Guidance on Private Student Loans with Graduated Payment Terms of Origination.” The guidance provides principles that financial institutions should consider in their policies and procedures for originating these loans. Financial institutions should prudently underwrite their private student loans in a manner consistent with safe and sound lending practices. Financial institutions should also comply with all applicable federal and state consumer laws and regulations, including providing disclosures that clearly communicate the timing and the amount of payments to facilitate borrower understanding of loan terms and features. Refer to SR-15-2/CA-15-1.

Section 2124.0

This section was revised to include a footnote reference to SR-14-4, “Examiner Loan Sampling Requirements for State Member Bank and Credit Extending Nonbank Subsidiaries of Banking Organizations with \$10–\$50 Billion in Total Consolidated Assets.” The guidance in SR-14-4 clarifies the expectations for the assessment of material retail credit portfolios for these institutions. The guidance in SR-14-4 superseded SR-94-13, “Loan Review Requirements for On-Site Examinations,” but only for these banking organizations. (For the SR-14-4 guidance, refer to subsection 2010.2.11, appendix I.)

Section 2124.01

This section, “Risk-Focused Supervision for Large Complex Banking Organizations,” was revised to (1) include 10 additional risk-focused SR letters to the listing in appendix A and (2) remove two inactive letters from this list.

Section 3110.0

This section, “Section 4 (c)(8) of the BHC Act (Industrial Banking)” was revised to amend the beginning discussion and to include statutory and regulatory citations and a current Board order reference within section 3110.0.4.

Section 3111.0

This section, “Section 4(c)(8) of the BHC Act (Acquisition of Savings Associations)” was revised to include a Dodd-Frank Act provision pertaining to a bank holding company’s application to acquire an insured depository institution when it is located in a home state other than the home state of the bank holding company. See subsection 3111.0.2.5. In addition, subsection 3111.0.3 lists additional Board orders that have authorized the acquisition of savings associations.

Section 4069.0

This new section, “Dodd-Frank Act Company Run Stress Testing for Banking Organizations with Total Consolidated Assets of \$10–\$50 Billion,” provides guidance on the supervisory expectations for the Dodd-Frank Wall Street Reform and Consumer Protection Act stress test practices for these companies and offers additional details about methodologies that should be employed. Refer to SR-14-3 and the 2014 interagency “Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of More Than \$10 Billion but Less than \$50 Billion” (see 79 Fed. Reg. 14153, March 13, 2014).

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SUMMARY OF CHANGES

Section 2010.2

The section, “Supervision of Subsidiaries (Loan Administration and Lending Standards),” is revised to include Appendix I — “Examiner Loan Sampling Requirements For Credit-Extending Nonbank Subsidiaries of BHCs with \$10-50 Billion in Total Consolidated Assets.” The subsection sets forth the loan sampling expectations that apply to the Federal Reserve’s inspection of credit-extending nonbank subsidiaries of bank holding companies (BHCs). Examiners will also have the flexibility, depending upon the structure and size of a nonbank subsidiary, to utilize the guidance so that it’s applicable to a smaller BHC with credit-extending nonbank subsidiaries having total assets below \$10 billion. Refer to SR-14-4 and its attachment.

Section 2020.1

This section, “Intercompany Transactions (Transactions Between Member Banks and Their Affiliates — Sections 23A and 23B of the Federal Reserve Act)” is revised to discuss statutory amendments to these sections of the Federal Reserve Act resulting from the Dodd-Frank Act. One amendment involved the definition of an “affiliate,” with regard to an investment fund when an insured depository institution (IDI) or one of its affiliates is an investment adviser. Also, the definition of “covered transactions” was revised to include the credit exposure resulting for derivative and securities lending and borrowing transactions between the IDI and its affiliates. In addition, the Dodd-Frank Act removed the quantitative 10 percent exemption limit between financial subsidiaries of an IDI. The retained earnings of a financial subsidiary are to be included as part of the IDI’s investment. The amendments were effective on July 21, 2012. (See sections 608(a)(1)(A), 608(a)(1)(B), and 609(a) of the Dodd-Frank Act.) A few additional or revised inspection objectives and procedures are included.

