About this Manual

Section 1000.0

PURPOSE AND THE ROLE OF GUIDANCE

The Bank Holding Company Supervision Manual is prepared by Federal Reserve supervision personnel to provide guidance to examiners as they conduct inspections of bank holding companies (BHCs) and their nonbank subsidiaries as well as savings and loan holding companies (SLHCs). The manual is a compilation of formalized procedures and Board supervisory policies that examiners and supervision personnel should follow for the supervision of these organizations. It also discusses the relevant statutes, regulations, interpretations, and orders that pertain to holding company supervision. The manual enhances the staff’s ability to implement the Board’s inspection, supervisory, and monitoring activities, which is integral to the Federal Reserve’s supervision program for organizations operating under a holding company structure. This manual is periodically updated on the Board’s public website to reflect the latest supervisory policy and procedures and to address changes in industry risk-management practices.1

The Federal Reserve and the other banking and regulatory agencies issue various types of supervisory guidance, including interagency statements, advisories, bulletins, policy statements, questions and answers, and frequently asked questions, to their respective supervised institutions. A statute or regulation has the force and effect of law.2 Unlike a law or regulation, supervisory guidance does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance. Rather, supervisory guidance outlines the agencies’ supervisory expectations or priorities and articulates the agencies’ general views regarding appropriate practices for a given subject area. Supervisory guidance often provides examples of practices that the agencies generally consider consistent with safety-and-soundness standards or other applicable laws and regulations, including those designed to protect consumers. See SR letter 18-5/CA letter 18-7, “Interagency Statement Clarifying Role of Supervisory Guidance.”

This manual is designed to provide guidance to examination and supervision personnel. It should not be considered a legal reference document. Questions concerning the applicability of and compliance with federal laws and regulations should be referred to appropriate legal counsel.

USE OF THE MANUAL

The Bank Holding Company Supervision Manual is presented in “sections” which have been grouped together into “parts” that have in common a central theme pertaining to holding company supervision. For example, Part I provides an overview of the supervisory process of holding companies. Part II is composed of sections that discuss topics of special interest for supervisory review. Part III is composed of sections that discuss the various exemptive provisions to the nonbank prohibitions of the BHC Act. Part IV presents sections on the preparation of a financial analysis.

The content of the sections within parts II–IV are grouped into four broad categories: (1) Main Section Content (2) Inspection Objectives, (3) Inspection Procedures, and (4) Laws, Regulations, Interpretations, and Orders. Not all of the categories are presented in each section. This manual uses a numbering system for organizing and referencing content. Content in subsections with headings having “tenths” or one decimal point generally provide higher-level or foundational information. Content under subheadings with several decimal points convey more detailed information.

Where a particular topic is exclusively financially related and does not involve legal considerations, the subsection on “Laws, Regulations,” may be omitted. These procedures were designed for a full-scope, comprehensive inspection. It is recognized that in some instances the procedures may not apply in their entirety to all holding companies. Examiners should exercise supervisory judgment in completing procedures depending upon the characteristics of the organization under inspection.

2. Government agencies issue regulations that generally have the force and effect of law. Such regulations generally take effect only after the agency proposes the regulation to the public and responds to comments on the proposal in a final rulemaking document.
TYPES OF HOLDING COMPANIES

Bank Holding Companies (Including Financial Holding Companies)

Banks are often owned or controlled by another company, called a bank holding company (BHC). The Federal Reserve has supervisory and regulatory authority for all BHCs, regardless of whether subsidiary banks of the holding company are national banks, state member banks, or state nonmember banks. It also has supervisory authority over any nonbank subsidiary of a BHC that is not functionally regulated by another federal or state supervisor, such as a leasing subsidiary.

The Gramm-Leach-Bliley Act of 1999 permits BHCs that meet certain criteria to become financial holding companies (FHCs), which are also under Federal Reserve’s supervisory and regulatory authority. FHCs engage in an expanded list of activities including securities underwriting and dealing, merchant banking, insurance underwriting, and the sale of insurance. When an FHC engages in these activities, the Federal Reserve coordinates its supervisory efforts with those of the subsidiary’s functional regulator—for example, the U.S. Securities and Exchange Commission in the case of a broker-dealer, and state insurance regulators in the case of an insurance company.

Savings and Loan Holding Companies

Savings and loan holding companies (SLHCs) directly or indirectly control a savings association. Federal savings associations (those with federal charters) are supervised by the Office of the Comptroller of the Currency, while state-chartered savings associations are generally supervised by the Federal Deposit Insurance Corporation and their chartering state. Besides owning federal and/or state savings associations, an SLHC that meets capital and management requirements and elects to be treated as a financial holding company may also engage in activities as if it were a financial holding company that controls a bank.

Historically, SLHCs were regulated by other agencies: at first, the Federal Home Loan Bank Board, and more recently, by the Office of Thrift Supervision (OTS). In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminated the OTS and transferred supervisory and regulatory responsibilities for SLHCs to the Federal Reserve. As a result, the Federal Reserve now supervises and regulates all SLHCs regardless of the charters of the subsidiary savings associations. The Federal Reserve coordinates its supervisory efforts with the appropriate functional regulator(s) for a SLHC.
## General Table of Contents

**Bank Holding Company Supervision Manual**

This general table of contents lists the major section heads for each part of the manual:

<table>
<thead>
<tr>
<th>Sections</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000</td>
<td>ABOUT THIS MANUAL, SUPERVISORY PROCESS</td>
</tr>
<tr>
<td>1000.0</td>
<td>About this Manual</td>
</tr>
<tr>
<td>1010.0</td>
<td>Table of Contents</td>
</tr>
<tr>
<td>1020.0–1030.0</td>
<td>Reserved</td>
</tr>
<tr>
<td>1040.0</td>
<td>Bank Holding Company Examination and Inspection Authority</td>
</tr>
<tr>
<td>1045.0</td>
<td>Supervision of Holding Companies with Total Consolidated Assets of $10 Billion or Less</td>
</tr>
<tr>
<td>1050.0</td>
<td>Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations</td>
</tr>
<tr>
<td>1050.1</td>
<td>Guidance for the Consolidated Supervision of Domestic Bank Holding Companies that are Large Complex Banking Organizations</td>
</tr>
<tr>
<td>1050.2</td>
<td>Guidance for the Consolidated Supervision of Regional Bank Holding Companies</td>
</tr>
<tr>
<td>1060.0</td>
<td>Large Financial Institution Rating System</td>
</tr>
<tr>
<td>1062.0</td>
<td>RFI Rating System</td>
</tr>
<tr>
<td>1063.0</td>
<td>Holding Company Ratings Applicability and Inspection Frequency</td>
</tr>
<tr>
<td>1065.0</td>
<td>Nondisclosure of Supervisory Ratings and Confidential Supervisory Information</td>
</tr>
<tr>
<td>1070.1</td>
<td>Communication of Supervisory Findings</td>
</tr>
<tr>
<td>2000</td>
<td>SUPERVISORY POLICY AND ISSUES</td>
</tr>
<tr>
<td>2000.0</td>
<td>Introduction to Topics for Supervisory Review</td>
</tr>
<tr>
<td>2010.0</td>
<td>Supervision of Subsidiaries</td>
</tr>
<tr>
<td>2010.1</td>
<td>Funding Policies</td>
</tr>
<tr>
<td>2010.2</td>
<td>Loan Administration</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>-------------</td>
<td>------------------------------------------------------------</td>
</tr>
<tr>
<td>2010.3</td>
<td>Investments</td>
</tr>
<tr>
<td>2010.4</td>
<td>Consolidated Planning Process</td>
</tr>
<tr>
<td>2010.5</td>
<td>Environmental Liability</td>
</tr>
<tr>
<td>2010.6</td>
<td>Financial Institution Subsidiary Retail Sales of Nondeposit Investment Products</td>
</tr>
<tr>
<td>2010.7</td>
<td>Reserved</td>
</tr>
<tr>
<td>2010.8</td>
<td>Sharing of Facilities and Staff by Banking Organizations</td>
</tr>
<tr>
<td>2010.9</td>
<td>Required Absences from Sensitive Positions</td>
</tr>
<tr>
<td>2010.10</td>
<td>Internal Loan Review</td>
</tr>
<tr>
<td>2010.11</td>
<td>Private-Banking Functions and Activities</td>
</tr>
<tr>
<td>2010.12</td>
<td>Fees Involving Investments of Fiduciary Assets in Mutual Funds and Potential Conflicts Interest</td>
</tr>
<tr>
<td>2010.13</td>
<td>Establishing Accounts for Foreign Governments Embassies, and Political Figures</td>
</tr>
<tr>
<td>2020.0</td>
<td>Intercompany Transactions—Introduction</td>
</tr>
<tr>
<td>2020.1</td>
<td>Intercompany Transactions Between Affiliates—Sections 23A and 23B of the Federal Reserve Act</td>
</tr>
<tr>
<td>2020.2</td>
<td>Loan Participations—Intercompany Transactions</td>
</tr>
<tr>
<td>2020.3</td>
<td>Sale and Transfer of Assets</td>
</tr>
<tr>
<td>2020.4</td>
<td>Compensating Balances</td>
</tr>
<tr>
<td>2020.5</td>
<td>Dividends</td>
</tr>
<tr>
<td>2020.6</td>
<td>Management and Service Fees</td>
</tr>
<tr>
<td>2020.7</td>
<td>Transfer of Low-Quality Assets</td>
</tr>
<tr>
<td>2020.8</td>
<td>Reserved</td>
</tr>
<tr>
<td>2020.9</td>
<td>Split-Dollar Life Insurance</td>
</tr>
<tr>
<td>2030.0</td>
<td>Grandfather Rights—Retention and Expansion of Activities</td>
</tr>
<tr>
<td>2040.0</td>
<td>Commitments to the Federal Reserve</td>
</tr>
<tr>
<td>2050.0</td>
<td>Extensions of Credit to BHC Officials</td>
</tr>
<tr>
<td>2060.0</td>
<td>Management Information Systems</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>-----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>2060.05</td>
<td>Policy Statement on the Internal Audit Function and Its Outsourcing</td>
</tr>
<tr>
<td>2060.07</td>
<td>Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing</td>
</tr>
<tr>
<td>2060.1</td>
<td>Audit</td>
</tr>
<tr>
<td>2060.2</td>
<td>Budget</td>
</tr>
<tr>
<td>2060.3</td>
<td>Records and Statements</td>
</tr>
<tr>
<td>2060.4</td>
<td>Structure and Reporting</td>
</tr>
<tr>
<td>2060.5</td>
<td>Insurance</td>
</tr>
<tr>
<td>2065.1</td>
<td>Accounting, Reporting, and Disclosure Issues— Nonaccrual Loans and Restructured Debt</td>
</tr>
<tr>
<td>2065.2</td>
<td>Determining an Adequate Level for the Allowance for Loan and Lease Losses</td>
</tr>
<tr>
<td>2065.3</td>
<td>Maintenance of an Adequate Allowance for Loan and Lease Losses</td>
</tr>
<tr>
<td>2065.4</td>
<td>ALLL Methodologies and Documentation</td>
</tr>
<tr>
<td>2065.5</td>
<td>ALLL Estimation Practices for Loans Secured by Junior Liens</td>
</tr>
<tr>
<td>2068.0</td>
<td>Sound Incentive Compensation Policies</td>
</tr>
<tr>
<td>2070.0</td>
<td>Taxes—Consolidated Tax Filing</td>
</tr>
<tr>
<td>2080.0</td>
<td>Funding—Introduction</td>
</tr>
<tr>
<td>2080.05</td>
<td>Bank Holding Company Funding and Liquidity</td>
</tr>
<tr>
<td>2080.1</td>
<td>Commercial Paper and Other Short-Term Uninsured Debt Obligations and Securities</td>
</tr>
<tr>
<td>2080.2</td>
<td>Long-Term Debt</td>
</tr>
<tr>
<td>2080.3</td>
<td>Equity</td>
</tr>
<tr>
<td>2080.4</td>
<td>Retention of Earnings</td>
</tr>
<tr>
<td>2080.5</td>
<td>Pension Funding and Employee Stock Option Plans</td>
</tr>
<tr>
<td>2080.6</td>
<td>Bank Holding Company Funding from Sweep Accounts</td>
</tr>
<tr>
<td>2090.0</td>
<td>Control and Ownership—General</td>
</tr>
<tr>
<td>2090.05</td>
<td>Qualified Family Partnerships</td>
</tr>
<tr>
<td>2090.1</td>
<td>Change in Control</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>2090.2</td>
<td>BHC Formations</td>
</tr>
<tr>
<td>2090.3</td>
<td>Treasury Stock Redemptions</td>
</tr>
<tr>
<td>2090.4</td>
<td>Policy Statements on Equity Investments in Banks and BHCs</td>
</tr>
<tr>
<td>2090.5</td>
<td>Acquisitions of Bank Shares Through Fiduciary Accounts</td>
</tr>
<tr>
<td>2090.6</td>
<td>Divestiture Control Determinants</td>
</tr>
<tr>
<td>2090.7</td>
<td>Nonbank Banks</td>
</tr>
<tr>
<td>2090.8</td>
<td>Liability for Commonly Controlled Depository Institutions</td>
</tr>
<tr>
<td>2091.0–</td>
<td>Reserved</td>
</tr>
<tr>
<td>2092.0</td>
<td></td>
</tr>
<tr>
<td>2093.0</td>
<td>Control and Ownership—Shareholder Protection Arrangements</td>
</tr>
<tr>
<td>2100.0</td>
<td>International Banking Activities</td>
</tr>
<tr>
<td>2110.0</td>
<td>Formal Corrective Actions</td>
</tr>
<tr>
<td>2120.0</td>
<td>Foreign Corrupt Practices Act and Federal Election Campaign Act</td>
</tr>
<tr>
<td>2122.0</td>
<td>Internal Credit-Risk Ratings at Large Banking Organizations</td>
</tr>
<tr>
<td>2124.0</td>
<td>Risk-Focused Safety-and-Soundness Inspections</td>
</tr>
<tr>
<td>2124.01</td>
<td>Risk-Focused Supervisory Framework for Large Complex Banking Organizations</td>
</tr>
<tr>
<td>2124.02–</td>
<td>Reserved</td>
</tr>
<tr>
<td>2124.04</td>
<td></td>
</tr>
<tr>
<td>2124.05</td>
<td>Consolidated Supervision Framework for Large Financial Institutions</td>
</tr>
<tr>
<td>2124.07</td>
<td>Compliance Risk-Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles</td>
</tr>
<tr>
<td>2124.1</td>
<td>Assessment of Information Technology in Risk-Focused Supervision</td>
</tr>
<tr>
<td>2124.2</td>
<td>Reserved</td>
</tr>
<tr>
<td>2124.3</td>
<td>Managing Outsourcing Risk</td>
</tr>
<tr>
<td>2124.4</td>