Section 2070.0

This revised section, “Taxes (Consolidated Tax Filing)” includes a June 13, 2014, Interagency Addendum to the 1998 “Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure” (Addendum). The federal banking agencies¹ (Agencies) announced the Addendum’s issuance to ensure that insured depository institutions (IDIs) in a consolidated group maintain an appropriate relationship regarding the payment of taxes and treatment of tax refunds. The Addendum is to ensure that tax allocation agreements expressly acknowledge an agency relationship between a holding company² and its IDI subsidiary to protect the IDI’s ownership rights in tax refunds. State member banks and holding companies should implement the guidance as soon as reasonably possible, which the Agencies expect would not be later than October 31, 2014. The Addendum clarifies and supplements but does not replace the 1998 Interagency Policy Statement. (Refer to SR-14-6 and its attachment.)

Section 2124.05

This section, “Consolidated Supervision Framework for Large Financial Institutions” is revised to include Appendix B — “Managing Foreign Exchange Settlement Risks for Physically Settled Securities.” (See SR-13-24 and its February 2013 attachment.) This guidance sets forth seven principles or “guidelines” for managing foreign exchange transaction settlement risks. The Federal Reserve supports these principles as part of its continuing effort to promote the global financial system’s ability to withstand severe market disruptions. Institutions covered by SR-13-24 should apply the seven guidelines to their foreign exchange activities with the stated clarifications regarding application of the guidance in the United States.

1. The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

2. For the purpose of this guidance, the term, “holding company” refers to a bank holding company or a savings and loan holding company.

Section 3070.0

This revised section, “Section 4(c)(8) of the BHC Act (Mortgage Banking),” includes a brief discussion of the December 13, 2013, “Inter-agency Statement on Supervisory Approach for Qualified and Non-Qualified Mortgage Loans” that was issued to clarify the safety-and-soundness expectations and Community Reinvestment Act (CRA) considerations for regulated institutions engaged in residential mortgage lending. The section references the Consumer Financial Protection Bureau’s (CFPB) Ability-to-Repay and Qualified Mortgage Standards Rule that was issued on January 10, 2013 (effective on January 10, 2014). Institutions may issue qualified mortgages or non-qualified mortgages, based on their business strategies and risk appetites. Refer to SR-13-20 and its attachment.

Section 4080.1

This section, “Surveillance Program for Small Holding Companies,” is modified to reflect changes to the small holding company surveillance program. The surveillance program for holding companies under \$1 billion in total consolidated assets includes both BHCs and SLHCs. (Refer to SR-13-21.)

Section 5000.0

This section, “BHC Inspection Program (General)” is revised to include supervisory guidance

on the periodic on- and off-site inspections that assess the safety and soundness of supervised BHCs and SLHCs (referred to as holding companies). The guidance updates the minimum inspection frequency and scope requirements for supervised holding companies with total consolidated assets of \$10 billion or less to

- conform inspection frequency and scope requirements for SLHCs with total consolidated assets of \$10 billion or less to those applicable to BHCs of the same size;
- clarify the scoping requirements for targeted inspections conducted at BHCs and SLHCs with total consolidated assets between \$1 billion and \$10 billion; and
- modify the requirement for targeted inspections for “3,” “4,” and “5”-rated BHCs with total consolidated assets between \$1 billion and \$10 billion.

Except for the addition of SLHCs, the inspection scope and frequency expectations for holding companies with less than \$1 billion in total consolidated assets have not changed.

These frequency and scope requirements vary depending on whether a holding company has been designated “complex,” with more complicated holding companies subject to more frequent and in-depth review. If needed for supervisory purposes, Reserve Banks may inspect a holding company with greater frequency and scope than described in this guidance. (Refer to SR-13-21 and its attachment.)