<td>Information Security Standards</td>
</tr>
<tr>
<td>2124.5</td>
<td>Identity Theft Red Flags and Address Discrepancies</td>
</tr>
<tr>
<td>2125.0</td>
<td>Trading Activities of Banking Organizations—Risk Management and Internal Controls</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>2126.0</td>
<td>Model Risk Management</td>
</tr>
<tr>
<td>2126.1</td>
<td>Investment Securities and End-User Derivatives Activities</td>
</tr>
<tr>
<td>2126.2</td>
<td>Investing in Securities without Reliance on Ratings of Nationally</td>
</tr>
<tr>
<td></td>
<td>Recognized Statistical Rating Organizations</td>
</tr>
<tr>
<td>2126.3</td>
<td>Counterparty Credit Risk Management Systems</td>
</tr>
<tr>
<td>2126.5</td>
<td>Procedures for a Banking Entity to Request an Extended Transition</td>
</tr>
<tr>
<td></td>
<td>Period for Illiquid Funds</td>
</tr>
<tr>
<td>2127.0</td>
<td>Interest-Rate Risk—Risk Management and Internal Controls</td>
</tr>
<tr>
<td>2128.0</td>
<td>Structured Notes—Risk Management and Internal Controls</td>
</tr>
<tr>
<td>2128.01</td>
<td>Reserved</td>
</tr>
<tr>
<td>2128.02</td>
<td>Asset Securitization</td>
</tr>
<tr>
<td>2128.03</td>
<td>Credit-Supported and Asset-Backed Commercial Paper</td>
</tr>
<tr>
<td>2128.04</td>
<td>Implicit Recourse Provided to Asset Securitizations</td>
</tr>
<tr>
<td>2128.05</td>
<td>Securitization Covenants Linked to Supervisory Actions or Thresholds</td>
</tr>
<tr>
<td>2128.06</td>
<td>Valuation of Retained Interests and Risk Management of Securitization</td>
</tr>
<tr>
<td></td>
<td>Activities</td>
</tr>
<tr>
<td>2128.07</td>
<td>Reserved</td>
</tr>
<tr>
<td>2128.08</td>
<td>Subprime Lending</td>
</tr>
<tr>
<td>2128.09</td>
<td>Elevated-Risk Complex Structured Finance Activities</td>
</tr>
<tr>
<td>2129.0</td>
<td>Credit Derivatives—Risk Management and Internal Controls</td>
</tr>
<tr>
<td>2129.05</td>
<td>Risk and Capital Management—Secondary-Market Credit Activities</td>
</tr>
<tr>
<td>2130.0</td>
<td>Futures, Forward, and Option Contracts</td>
</tr>
<tr>
<td>2140.0</td>
<td>Securities Lending</td>
</tr>
<tr>
<td>2150.0</td>
<td>Repurchase Transactions</td>
</tr>
<tr>
<td>2160.0</td>
<td>Recognition and Control of Exposure to Risk</td>
</tr>
<tr>
<td>2175.0</td>
<td>Sale of Uninsured Annuities</td>
</tr>
<tr>
<td>2178.0</td>
<td>Support of Bank-Affiliated Investment Funds</td>
</tr>
<tr>
<td>2180.0</td>
<td>Securities Activities in Overseas Markets</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>2187.0</td>
<td>Violations of Federal Reserve Margin Regulations Resulting from</td>
</tr>
<tr>
<td></td>
<td>“Free-Riding” Schemes</td>
</tr>
<tr>
<td>2220.3</td>
<td>Note Issuance and Revolving Underwriting Credit Facilities</td>
</tr>
<tr>
<td>2231.0</td>
<td>Real Estate Appraisals and Evaluations</td>
</tr>
<tr>
<td>2240.0</td>
<td>Guidelines for the Review and Classification of Troubled Real Estate</td>
</tr>
<tr>
<td>2241.0</td>
<td>Retail-Credit Classification</td>
</tr>
<tr>
<td>2250.0</td>
<td>Domestic and Other Reports to Be Submitted to the Federal Reserve</td>
</tr>
<tr>
<td>2260.0</td>
<td>Venture Capital</td>
</tr>
<tr>
<td>2500.0</td>
<td>Supervision of Savings and Loan Holding Companies</td>
</tr>
<tr>
<td>3000</td>
<td>NONBANKING ACTIVITIES</td>
</tr>
<tr>
<td>3000.0</td>
<td>Introduction to BHC Nonbanking and FHC Activities</td>
</tr>
<tr>
<td>3001.0</td>
<td>Section 2(c) of the BHC Act—Savings Bank Subsidiaries of BHCs</td>
</tr>
<tr>
<td></td>
<td>Engaging in Nonbanking Activities</td>
</tr>
<tr>
<td>3005.0</td>
<td>Section 2(c)(2)(F) of the BHC Act—Credit Card Bank Exemption from</td>
</tr>
<tr>
<td></td>
<td>the Definition of a Bank</td>
</tr>
<tr>
<td>3010.0</td>
<td>Section 4(c)(i) and (ii) of the BHC Act—Exemptions from Prohibitions</td>
</tr>
<tr>
<td></td>
<td>on Acquiring Nonbank Interests</td>
</tr>
<tr>
<td>3020.0</td>
<td>Section 4(c)(1) of the BHC Act—Investment in Companies Whose Activities</td>
</tr>
<tr>
<td></td>
<td>Are Incidental to Banking</td>
</tr>
<tr>
<td>3030.0</td>
<td>Section 4(c)(2) and (3) of the BHC Act—Acquisition of DPC Shares,</td>
</tr>
<tr>
<td></td>
<td>Assets, or Real Estate</td>
</tr>
<tr>
<td>3032.0</td>
<td>Rental of Other Real Estate Owned Residential Property</td>
</tr>
<tr>
<td>3040.0</td>
<td>Section 4(c)(4) of the BHC Act—Interests in Nonbanking Organizations</td>
</tr>
<tr>
<td>3050.0</td>
<td>Section 4(c)(5) of the BHC Act—Investments Under Section 5136 of the</td>
</tr>
<tr>
<td></td>
<td>Revised Statutes</td>
</tr>
<tr>
<td>3060.0</td>
<td>Section 4(c)(6) and (7) of the BHC Act—Ownership of Shares in Any</td>
</tr>
<tr>
<td></td>
<td>Nonbank Company of 5 Percent or Less</td>
</tr>
<tr>
<td>3070.0</td>
<td>Section 4(c)(8) of the BHC Act—Mortgage Banking</td>
</tr>
<tr>
<td>3070.3</td>
<td>Non-Traditional Mortgages—Associated Risks</td>
</tr>
<tr>
<td>3071.0</td>
<td>Section 4(c)(8) of the BHC Act—Mortgage Banking—Derivative Commitments</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>3072.0</td>
<td>Section 4(c)(8) of the BHC Act—Activities Related to Extending Credit</td>
</tr>
<tr>
<td>3072.8</td>
<td>Real Estate Settlement Services</td>
</tr>
<tr>
<td>3073.0</td>
<td>Section 4(c)(8) of the BHC Act—Education-Financing Activities</td>
</tr>
<tr>
<td>3080.0</td>
<td>Section 4(c)(8) of the BHC Act—Servicing Loans</td>
</tr>
<tr>
<td>3084.0</td>
<td>Section 4(c)(8) of the BHC Act—Asset-Management, Asset-Servicing, and Collection Activities</td>
</tr>
<tr>
<td>3090.0</td>
<td>Section 4(c)(8) of the BHC Act—Receivables</td>
</tr>
<tr>
<td>3090.1</td>
<td>Factoring</td>
</tr>
<tr>
<td>3090.2</td>
<td>Accounts Receivable Financing</td>
</tr>
<tr>
<td>3100.0</td>
<td>Section 4(c)(8) of the BHC Act—Consumer Finance</td>
</tr>
<tr>
<td>3104.0</td>
<td>Section 4(c)(8) of the BHC Act—Acquiring Debt in Default</td>
</tr>
<tr>
<td>3105.0</td>
<td>Section 4(c)(8) of the BHC Act—Credit Card Authorization and Lost/Stolen Credit Card Reporting Services</td>
</tr>
<tr>
<td>3107.0</td>
<td>Section 4(c)(8) of the BHC Act—Stand-Alone Inventory Inspection Services</td>
</tr>
<tr>
<td>3110.0</td>
<td>Section 4(c)(8) of the BHC Act—Industrial Banking</td>
</tr>
<tr>
<td>3111.0</td>
<td>Section 4(c)(8) of the BHC Act—Acquisition of Savings Associations</td>
</tr>
<tr>
<td>3120.0</td>
<td>Section 4(c)(8) of the BHC Act—Trust Services</td>
</tr>
<tr>
<td>3130.0</td>
<td>Section 4(c)(8) of the BHC Act—General Financial and Investment Advisory Activities</td>
</tr>
<tr>
<td>3130.1</td>
<td>Investment or Financial Advisers</td>
</tr>
<tr>
<td>3130.2</td>
<td>Reserved</td>
</tr>
<tr>
<td>3130.3</td>
<td>Advice on Mergers and Similar Corporate Structurings, Capital Structurings, and Financing Transactions</td>
</tr>
<tr>
<td>3130.4</td>
<td>Informational, Statistical Forecasting, and Advisory Services for Transactions in Foreign Exchange and Swaps, Commodities, and Derivative Instruments</td>
</tr>
<tr>
<td>3130.5</td>
<td>Providing Educational Courses and Instructional Materials for Consumers on Individual Financial Management Matters</td>
</tr>
<tr>
<td>3130.6</td>
<td>Tax-Planning and Tax-Preparation Services</td>
</tr>
<tr>
<td>3140.0</td>
<td>Section 4(c)(8) of the BHC Act—Leasing Personal or Real Property</td>
</tr>
<tr>
<td>3150.0</td>
<td>Section 4(c)(8) of the BHC Act—Community Welfare Projects</td>
</tr>
</tbody>
</table>
### Sections