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SUMMARY OF CHANGES

Section 2010.2

The section, “Supervision of Subsidiaries (Loan Administration and Lending Standards),” is revised to supplement the March 23, 2013, “Interagency Guidance on Leveraged Lending” with inspection objectives, inspection procedures, and an internal control questionnaire for leveraged lending. The section provides guidance about the risk-management expectations for leveraged loans as well as examiner guidance for the review of such loans. Refer to SR-13-3 and its attachment.

Section 2020.1

This section, “Intercompany Transactions (Transactions Between Member Banks and Their Affiliates—Sections 23A and 23B of the Federal Reserve Act)” is revised to indicate that violations of sections 23A and 23B of the Federal Reserve Act or Regulation W should be brought to management’s attention. They may be discussed in the inspection report as “Other Matters” and referred to the bank’s primary supervisor. In this regard, there are some revised inspection objectives and inspection procedures.

Section 2060.05

This section consists of the 2003 interagency guidance, “Policy Statement on the Internal Audit Function and its Outsourcing.” The section includes new and revised inspection objectives and inspection procedures for both the 2003 guidance and the January 23, 2013, Federal Reserve policy statement that supplements the 2003 interagency guidance. Refer to SR-03-5 and SR 13-1/CA 13-1 and section 2060.07.

Section 2124.05

This section, “Consolidated Supervision Framework for Large Financial Institutions,” includes an appendix, the December 20, 2013, guidance of SR-13-23, “Risk Transfer Considerations When Assessing Capital Adequacy—Supplemental Guidance on Consolidated Supervision Framework for Large Financial Institutions” (Refer to SR-12-17/CA-12-14). The additional guidance centers on how certain risk transfer transactions affect assessments of capital adequacy at large financial institutions. It provides clarification on supervisory expectations when assessing a firm’s capital adequacy in certain circumstances when the risk-based capital framework may not fully capture the residual risks of a transaction.

Section 2124.3

This new section, “Managing Outsourcing Risk” consists of the December 5, 2013, Federal Reserve “Guidance on Managing Outsourcing Risk” that was issued to assist financial institutions¹ in understanding and managing the risks associated with outsourcing a bank activity to a service provider to perform that activity. The guidance addresses the characteristics, governance, and operational effectiveness of a financial institution’s service provider risk-management program for outsourced activities beyond traditional core bank processing and information technology services. The guidance applies to all service provider relationships regardless of the type of activity that is outsourced. See SR-13-19/CA-13-21 and its attachment.

Section 5010.15

This section, “Procedures for Inspection Report Preparation—Violations” is revised to provide clarifying instructions on the reporting of violations or apparent violations in the inspection report. The “Violations” section or page should include all BHC and nonbank subsidiary viola-

1. For purposes of this guidance, “financial institutions” refers to state member banks, bank and savings and loan holding companies (including their nonbank subsidiaries), and U.S. operations of foreign banking organizations.

tions of the Federal Reserve Act (the act), Regulation Y, and other applicable statutes and regulations. Section 23A and 23B violations of the act should only be included if they have been cited by the primary regulator of the subsidiary

banks. If the bank's primary regulator has not cited a violation of Section 23A and 23B of the act, apparent violations should be noted in the "Other Matters" section or page of the inspection report.

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Bank Holding Company Supervision Manual

Supplement 44—July 2013

This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the January 2013 supplement.