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>3160.0</td>
<td>Section 4(c)(8) of the BHC Act—EDP Servicing Company</td>
</tr>
<tr>
<td>3160.1</td>
<td>EDP Servicing—Network for the Processing and Transmission of Medical Payment Data</td>
</tr>
<tr>
<td>3160.2</td>
<td>Electronic Benefit Transfer, Stored-Value-Card, and Electronic Data Interchange Services</td>
</tr>
<tr>
<td>3160.3</td>
<td>Data Processing Activities: Obtaining Traveler’s Checks and Postage Stamps Using an ATM Card and Terminal</td>
</tr>
<tr>
<td>3160.4</td>
<td>Providing Data Processing for ATM Distribution of Tickets, Gift Certificates, Telephone Cards, and Other Documents</td>
</tr>
<tr>
<td>3160.5</td>
<td>Engage in Transmitting Money</td>
</tr>
<tr>
<td>3165.1</td>
<td>Support Services—Printing and Selling MICR-Encoded Items</td>
</tr>
<tr>
<td>3170.0</td>
<td>Section 4(c)(8) of the BHC Act—Insurance Agency Activities of Bank Holding Companies</td>
</tr>
<tr>
<td>3180.0</td>
<td>Section 4(c)(8) of the BHC Act—Insurance Underwriters</td>
</tr>
<tr>
<td>3190.0</td>
<td>Section 4(c)(8) of the BHC Act—Courier Services</td>
</tr>
<tr>
<td>3200.0</td>
<td>Section 4(c)(8) of the BHC Act—Management Consulting and Counseling</td>
</tr>
<tr>
<td>3202.0</td>
<td>Section 4(c)(8) of the BHC Act—Employee Benefits Consulting Services</td>
</tr>
<tr>
<td>3204.0</td>
<td>Section 4(c)(8) of the BHC Act—Career Counseling</td>
</tr>
<tr>
<td>3210.0</td>
<td>Section 4(c)(8) of the BHC Act—Money Orders, Savings Bonds, and Traveler’s Checks</td>
</tr>
<tr>
<td>3210.1</td>
<td>Payment Instruments</td>
</tr>
<tr>
<td>3220.0</td>
<td>Section 4(c)(8) of the BHC Act—Arranging Commercial Real Estate Equity Financing</td>
</tr>
<tr>
<td>3230.0</td>
<td>Section 4(c)(8) of the BHC Act—Agency Transaction Services for Customer Investments (Securities Brokerage)</td>
</tr>
<tr>
<td>3230.05</td>
<td>Securities Brokerage (Board Decisions)</td>
</tr>
<tr>
<td>3230.1</td>
<td>Securities Brokerage in Combination with Investment Advisory Services</td>
</tr>
<tr>
<td>3230.2</td>
<td>Securities Brokerage with Discretionary Investment Management and Investment Advisory Services</td>
</tr>
<tr>
<td>3230.3</td>
<td>Offering Full Brokerage Services for Bank-Ineligible Securities</td>
</tr>
<tr>
<td>3230.4</td>
<td>Private-Placement and Riskless-Principal Activities</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>--------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>3230.5</td>
<td>Acting as a Municipal Securities Brokers’ Broker</td>
</tr>
<tr>
<td>3230.6</td>
<td>Acting as a Conduit in Securities Borrowing and Lending</td>
</tr>
<tr>
<td>3240.0</td>
<td>Section 4(c)(8) of the BHC Act—Underwriting and Dealing in U.S. Obligations, Municipal Securities, and Money Market Instruments</td>
</tr>
<tr>
<td>3250.0</td>
<td>Section 4(c)(8) of the BHC Act—Agency Transactional Services (Futures Commission Merchants and Futures Brokerage)</td>
</tr>
<tr>
<td>3251.0</td>
<td>4(c)(8) Agency Transactional Services—FCM Board Orders</td>
</tr>
<tr>
<td>3255.0</td>
<td>Section 4(c)(8) of the BHC Act—Agency Transactional Services for Customer Investments</td>
</tr>
<tr>
<td>3260.0</td>
<td>Section 4(c)(8) of the BHC Act—Investment Transactions as Principal</td>
</tr>
<tr>
<td>3270.0</td>
<td>Section 4(c)(8) of the BHC Act—Real Estate and Personal Property Appraising</td>
</tr>
<tr>
<td>3320.0</td>
<td>Section 4(c)(8) of the BHC Act—Check-Guaranty and Check-Verification Services</td>
</tr>
<tr>
<td>3330.0</td>
<td>Section 4(c)(8) of the BHC Act—Operating a Collection Agency</td>
</tr>
<tr>
<td>3340.0</td>
<td>Section 4(c)(8) of the BHC Act—Operating a Credit Bureau</td>
</tr>
<tr>
<td>3500.0</td>
<td>Tie-In Considerations of the BHC Act</td>
</tr>
<tr>
<td>3510.0</td>
<td>Sections 4(c)(9) and 2(h) of the BHC Act—Nonbanking Activities of Foreign Banking Organizations</td>
</tr>
<tr>
<td>3520.0</td>
<td>Section 4(c)(10) of the BHC Act—Grandfather Exemption from Section 4 for BHCs Which Are Banks</td>
</tr>
<tr>
<td>3530.0</td>
<td>Section 4(c)(11) of the BHC Act—Authorization for BHCs to Reorganize Share Ownership Held on the Basis of Any Section 4 Exemption</td>
</tr>
<tr>
<td>3540.0</td>
<td>Section 4(c)(12) of the BHC Act—Ten-Year Exemption from Section 4 of the BHC Act</td>
</tr>
<tr>
<td>3550.0</td>
<td>Section 4(c)(13) of the BHC Act—International Activities of Bank Holding Companies</td>
</tr>
<tr>
<td>3560.0</td>
<td>Section 4(c)(14) of the BHC Act—Export Trading Companies</td>
</tr>
<tr>
<td>3600.0</td>
<td>Permissible Activities by Board Order</td>
</tr>
<tr>
<td>3600.1</td>
<td>Operating a “Pool Reserve Plan”</td>
</tr>
<tr>
<td>3600.2–3600.4</td>
<td>Reserved</td>
</tr>
<tr>
<td>3600.5</td>
<td>Engaging in Banking Activities via Foreign Branches</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>3600.6</td>
<td>Operating a Securities Exchange</td>
</tr>
<tr>
<td>3600.7</td>
<td>Acting as a Certification Authority for Digital Signatures</td>
</tr>
<tr>
<td>3600.8</td>
<td>Private Limited Investment Partnerships</td>
</tr>
<tr>
<td>3600.9–</td>
<td>Reserved</td>
</tr>
<tr>
<td>3600.12</td>
<td></td>
</tr>
<tr>
<td>3600.13</td>
<td>FCM Activities</td>
</tr>
<tr>
<td>3600.14–</td>
<td>Reserved</td>
</tr>
<tr>
<td>3600.16</td>
<td></td>
</tr>
<tr>
<td>3600.17</td>
<td>Insurance Activities</td>
</tr>
<tr>
<td>3600.18–</td>
<td>Reserved</td>
</tr>
<tr>
<td>3600.20</td>
<td></td>
</tr>
<tr>
<td>3600.21</td>
<td>Underwriting and Dealing</td>
</tr>
<tr>
<td>3600.22</td>
<td>Reserved</td>
</tr>
<tr>
<td>3600.23</td>
<td>Issuance and Sale of Mortgage-Backed Securities Guaranteed by GNMA</td>
</tr>
<tr>
<td>3600.24</td>
<td>Sales-Tax Refund Agent and Cashing U.S. Dollar Payroll Checks</td>
</tr>
<tr>
<td>3600.25</td>
<td>Providing Government Services</td>
</tr>
<tr>
<td>3600.26</td>
<td>Real Estate Settlement through a Permissible Title Insurance Agency</td>
</tr>
<tr>
<td>3600.27</td>
<td>Providing Administrative and Certain Other Services to Mutual Funds</td>
</tr>
<tr>
<td>3600.28</td>
<td>Developing Broader Marketing Plans and Advertising and Sales Literature for Mutual Funds</td>
</tr>
<tr>
<td>3600.29</td>
<td>Providing Employment Histories to Third Parties</td>
</tr>
<tr>
<td>3600.30</td>
<td>Real Estate Title Abstracting</td>
</tr>
<tr>
<td>3610.1</td>
<td>Section 4(c)(8) of the BHC Act—Board Staff Legal Interpretation—Financing Customers’ Commodity Purchase and Forward Sales</td>
</tr>
<tr>
<td>3610.2</td>
<td>Section 4(c)(8) of the BHC Act—Board Legal Staff Interpretation—Certain Volumetric-Production-Payment Transactions Involving Physical Commodities</td>
</tr>
<tr>
<td>3700.0</td>
<td>Impermissible Activities</td>
</tr>
<tr>
<td>3700.1</td>
<td>Land Investment and Development</td>
</tr>
<tr>
<td>3700.2</td>
<td>Insurance Activities</td>
</tr>
<tr>
<td>3700.3</td>
<td>Real Estate Brokerage and Syndication</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>3700.4</td>
<td>General Management Consulting</td>
</tr>
<tr>
<td>3700.5</td>
<td>Property Management</td>
</tr>
<tr>
<td>3700.6</td>
<td>Travel Agencies</td>
</tr>
<tr>
<td>3700.7</td>
<td>Providing Credit Ratings on Bonds, Preferred Stock, and Commercial Paper</td>
</tr>
<tr>
<td>3700.8</td>
<td>Acting as a Specialist in Foreign-Currency Options on a Securities Exchange</td>
</tr>
<tr>
<td>3700.9</td>
<td>Design and Assembly of Hardware for Processing or Transmission of Banking and Economic Data</td>
</tr>
<tr>
<td>3700.10</td>
<td>Armored Car Services</td>
</tr>
<tr>
<td>3700.11</td>
<td>Computer Output Microfilm Service</td>
</tr>
<tr>
<td>3700.12</td>
<td>Clearing Securities Options and Other Financial Instruments for the Accounts of Professional Floor Traders</td>
</tr>
<tr>
<td>3900.0</td>
<td>Section 4(k) of the BHC Act—Financial Holding Companies</td>
</tr>
<tr>
<td>3901.0</td>
<td>U.S. Bank Holding Companies Operating as Financial Holding Companies</td>
</tr>
<tr>
<td>3903.0</td>
<td>Foreign Banks Operating as Financial Holding Companies</td>
</tr>
<tr>
<td>3905.0</td>
<td>Permissible Activities for FHCs</td>
</tr>
<tr>
<td>3906.0</td>
<td>Disease Management and Mail-Order Pharmacy Activities</td>
</tr>
<tr>
<td>3907.0</td>
<td>Merchant Banking</td>
</tr>
<tr>
<td>3909.0</td>