SUMMARY OF CHANGES

Section 2010.2

The “Supervision of Subsidiaries (Loan Administration and Lending Standards)” section is revised to include the 2013 leveraged lending guidance, which replaced the 2001 *Interagency Guidance on Leveraged Financing*. This guidance describes expectations for the sound risk management of leveraged lending activities, including why institutions need to develop

- Transactions structured to reflect a sound business premise, an appropriate capital structure, and reasonable cash flow and balance sheet leverage;
- A definition of leveraged lending that facilitates consistent application across all business lines;
- Well-defined underwriting standards that, among other things, define acceptable leverage levels and describe amortization expectations for senior and subordinate debt;
- A credit limit and concentration framework consistent with the institution’s risk appetite;
- Sound management information systems that enable management to identify, aggregate, and monitor leveraged exposures and comply with policy across all business lines;
- Strong pipeline management policies and procedures that, among other things, provide for real-time information on exposures and limits, and exceptions to the timing of expected distributions and approved hold levels; and
- Guidelines for conducting periodic portfolio and pipeline stress tests to quantify the potential impact of economic and market conditions on the institution’s asset quality, earnings, liquidity, and capital.

This guidance should be consistent with the size and risk profile of an institution’s leveraged activities relative to its assets, earnings, liquidity, and capital. Institutions that originate or sponsor leveraged transactions should consider the entire guidance. See SR-13-3 and its attachment.

Section 2060.07

This new section, “Supplemental Policy Statement on the Internal Audit Function and its Outsourcing,” consists of the January 23, 2013, Federal Reserve policy statement that supplements the 2003 interagency guidance, which is in section 2060.05 of this manual. (See SR-13-1/CA-13-1.)

Section 2500.0

This section on “Supervision of Savings and Loan Holding Companies” was revised to clarify the manner in which Federal Reserve examiners communicate supervisory findings to banking organizations and institutions supervised by the Federal Reserve. It discusses the examiner’s use of the standardized terms, “Matters Requiring Immediate Attention” and “Matters Requiring Attention.” (Refer to SR-13-13/CA-13-10 and its attachment.)

Section 5000.0

This section, “BHC Inspection Program—General,” is updated to discuss the Federal Reserve’s adoption of a flexible, letter-format report in lieu of the standard, longer-form report. The report communicates the findings of on-site safety-and-soundness inspections of community banking organizations¹ that result in composite supervisory ratings of “4” or “5.” Examiners may use the letter-format report provided that all mandatory and any applicable optional information is included in the report. (See SR-13-10.)

The section also clarifies the manner in which Federal Reserve examiners communicate supervisory findings to banking organizations and institutions supervised by the Federal Reserve. The guidance discusses the Federal Reserve’s use of standard language for examination/inspection findings with regard to “*Matters Requiring Immediate Attention* (MRIs)” and “*Matters Requiring Attention* (MRAs),” reaffirming their definitions, includ-

1. “Community banking organizations include state member banks, bank holding companies, and savings and loan holding companies with assets of \$10 billion or less.

ing their use by safety-and-soundness and consumer compliance examiners when communicating supervisory findings to banking organizations. The use of the term, “Observations” is discontinued. (Refer to SR-13-13/CA-13-10 and its attachment.)

The section, in addition, is revised to further clarify the 60-calendar-days’ completion standard for examination and inspection reports for community banking organizations, clarifying the “close date” for examinations or inspections. (See SR-13-14.)

Section 5010.1

The “Procedures for Inspection Report Preparation (General Instructions...)” section has been revised to include a new subsection that applies

to community holding companies rated composite “4” or “5,” for which the Federal Reserve has adopted a flexible, letter-format report in lieu of the standard, longer-form report. (Refer to SR-13-10.)

Section 5010.4

This section, “Procedures for Inspection Report Preparation (Core Page 1-Examiner’s Comments; Matters Requiring Special Board Attention),” was amended to incorporate a reference to the guidance found in SR-13-13/CA-13-10, “Communication of Supervisory Findings,” which clarified the Federal Reserve’s use of standardized terminology and definitions for MRIs and MRA’s.

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This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the July 2012 supplement.

SUMMARY OF CHANGES

Section 2010.0

The “Supervision of Subsidiaries” section includes a revision of the Federal Deposit Insurance Act (FDIA) to require bank holding companies (BHCs) and savings and loan holding companies to act as a source of strength to their depository institution subsidiaries. See section 38A of the FDIA and section 616(d) of the Dodd-Frank Act.