<td>Supervisory Guidance on Equity Investment and Merchant Banking Activities</td>
</tr>
<tr>
<td>3910.0</td>
<td>Acting as a Finder</td>
</tr>
<tr>
<td>3912.0</td>
<td>To Acquire, Manage, and Operate Defined Benefit Pension Plans in the United Kingdom (Section 4(k) of the BHC Act)</td>
</tr>
<tr>
<td>3920.0</td>
<td>Limited Physical-Commodity-Trading Activities</td>
</tr>
<tr>
<td>3950.0</td>
<td>Insurance Sales Activities and Consumer Protection in Sales of Insurance</td>
</tr>
<tr>
<td>3980.0</td>
<td>Establishment of an Intermediate Holding Company</td>
</tr>
<tr>
<td>4000</td>
<td>FINANCIAL ANALYSIS</td>
</tr>
<tr>
<td>4000.0</td>
<td>Financial Factors—Introduction</td>
</tr>
<tr>
<td>4010.0</td>
<td>Parent Only: Debt-Servicing Capacity—Cash Flow</td>
</tr>
<tr>
<td>4010.1</td>
<td>Leverage</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>4010.2</td>
<td>Liquidity</td>
</tr>
<tr>
<td>4020.0</td>
<td>Banks</td>
</tr>
<tr>
<td>4020.1</td>
<td>Banks: Capital</td>
</tr>
<tr>
<td>4020.2</td>
<td>Banks: Asset Quality</td>
</tr>
<tr>
<td>4020.3</td>
<td>Banks: Earnings</td>
</tr>
<tr>
<td>4020.4</td>
<td>Banks: Liquidity</td>
</tr>
<tr>
<td>4020.5</td>
<td>Banks: Summary Analysis</td>
</tr>
<tr>
<td>4020.6–4020.8</td>
<td>Reserved</td>
</tr>
<tr>
<td>4020.9</td>
<td>Supervision Standards for De Novo State Member Banks of Bank Holding Companies</td>
</tr>
<tr>
<td>4030.0</td>
<td>Nonbanks</td>
</tr>
<tr>
<td>4030.1</td>
<td>Nonbanks: Credit Extending—Classifications</td>
</tr>
<tr>
<td>4030.2</td>
<td>Nonbanks: Credit Extending—Earnings</td>
</tr>
<tr>
<td>4030.3</td>
<td>Nonbanks: Credit Extending—Leverage</td>
</tr>
<tr>
<td>4030.4</td>
<td>Nonbanks: Credit Extending—Reserves</td>
</tr>
<tr>
<td>4040.0</td>
<td>Nonbanks: Noncredit Extending</td>
</tr>
<tr>
<td>4050.0</td>
<td>Nonbanks: Noncredit Extending—Service Charters</td>
</tr>
<tr>
<td>4060.0</td>
<td>Consolidated—Earnings</td>
</tr>
<tr>
<td>4060.1</td>
<td>Consolidated: Asset Quality</td>
</tr>
<tr>
<td>4060.2</td>
<td>Reserved</td>
</tr>
<tr>
<td>4060.3</td>
<td>Consolidated Capital—Examiners’ Guidelines for Assessing the Capital Adequacy of BHCs</td>
</tr>
<tr>
<td>4060.4</td>
<td>Reserved</td>
</tr>
<tr>
<td>4060.5</td>
<td>Capital Adequacy—Advanced Approaches</td>
</tr>
<tr>
<td>4060.6</td>
<td>Reserved</td>
</tr>
<tr>
<td>4060.7</td>
<td>Assessing Capital Adequacy and Risk at Large Banking Organizations and Others with Complex Risk Profiles</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>4060.8</td>
<td>Overview of Asset-Backed Commercial Paper Programs</td>
</tr>
<tr>
<td>4060.9</td>
<td>Consolidated Capital Planning Processes—Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies</td>
</tr>
<tr>
<td>4061.0</td>
<td>Consolidated Capital—Capital Planning</td>
</tr>
<tr>
<td>4062.0</td>
<td>Reserved</td>
</tr>
<tr>
<td>4063.0</td>
<td>Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms</td>
</tr>
<tr>
<td>4064.0</td>
<td>Reserved</td>
</tr>
<tr>
<td>4065.0</td>
<td>Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms</td>
</tr>
<tr>
<td>4066.0</td>
<td>Consolidated—Funding and Liquidity Risk Management</td>
</tr>
<tr>
<td>4070.1</td>
<td>Rating Risk-Management Processes and Internal Controls of BHCs Having $50 Billion or More in Total Assets</td>
</tr>
<tr>
<td>4070.2</td>
<td>Reserved</td>
</tr>
<tr>
<td>4070.3</td>
<td>Revising Supervisory Ratings</td>
</tr>
<tr>
<td>4070.4</td>
<td>Reserved</td>
</tr>
<tr>
<td>4071.0</td>
<td>Supervisory Guidance for Assessing Risk Management at Supervised Institutions With Total Consolidated Assets Less than $50 Billion</td>
</tr>
<tr>
<td>4080.0</td>
<td>Federal Reserve System BHC Surveillance Program</td>
</tr>
<tr>
<td>4080.1</td>
<td>Surveillance Program for Small Holding Companies</td>
</tr>
<tr>
<td>4090.0</td>
<td>Country Risk</td>
</tr>
<tr>
<td>5000</td>
<td>BHC INSPECTION PROGRAM</td>
</tr>
<tr>
<td>5000.0</td>
<td>BHC Inspection Program—General</td>
</tr>
<tr>
<td>5010.0</td>
<td>Procedures for Inspection Report Preparation—Inspection Report References</td>
</tr>
<tr>
<td>5010.1</td>
<td>General Instructions to FR 1225</td>
</tr>
<tr>
<td>5010.2</td>
<td>Cover</td>
</tr>
<tr>
<td>5010.3</td>
<td>Page i—Table of Contents</td>
</tr>
<tr>
<td>5010.4</td>
<td>Core Page 1—Examiner’s Comments and Matters Requiring Special Board Attention</td>
</tr>
<tr>
<td>5010.5</td>
<td>Core Page 2—Scope of Inspection and Abbreviations</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>-----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>5010.6</td>
<td>Core Page 3—Analysis of Financial Factors</td>
</tr>
<tr>
<td>5010.7</td>
<td>Core Page 4—Audit Program</td>
</tr>
<tr>
<td>5010.8</td>
<td>Appendix Page 5—Parent Company Comparative Balance Sheet</td>
</tr>
<tr>
<td>5010.9</td>
<td>Appendix Page 6—Comparative Statement of Income and Expenses (Parent)</td>
</tr>
<tr>
<td>5010.10</td>
<td>Appendix Page 7—Consolidated Classified and Special Mention Assets</td>
</tr>
<tr>
<td>5010.11</td>
<td>Appendix Page 8—Consolidated Comparative Balance Sheet</td>
</tr>
<tr>
<td>5010.12</td>
<td>Appendix Page 9—Comparative Consolidated Statement of Income and Expenses</td>
</tr>
<tr>
<td>5010.13</td>
<td>Capital Structure</td>
</tr>
<tr>
<td>5010.14</td>
<td>Page—Policies and Supervision</td>
</tr>
<tr>
<td>5010.15</td>
<td>Page—Violations</td>
</tr>
<tr>
<td>5010.16</td>
<td>Page—Other Matters</td>
</tr>
<tr>
<td>5010.17</td>
<td>Page—Classified Assets and Capital Ratios of Subsidiary Banks</td>
</tr>
<tr>
<td>5010.18</td>
<td>Page—Organization Chart</td>
</tr>
<tr>
<td>5010.19</td>
<td>Page—History and Structure</td>
</tr>
<tr>
<td>5010.20</td>
<td>Page—Investment in and Advances to Subsidiaries</td>
</tr>
<tr>
<td>5010.21</td>
<td>Page—Commercial Paper (Parent)</td>
</tr>
<tr>
<td>5010.22</td>
<td>Page—Lines of Credit (Parent)</td>
</tr>
<tr>
<td>5010.23</td>
<td>Page—Questions on Commercial Paper and Lines of Credit (Parent)</td>
</tr>
<tr>
<td>5010.24</td>
<td>Page—Contingent Liabilities and Other Accounts</td>
</tr>
<tr>
<td>5010.25</td>
<td>Page—Statement of Changes in Stockholders’ Equity (Parent)</td>
</tr>
<tr>
<td>5010.26</td>
<td>Page—Income from Subsidiaries</td>
</tr>
<tr>
<td>5010.27</td>
<td>Page—Cash Flow Statement (Parent)</td>
</tr>
<tr>
<td>5010.28</td>
<td>Page—Parent Company Liquidity Position</td>
</tr>
<tr>
<td>5010.29</td>
<td>Page—Classified Parent Company and Nonbank Assets</td>
</tr>
<tr>
<td>5010.30</td>
<td>Page—Bank Subsidiaries</td>
</tr>
<tr>
<td>5010.31</td>
<td>Page—Nonbank Subsidiary</td>
</tr>
<tr>
<td>Sections</td>
<td>Title</td>
</tr>
<tr>
<td>-----------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>5010.32</td>
<td>Page—Nonbank Subsidiary Financial Statements</td>
</tr>
<tr>
<td>5010.33</td>
<td>Page—Fidelity and Other Indemnity Insurance</td>
</tr>
<tr>
<td>5010.34</td>
<td>Reserved</td>
</tr>
<tr>
<td>5010.35</td>
<td>Page—Other Supervisory Issues</td>
</tr>
<tr>
<td>5010.36</td>
<td>Page—Extensions of Credit to BHC Officials . . .</td>
</tr>
<tr>
<td>5010.37</td>
<td>Page—Interest Rate Sensitivity—Assets and Liabilities</td>
</tr>
<tr>
<td>5010.38</td>
<td>Treasury Activities/Capital Markets</td>
</tr>
<tr>
<td>5010.39</td>
<td>Reserved</td>
</tr>
<tr>
<td>5010.40</td>
<td>Confidential Page A—Principal Officers and Directors</td>
</tr>
<tr>
<td>5010.41</td>
<td>Confidential Page B— Condition of BHC</td>
</tr>
<tr>
<td>5010.42</td>
<td>Confidential Page C—Liquidity and Debt Information</td>
</tr>
<tr>
<td>5010.43</td>
<td>Confidential Page D—Administrative and Other Matters</td>
</tr>
<tr>
<td>5020.1</td>
<td>Bank Subsidiary (FR 1241)</td>
</tr>
<tr>
<td>5020.2</td>
<td>Other Supervisory Issues (FR 1241)</td>
</tr>
<tr>
<td>5030.0</td>
<td>BHC Inspection Report Forms</td>
</tr>
<tr>
<td>5040.0</td>
<td>Procedures for “Limited-Scope” Inspection Report Preparation—</td>
</tr>
<tr>
<td></td>
<td>General Instructions</td>
</tr>
<tr>
<td>5050.0</td>
<td>Procedures for “Targeted” Inspection Report Preparation—General Instructions</td>
</tr>
<tr>
<td>5052.0</td>
<td>Targeted MIS Inspection</td>
</tr>
<tr>
<td>5060.0</td>
<td>Portions of Bank Holding Company Inspections Conducted in Federal Reserve Bank Office</td>
</tr>
</tbody>
</table>