Section 2050.0

This section on “Extensions of Credit to BHC Officials” was revised for amendments to the Federal Reserve Act (FRA) regarding insider lending. The definition of “extension of credit” was revised to include an insured depository institution (IDI)’s credit exposure to a person arising from a derivatives transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction. See the FRA, section 22(h)(9)(D)(i), as amended by the Dodd-Frank Act, section 614(a).

The FDIA was amended to prohibit the purchase or sale of assets between an IDI and an executive officer, director, or principal shareholder of the IDI and any related interest of such person unless the transaction is on market terms. In addition, if the asset purchase or sale represents more than 10 percent of the IDI’s capital stock and surplus, the transaction must be approved by the majority of the board of directors of the IDI who do not have an interest in the transaction. See the Dodd-Frank Act, section 615(1).

Section 2110.0

This section is updated for the various types of formal supervisory actions—corrective actions (i.e., cease and desist orders (including placing limits on the activities or functions of an IDI or institution-affiliated party)), written agreements, suspensions (also removals and prohibitions), nonbank activity terminations, violations of orders and written agreements, civil-money penalties (revised penalty amounts), etc.

The cease-and-desist order discussion has been expanded to include what an order may require from a BHC or person, and it provides a discussion of the nature of affirmative actions by a BHC or person that may need to be taken to restore a BHC to a safe and sound condition. The prohibition and removal discussion has been expanded to detail what entities or individuals that the Board may take action against. It also discusses the prohibition against any individual that has been convicted of a crime involving dishonesty, breach of trust, or money laundering from serving, participating in, or owning or controlling a BHC, bank or nonbank subsidiary, or any affiliate thereof without the prior approval of the Federal Deposit Insurance Corporation (FDIC), or in certain cases, the Board of Governors of the Federal Reserve System. The discussion on indemnifications and payments includes a detailed discussion of the provisions of section 18(k) of the FDIA and the FDIC’s regulation on indemnification agreements and payments. The definition of a prohibited indemnification payment is included.

Section 2124.05

Effective January 2013, this new section provides the “Consolidated Supervision Framework for Large Financial Institutions,” which supersedes the guidance found in inactive SR-99-15, “Risk-Focused Supervision of Large Complex Banking Organizations” (former manual section 2124.04). On December 17, 2012, the Federal Reserve set forth a new framework for the consolidated supervision of large financial institutions. The framework strengthens traditional microprudential supervision and regulation to enhance the safety and soundness of individual firms. In addition, it incorporates macroprudential considerations to reduce poten-

tial threats to the stability of the financial system and to provide insights into financial market trends. The consolidated supervision framework has two primary objectives:

- *Enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary.*

Each firm is expected to ensure that the consolidated organization (or the combined U.S. operations in the case of foreign banking organizations) and its core business lines can survive under a broad range of internal or external stresses. This requires financial resilience by providing sufficient capital and liquidity, and operational resilience to maintain effective corporate governance, risk management, and recovery planning.

- *Reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness.*

Each firm is expected to ensure the sustainability of its critical operations and banking offices¹ under a broad range of internal or external stresses. This requires, among other things, effective resolution planning that addresses the complexity and the interconnectivity of the firm's operations.

The framework is being implemented in a multi-stage approach. (See SR-12-17 / CA-12-14)

Section 2126.1

This section, "Investment Securities and End-User Derivatives Activities," was amended to

1. "Banking offices" are defined as U.S. depository institution subsidiaries, as well as the U.S. branches and agencies of foreign banking organizations.

state that depository institutions can no longer rely solely on reports from external credit reporting agencies when making a determination as to the quality and permissibility of an investment in accordance with the Office of the Controller's (OCC's) Rule (12 C.F.R. 1).