*BHC Supervision Manual*  
February 2020  
Page 15
WHAT'S NEW IN THIS REVISED SECTION

Effective July 2012, this section has been revised to discuss the current authority for the Federal Reserve (FR) to conduct BHC inspections (examinations) under section 5(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)) and also 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 (section 604(c)(2)), which removed the enforcement provisions of section 10A of the Bank Holding Company Act that limited the FR's rulemaking and enforcement authority. 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.

1040.0.1 BHC INSPECTIONS

The Gramm-Leach-Bliley Act (GLB Act) amended section 5(c) of the Bank Holding Company Act (BHC Act) pertaining to BHC reports and examinations (or inspections, in the case of BHCs). The GLB Act provides specific supervisory guidance to the Board of Governors (Board) of the Federal Reserve System (and the Federal Reserve Banks via delegated authority) with respect to the breadth of BHC inspections. It also emphasized the focus and scope of BHC inspections and the inspections of BHC subsidiaries. An inspection is to be conducted to—

1. inform the board of the nature of the operations and financial condition of each BHC and its subsidiaries, including—
   a. the financial and operational risks within the holding company system that may pose a threat to the safety and soundness of any depository institution (DI) subsidiary of such bank holding company, and
   b. the systems for monitoring and controlling such financial and operational risks; and
2. monitor compliance by any entity with the provisions of the BHC Act or any other federal law that the Board has specific jurisdiction to enforce against the entity, and to monitor compliance with any provisions of federal law governing transactions and relationships between any DI subsidiary of a BHC and its affiliates.

1040.0.1.1 Authority for Bank Holding Company Inspections

Section 5 of the BHC Act of 1956 authorizes the Board to require reports and to conduct inspections of bank holding companies and their affiliates. Subject to the limitations discussed below, Section 5 authorizes the Board to examine each bank holding company and nonbank subsidiary thereof. Within those limitations, the Federal Reserve System’s supervisory staff (includes BHC inspection and examination staff) may review all books and records of a banking organization that is subject to Federal Reserve (FR) supervision.

1040.0.2 FOCUS AND SCOPE OF BHC INSPECTIONS

The focus and scope of an inspection is to be limited, to the fullest extent possible, to the BHC and any subsidiary of the BHC that could have a materially adverse effect on the safety and soundness of any DI subsidiary of the holding company due to (1) the size, condition, or activities of the subsidiary, or (2) the nature or size of the transactions between the subsidiary and any DI subsidiary of the BHC.

The Board is to use, to the fullest extent possible, the bank examination reports of DIs prepared by the appropriate federal or state DI supervisory authority. The Board also is to use, to the fullest extent possible, the examination reports for non-DIs prepared by the following:

1. the Securities and Exchange Commission (SEC) for any registered broker or dealer
2. the SEC or any state for any investment adviser registered under the Investment Company Act of 1940
3. any state insurance regulatory authority for any licensed insurance company
4. any federal or state authority for any other subsidiary that the Board finds to be comprehensively supervised

2. Supervisory staff includes individuals that are on and/or off site.
1040.0.3 EXAMINATIONS OF FUNCTIONALLY REGULATED SUBSIDIARIES

In general, the Board may examine (inspect) any BHC and each subsidiary to inform the Board of

- the nature of the operations and financial condition of the company and such subsidiary;
- the financial, operational, and other risks of the company or such subsidiary that may pose a threat to the safety and soundness of such company or subsidiary or to the financial stability of the United States;
- the systems for monitoring and controlling such risks; and
- compliance by the company or such subsidiary with the requirements of 12 U.S.C. 5361(b) and other provisions of the BHC Act and certain other federal statutes.

1040.0.3.1 Use of Examination Reports and Information

The Board is required, to the fullest extent possible, to rely on reports of examination of any subsidiary depository institution or functionally regulated subsidiary made by the primary financial regulatory agency for that subsidiary, and on information described for reports under 12 U.S.C. 5361(a)(2). (See 12 U.S.C. 5361(b)(2).)

1040.0.3.2 Coordination with Other Regulators

The Board is to

- provide reasonable notice to, and to consult with, the primary financial regulatory agency for any subsidiary before requiring a report or commencing an examination of such subsidiary under this section; and
- avoid duplication of examination activities, reporting requirements, and requests for information, to the fullest extent possible.

(See 12 U.S.C. 5361(c).)

1040.0.4 SUPERVISION OF A NONBANK FINANCIAL COMPANY

The FR, as the appropriate federal supervisory banking agency, must, to the fullest extent possible, rely on (1) reports and other supervisory information that the BHC, or any subsidiary thereof, has been required to provide to other federal and state regulatory agencies; (2) externally audited financial statements of the BHC or subsidiary; (3) information that is otherwise available from federal and state regulatory agencies; and (4) information that is required to be reported publicly. (See 12 U.S.C. 1844(c)(1) or section 5(c) of the BHC Act.)
Supervision of Holding Companies with Total Consolidated Assets of $10 Billion or Less

Section 1045.0

1045.0.1 OVERVIEW AND RELIANCE ON THE INSURED DEPOSITORY INSTITUTION REGULATOR

The Federal Reserve’s approach to the supervision of holding companies with total consolidated assets of $10 billion or less is primarily described in SR-13-21, “Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less.” Reserve Banks, in the vast majority of cases, conduct abbreviated off-site reviews of small, noncomplex holding companies with total consolidated assets of up to $3 billion upon receipt of examination reports from the insured depository institution (IDI) regulator of the lead subsidiary IDI.

These Reserve Bank reviews assess activities conducted outside of the subsidiary IDI and rely substantially on the findings of the IDI regulator to evaluate the overall condition of the institution. For larger holding companies in the community banking organization (CBO) supervision portfolio, Reserve Banks conduct point-in-time on- or off-site reviews that are coordinated with, or closely follow, onsite examinations of the lead subsidiary IDI by its IDI regulator. The Reserve Bank reviews of larger CBO holding companies are targeted toward assessing parent company and nonbank activities and their potential effect on the safety and soundness of the subsidiary IDI.

The Reserve Bank evaluates the condition, performance, and prospects of the subsidiary IDI based on the conclusions of the IDI regulator and makes best efforts not to duplicate the work of other prudential regulators. Refer to SR-16-4.

The Federal Reserve relies on periodic on- and off-site inspections to assess the safety and soundness of supervised bank holding companies (BHCs) and savings and loan holding companies (SLHCs) (collectively referred to as “holding companies”). The guidance in SR-13-21 outlines 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 holding companies with total consolidated assets between $3 billion and $10 billion; and
- modify the requirement for targeted inspections for “3,” “4,” and “5”-rated holding companies with total consolidated assets between $3 billion and $10 billion.

These frequency and scope requirements vary depending on whether a holding company has been designated as “complex,” with more complex 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.

1045.0.2 DEFINITION OF COMPLEX HOLDING COMPANIES

The determination of whether a holding company is “complex” should be made at least annually by the responsible Reserve Bank. Utilizing surveillance screens and other information obtained through supervisory or applications processes, Reserve Banks should update the complexity designation of a company as its activities or condition changes. The determination of a holding company’s complexity should take into account a number of factors. These factors include the

- size and structure of the company;
- the extent of intercompany transactions between IDI subsidiaries and the holding company or uninsured subsidiaries of the holding company;
- the risk, scale, and complexity of activities of any nondepository subsidiaries;¹ and
- the degree of leverage at the holding company, including the extent of its debt outstanding to the public.

Companies should also be designated “complex” if material risk-management processes for the holding company and its affiliates are consolidated at the parent company.