Section 2126.2

This is a new section on "Investing in Securities Without Reliance on Ratings of Nationally Recognized Statistical Rating Organizations" (NRSROs). State member banks were advised on November 15, 2012, that, effective January 1, 2013, they may no longer rely solely on credit ratings issued by NRSROs (i.e., external credit ratings) to determine whether a particular security is an "investment security" that is permissible for investment. Under the regulations of the OCC's rule (12 C.F.R. 1), securities may qualify for investment by national banks only if they are determined by the bank to be "investment grade" and not predominantly speculative in nature.² (See SR-12-15 and its attachment, "OCC Guidance on Due Diligence Requirements in Determining Whether Securities are Eligible for Investment.") Institutions may perform due diligence by maintaining and updating internal credit-rating reports and assessments, which can be supplemented by reports from external credit-rating services.

2. Under the FRA (12 USC 335) and the Federal Reserve's Regulation H (12 C.F.R. 208.21), state member banks are subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as national banks under the National Banking Act (12 U.S.C. 24 (Seventh)). When investing in securities, state member banks must comply with the provisions of the National Banking Act and the OCC regulations in 12 C.F.R. 1. In addition to this federal requirement, a state member bank may purchase, sell, underwrite, or hold securities and stock only to the extent permitted under applicable state law.

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Bank Holding Company Supervision Manual

Supplement 42—July 2012

This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, supervisory guidance, and instructions that the Division of Banking Supervision and Regulation has issued since the publication of the January 2012 supplement.

SUMMARY OF CHANGES

Section 1040.0

The section, “Bank Holding Company Examination and Inspection Authority,” has been revised to discuss the Federal Reserve’s (FR) current authority to conduct bank holding company (BHC) inspections under section 5(c) of the BHC Act (12 U.S.C. 1844(c) and 12 U.S.C. 5361(a)–(c)). The section also is revised to include provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act removes the enforcement provisions of section 10A of the BHC Act that limited the FR’s rulemaking and enforcement authority over functionally regulated subsidiaries. Previously, the FR was only able to take enforcement actions against a functionally regulated subsidiary when its actions posed a threat to the safety and soundness of a depository institution affiliate.

The FR, to the fullest extent possible, is to rely on reports of examination of any subsidiary depository institution or functionally regulated subsidiary made by the primary financial regulatory agency. Also, the FR should notify, consult, and work with the primary financial regulatory agency for examination activities, information requests, and required reporting while avoiding duplication and increased burden on the institution. With regard to its supervision of a nonbank financial company, the FR is to rely on (1) reports and other supervisory information provided to other federal and state regulatory agencies, (2) externally audited financial statements, (3) information that is otherwise available from federal and state regulatory agencies, and (4) information that is required to be reported publicly.

Section 2065.5

This new section, “ALLL Estimation Practices for Loans Secured by Junior Liens,” provides the January 31, 2012, “Interagency Supervisory Guidance on Allowance for Loan and Lease Losses Estimation Practices for Loans and Lines of Credit Secured by Junior Liens on 1–4 Family Residential Properties.” Institutions should consider all credit-quality indicators for junior-lien loans and lines of credit (collectively, junior liens). Generally, this information should include the delinquency status of senior liens associated with the institution’s junior liens and whether the senior liens have been modified. Institutions should ensure that during the allowance for loan and lease losses estimation process sufficient information is gathered to adequately assess the probable loss incurred within junior-lien portfolios.

Institutions with significant holdings of junior liens should gather and analyze data on the associated senior-lien loans they own or service. When an institution does not own or service the associated senior-lien loans, it should use reasonably available tools to determine the payment status of the senior-lien loans. Such tools include obtaining credit reports or data from third-party services to assist in matching an institution’s junior liens with its associated senior liens. Inspection objectives and procedures are provided. See SR-12-3 and its attachment.

Section 3000.0

This section, “Introduction to BHC Nonbanking and FHC Activities” was revised for an amendment made under section 604(e) of the Dodd-Frank Act (see section 4(j)(2)(A) of the BHC Act or 12 U.S.C. 1843(j)(2)(A)). The Board is required to apply a “balancing test” in connection with a notice filed by a BHC to engage in a nonbanking activity. The Board must consider whether the performance of the activity by the company can “reasonably be expected to produce benefits to the public, such as greater convenience, increased competition or gains in efficiency that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.” The amendment added another adverse factor to

consider—whether the performance of the non-bank activity by a BHC would pose a risk to the stability of the U.S. banking or financial system.

Section 3032.0

This new section presents the Federal Reserve’s April 5, 2012, policy statement, “Policy Statement on Rental of Residential Other Real Estate Owned (OREO) Properties.” The policy statement reminds banking organizations and examiners that the Federal Reserve’s regulations and policies permit the rental of OREO properties as part of an orderly disposition strategy within statutory and regulatory limits. Banking organizations may rent one- to four-family residential OREO properties without having to demonstrate continuous active marketing of the properties, provided that suitable policies and procedures are followed.

The policy statement describes key risk-management considerations for banking organizations that engage in the rental of residential OREO. The policy statement also establishes specific supervisory expectations for banking organizations that undertake large-scale residential OREO rentals, which generally encompasses 50 properties or more available for rent. See SR-12-5/CA-12-3 and its attachment. Also see SR-12-10/CA-12-9, “Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned (OREO).”

Section 3980.0

This new section, “Establishment of an Intermediate Holding Company,” discusses the Board’s authority under section 167 of the Dodd-Frank Act (12 U.S.C. 5667). If a nonbank financial company supervised by the FR conducts activities other than those determined to be financial in nature or incidental thereto under section 4(k) of the BHC Act (12 U.S.C. 1843(k)), the Board is authorized to require the company to establish and conduct all or a portion of those activities that are financial in nature or incidental thereto in or through an intermediate holding company. The intermediate holding company must be established in accordance with the Board’s regulation no later than 90 days (or other longer appropriate time) after the date on which the Board notifies the nonbank financial company of the determination.

The Board must require a nonbank financial company to establish an intermediate holding company, if it makes a determination that the establishment of such an intermediate holding company is necessary to

- appropriately supervise activities that are determined to be financial in nature or incidental thereto; or
- ensure that supervision by the Board does not extend to the commercial activities of the nonbank financial company.

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Bank Holding Company Supervision Manual

Supplement 41—January 2012

This supplement reflects decisions of the Board of Governors, new and revised statutory and regulatory provisions, and new and revised supervisory guidance and instructions issued by the Division of Banking Supervision and Regulation since the publication of the July 2011 supplement.

SUMMARY OF CHANGES

Section 2500.0

This new section, “Supervision of Savings and Loan Holding Companies” describes the supervisory approach for savings and loan holding companies (SLHCs) the Board will use during the first supervisory cycle.¹ The condition, performance, and activities of SLHCs will be assessed on a consolidated basis in a manner that is consistent with the Board’s established risk-based supervisory approach for bank holding companies (BHCs). For specific information about the supervisory approach during the first

1. The first supervisory cycle for an SLHC is the period of time between July 21, 2011, and the close of the first required inspection.

supervisory cycle for holding companies of varying size and complexity, see SR-11-11 and its attachments.

Section 4061.0

This new section on “Consolidated Capital (Capital Planning)” summarizes amendments to Regulation Y that require BHCs with \$50 billion or more (large BHCs) of total consolidated assets to develop and submit annual capital plans to the Federal Reserve. These BHCs are required to obtain approval from the Federal Reserve under certain circumstances before making a capital distribution. The section generally discusses significant provisions of the rule’s amendments.

The large U.S. BHCs should have credible capital plans that show sufficient capital to lend to households and businesses, even under adverse conditions. Each year, boards of directors of large BHCs will be required to review and approve the capital plans before submitting them to the Federal Reserve. The rule was effective on December 30, 2011. See the Board’s November 22, 2011, press release, 76 *Fed. Reg.* 74631 (December 1, 2011), and 12 C.F.R. 225.8.

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