¹ For SLHCs, consideration should be given to whether the holding company is a grandfathered unitary SLHC, and if so, the type and extent of the activities in which the company engages.
1045.0.3 SUPERVISION AND SURVEILLANCE APPROACH

The frequency and scope of on- and off-site inspections should be adjusted based on the results of examinations of a company’s depository institution subsidiaries and off-site quarterly surveillance. Whether the inspection is conducted on- or off-site will depend on the level and nature of the risks involved, the holding company’s ability to manage those risks, and the Reserve Bank’s ability to acquire the necessary information to analyze the activity off-site. If information obtained off-site is not sufficient for the Reserve Bank to determine the condition or assess the activity of the company to assign a rating, the Reserve Bank should conduct an on-site inspection (full-scope or targeted, as appropriate).

To facilitate prompt follow-up on changes in a company’s performance and condition, the Federal Reserve maintains distinct surveillance programs for small holding companies (less than $3 billion in total consolidated assets) and all other holding companies. Surveillance screens for holding companies with $3 billion or more in total consolidated assets focus on identifying those companies reporting financial results that seem to be inconsistent with their current supervisory ratings, as well as activities conducted outside of depository institution subsidiaries. For small holding companies, quarterly surveillance screens focus on the identification of potential parent company and nondepository subsidiary issues that may adversely affect affiliated depository institutions. In particular, these screens address parent company cash flow, intercompany transactions, parent company leverage, and consolidated capital ratios, when applicable. Screens also assist in maintaining up-to-date complexity designations and are updated periodically to reflect industry trends and conditions as well as changes in regulatory reporting requirements.

1045.0.4 FREQUENCY AND SCOPE OF INSPECTIONS OF HOLDING COMPANIES WITH TOTAL CONSOLIDATED ASSETS BETWEEN $3–10 BILLION

Complex holding companies in satisfactory condition are inspected at least once per calendar year, while noncomplex holding companies may be inspected every other year. The Reserve Banks should attempt to conduct inspections of holding companies between $3 billion and $10 billion in total consolidated assets shortly after the examination of the lead depository subsidiary is completed. Holding companies between $3 billion and $10 billion in total consolidated assets are assigned a complete RFI rating (component ratings, subcomponent ratings, and a composite rating) regardless of their complexity.2

Depending on their condition and complexity, holding companies in this category will receive full-scope inspections or targeted inspections. At a minimum, a full-scope inspection should include sufficient procedures to reach an informed judgment regarding the assigned ratings for the factors addressed by the RFI rating system, evaluating the organization’s methods of managing and controlling its risk exposures, and ascertaining whether management and directors fully understand and are actively monitoring the organization’s exposure to those risks.

A targeted inspection is designed to focus intensively on one or more specific areas, activities, or problems relating to a holding company. Targeted inspections of holding companies with total consolidated assets between $3 billion and $10 billion should focus primarily on parent company leverage, parent company cash flow, nondepository subsidiaries, consolidated capital (when applicable), and intercompany transactions. Targeted inspections may also cover other applicable areas, such as deficient risk-management practices at the holding company.

In addition, because compliance with laws and regulations is a statutory factor that must be considered as part of any supervisory review of an application or notice by the holding company, it is important that Reserve Bank staff ensure that compliance with relevant laws and regulations, including any commitments provided by a holding company in connection with an application or notice, is evaluated and addressed in written inspection reports.

1045.0.4.1 Complex Holding Companies

- If a complex holding company is rated composite “1” or “2,” a full-scope, on-site inspection is required annually.
- The following apply for a complex holding company rated composite “3,” “4,” or “5.”

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— A full-scope, on-site inspection is required annually.
— If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution, Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. The targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead depository institution.

• Interim inspections between regular full-scope, on-site inspections are not required. However, additional follow-up, including interim inspections, may be necessary in response to off-site surveillance program results.

1045.0.4.2 Noncomplex Holding Companies

• If a noncomplex holding company is rated composite “1” or “2,” an off-site targeted inspection is required every two years.
• The following apply for a noncomplex holding company rated composite “3,” “4,” or “5.”
— A full-scope, off-site inspection is required annually.
— If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution, Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. This targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead depository institution.

• Interim inspections between regular full-scope inspections are not required. However, additional follow-up, including interim inspections, may be necessary in response to off-site surveillance program results.

1045.0.5 FREQUENCY AND SCOPE OF REVIEW OF HOLDING COMPANIES WITH LESS THAN $3 BILLION IN TOTAL CONSOLIDATED ASSETS

The supervisory cycle for holding companies with less than $3 billion in total consolidated assets generally is determined by the examination frequency of the lead depository institution. Complex companies in this size category are assigned only a risk-management rating and a composite rating. All ratings assigned should be promptly entered into the National Examination Database (NED) and communicated to the company, Board staff, and appropriate state and federal regulatory authorities as soon as possible, but generally no later than 90 days after receipt of the lead depository institution examination report.

Although an off-site review of small holding companies will be appropriate in many cases, in some instances it may be necessary to conduct an on-site review for complex holding companies, as discussed below. In those cases when an on-site review is required, the findings of that review and the assigned ratings should be communicated to the company no later than 120 days after receipt of the lead depository institution examination report. Documentation for the ratings and off-site or on-site reviews will generally consist of the examination reports for the depository institution subsidiaries, a copy of the transmittal letter communicating the ratings to the company, information related to relevant System surveillance results, and memoranda supporting any on-site review conducted. A meeting between Reserve Bank staff and the company’s board of directors to communicate findings is not required, but should be conducted when warranted by supervisory concerns.

1045.0.5.1 Complex Holding Companies

• An off-site review should be conducted upon receipt of the lead depository institution examination report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a complete RFI rating, the Reserve Bank should conduct an on-site review of the company.
• Any on-site review should be targeted at those areas where additional information or analysis is needed to assign a complete supervisory rating.
1045.0.5.2 Noncomplex Holding Companies

- If all subsidiary depository institutions have a management component rating and a composite supervisory rating of “1” or “2” and no material holding company issues are otherwise indicated, the Reserve Bank should assign only a composite rating and risk management rating to the holding company based on the ratings of the lead depository institution.
- If one or more subsidiary depository institutions have a management component rating or a composite supervisory rating of “3,” “4,” or “5” or a material holding company issue is otherwise indicated, an off-site review is required upon receipt of the lead depository institution examination report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a risk-management rating and a composite rating, Reserve Bank staff should contact the holding company to obtain more information.
- Any off-site review should be targeted, as appropriate, at those areas where additional information or analysis is needed to develop the risk-management and composite ratings.

1045.0.6 COMPLETION STANDARD FOR EXAMINATION AND INSPECTION REPORTS

Safety-and-soundness examination and inspection reports for CBOs issued by the Federal Reserve should be completed and sent to the supervised institution within 60 calendar days following the “close date” of the examination. These standards apply to formal examination and inspection reports for institutions supervised by the Federal Reserve with $10 billion or less in total consolidated assets including state member banks, BHCs, SLHCs, Edge Act and agreement corporations, U.S. branches and agencies of foreign banks, and foreign subsidiaries and branches of U.S. banks. For institutions rated composite “3,” “4,” or “5,” Reserve Banks are encouraged to adopt an internal target of 45 calendar days from the close date for sending the reports.

The “close date” of an on-site examination and inspection is defined as the last date that the examination team is physically on-site at the institution. For examinations and inspections for which all or a portion of the work is performed off-site, the “close date” is defined as the earlier of the following dates: (1) the date when the analysis (including loan file review) is completed and ready for the examiner-in-charge’s review or (2) the date when the preliminary exit meeting is held with management, which can be conducted either on-site or off-site by conference call.

Further, to ensure that findings are communicated to a supervised institution in a timely manner, Reserve Banks should ensure that the duration between the start of an examination/inspection to the completion and delivery of an examination/inspection report does not exceed 90 days. In cases when reports are subject to statutory requirements for other state or federal agency review, such as by the Consumer Financial Protection Bureau (CFPB), Reserve Banks may exceed these guidelines at the discretion of senior management. However, deviations from these guidelines are expected to be rare. At the discretion of senior Reserve Bank management, additional exemptions from this 90-day guideline may be considered for examinations that are conducted simultaneously on multiple affiliated banks or examinations of larger complex CBOs that require additional time on-site to review specialized or complex business lines.

Findings and conclusions delivered to a supervised institution at the close date and exit meetings for examinations and inspections must be consistently documented in workpapers. At a

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3. This completion standard gives recognition to the continuous monitoring and roll-up supervisory process for larger organizations having consolidated assets in excess of $10 billion.

4. Most BHCs and SLHCs with total consolidated assets of

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$3 billion or less are subject to a separate program that has different requirements for the issuance of reports of inspection.

5. The start date is the date that Reserve Bank examiners and supervisory staff commence the examination and inspection work, excluding pre-examination visitations and preparation.

6. See sections 1022, 1024, and 1025 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. For more information on the coordination of supervisory activities with the CFPB, see also the “Memorandum of Understanding on Supervisory Coordination” and the June 4, 2012, joint press release.

7. In some cases, Reserve Bank examiners or supervisory staff may conduct a pre-exit meeting with the institution’s management at the close date of the examination or inspection. Representatives from the on-site examination or inspection team may also hold a final exit meeting with the institu-
minimum, documentation should include

1. a list of attendees at the meetings;
2. a description of significant examination and inspection findings discussed, including preliminary ratings; and
3. a summary of the bank management’s views on the findings and, if applicable, the views of the board of directors.

To the extent conclusions in the final report differ from those discussed at the close date and exit meetings, Reserve Bank examiners and supervisory staff should communicate the reasons for the differences to the supervised institution and document these discussions in their workpapers. See SR-13-14, “Timing Standards for the Completion of Safety-and-Soundness Examination and Inspection Reports for Community Banking Organizations,” for more information.


WHAT’S NEW IN THIS REVISED SECTION

Effective January 2015, this section was revised to delete a reference to SR-99-15, which was superseded by SR-12-17/CA-12-14, “Consolidated Supervision Framework for Large Financial Institutions.”

The continuing growth in the size and complexity of many banking organizations exposes these firms to a wide array of potential risks, while at the same time making it more challenging for a single supervisor to have a complete view of firmwide risks and controls. In response to these trends, and to better fulfill both its responsibilities as consolidated supervisor and its other central bank objectives, the Federal Reserve continues to refine and enhance its programs for the consolidated supervision of bank holding companies (BHCs) and the combined U.S. operations of foreign banking organizations (FBOs).

The Federal Reserve has set forth its consolidated supervision program for bank holding companies and the combined U.S. operations of Foreign Banking Organizations in SR-08-9/CA-08-12 and its attachments. (See sections 1050.1 for the consolidated supervision of large complex banking organizations and see 1050.2 for the consolidated supervision of regional banking organizations.) The primary objectives of this supervisory guidance are to specify principal areas of focus for consolidated supervision activities and thereby provide for consistent Federal Reserve supervisory practices and assessments across organizations with similar activities and risks. Consistent with these objectives, the SR letter and its attached guidance detail specific expectations for Federal Reserve staff for understanding and assessing primary governance functions and risk controls, material business lines, nonbank operations, financial condition, and other key activities and risks at banking organizations; address unique aspects of supervising the combined U.S. operations of FBOs; and highlight the supervisory attention that should be paid to risk-management systems and internal controls used by BHCs and FBOs that provide core clearing and settlement services (core clearing and settlement organizations) or that have a significant presence in critical or key financial markets.¹ The guidance also reiterates the importance of coordination with, and reliance on, the work of other relevant primary supervisors and functional regulators.

The Federal Reserve’s enhanced approach to consolidated supervision emphasizes several elements that should help make the financial system more resilient. These include focus on corporate governance, capital adequacy, funding and liquidity management, and the supervision of material nonbank subsidiaries,² as well as other aspects of the Federal Reserve’s consolidated supervision activities designed to further the objectives of fostering financial stability and deterring or managing financial crises. In addition, the Federal Reserve continues to work, both independently and in conjunction with other domestic and foreign bank supervisors and functional regulators, on a number of other initiatives to strengthen supervisory approaches and reinforce expectations for sound practices in response to recent lessons learned.

1050.0.1 SUPERVISION AND REGULATION FRAMEWORK FOR COMPANIES THAT CONTROL A BANK AND THE SUBSIDIARIES OF SUCH COMPANIES

The Bank Holding Company Act (BHC Act), originally enacted in 1956, provides a federal framework for the supervision and regulation of all domestic and foreign companies that control a bank and the subsidiaries of such companies. Among the principal purposes of the BHC Act is to protect the safety and soundness of corporately controlled banks. Financial trouble in one part of an organization can spread rapidly to other parts of the organization; moreover, large BHCs increasingly operate and manage their businesses on an integrated basis across corporate boundaries. Risks that cross legal entities or that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one of the legal entity subsidiaries within the overall organization.

The BHC Act provides for all BHCs, including financial holding companies formed under

¹. See Attachment C to SR-08-9/CA-08-12 or this section’s appendix for the definitions of “core clearing and settlement organizations,” “critical financial markets,” and “key financial markets.”

². The term “nonbank subsidiaries” as used in SR-08-9/CA-08-12 and its attachments does not include savings associations.
the Gramm-Leach-Bliley Act (GLBA), to be supervised on a consolidated basis by the Federal Reserve. Consolidated supervision of a BHC encompasses the parent company and its subsidiaries, and allows the Federal Reserve to understand the organization’s structure, activities, resources, and risks, as well as to address financial, managerial, operational, or other deficiencies before they pose a danger to the BHC’s subsidiary depository institutions.

To carry out these responsibilities, the BHC Act grants the Federal Reserve broad authority to inspect and obtain reports from a BHC and its subsidiaries concerning, among other things, the company’s financial condition, systems for monitoring and controlling financial and operational risks, and compliance with the BHC Act and other federal law (including consumer protection laws) that the Board has specific jurisdiction to enforce. In addition, federal law authorizes the Federal Reserve to take action against a BHC or nonbank subsidiary to prevent these entities from engaging in unsafe or unsound practices or to address violations of law that occur in connection with their own business operations even if those operations are not directly connected to the BHC’s subsidiary depository institutions. Using its authority, the Federal Reserve also has established consolidated capital standards for BHCs, helping to ensure that a BHC maintains adequate capital to support its groupwide activities, does not become excessively leveraged, and is able to serve as a source of strength for its depository institution subsidiaries.

The Federal Reserve’s consolidated supervision program has served as the benchmark for many of the current and evolving international standards for the consolidated supervision of financial groups. Key concepts that have been part of the Federal Reserve’s approach to consolidated supervision for many years are reflected in the Basel Committee on Banking Supervision’s Minimum Standards for Internationally Active Banks (1992), capital accords (1988 and 2006), and Core Principles for Effective Banking Supervision (1997 and 2006), and are now used by the International Monetary Fund and the World Bank in connection with their assessments of countries’ bank supervisory regimes.

In addition to its role as consolidated supervisor of BHCs, the Federal Reserve also is responsible for the overall supervision of the U.S. operations of foreign banks that have a banking presence in the United States. This role was established by the International Banking Act of 1978, which introduced a policy of national treatment3 promoting competitive equality between FBOs operating in the United States and domestic banking organizations. The Foreign Bank Supervision Enhancement Act of 1991 established uniform federal standards for entry, expansion, and supervision of FBOs in the United States and increased the Federal Reserve’s supervisory responsibility and authority over the U.S. operations of FBOs. This act also introduced the requirement that the Federal Reserve approve the establishment of all U.S. banking offices of foreign banks and, in that regard, take into account whether the foreign bank is subject to comprehensive, consolidated supervision by its home-country supervisor.

The Federal Reserve’s consolidated supervision activities closely complement its other central bank responsibilities, including the objectives of fostering financial stability and deterring or managing financial crises. The information, expertise, and powers that the Federal Reserve derives from its supervisory authority enhance its ability to help prevent financial crises and to manage such crises (in consultation and conjunction with the Treasury Department and other U.S. and foreign authorities) should they occur. Similarly, the supervisory responsibilities of the Federal Reserve benefit from its responsibilities for financial stability. For example, knowledge gained about financial market developments through interactions with primary dealers in government securities and capital market expertise derived from nonsupervisory activities improve the Federal Reserve’s ability to understand and evaluate the activities of banking organizations and otherwise enhance its contributions to supervisory and regulatory policy initiatives.

Effective consolidated supervision requires strong, cooperative relationships between the Federal Reserve and relevant primary supervisors and functional regulators.4 These relation-
ships respect the individual statutory authorities and responsibilities of the respective supervisors and regulators and provide for appropriate information flows and coordination so that individual responsibilities can be carried out effectively, while limiting the potential for duplication or undue burden. Information sharing among domestic and foreign supervisors, consistent with applicable law and the jurisdiction of each supervisor, is essential to ensure that a banking organization’s global activities are supervised on a consolidated basis.

These concepts underlie the provisions of the GLBA governing the interaction between the Federal Reserve, as consolidated supervisor, and the other primary supervisors or functional regulators that may be involved in supervising one or more subsidiaries of a BHC. Under these provisions, the Federal Reserve, in conducting its consolidated supervisory responsibilities, relies to the fullest extent possible on (1) the reports that a BHC or subsidiary has provided to another federal or state supervisor or to an appropriate self-regulatory organization, (2) information that is otherwise required to be reported publicly, and (3) externally audited financial statements. In addition, the Federal Reserve relies to the fullest extent possible on the reports of examination of a depository institution made by its appropriate federal or state bank supervisor, of a broker-dealer or investment adviser made by or on behalf of the SEC or relevant state regulatory authority, or of a licensed insurance company made by or on behalf of its appropriate state regulatory authority. In developing its overall assessment of a BHC or the combined U.S. operations of an FBO, the Federal Reserve also relies to the fullest extent possible on the information gathered and assessments developed by these other supervisors and regulators.

Similarly, the Federal Reserve seeks to assist relevant primary supervisors and functional regulators in performing their supervisory responsibilities with respect to regulated subsidiaries by sharing pertinent information that relates to these regulated subsidiaries consistent with each agency’s supervisory responsibilities and applicable law. Examples include shared information relating to the financial condition, risk-management policies, and operations of a banking organization that may have a material impact on regulated subsidiaries, as well as information concerning transactions or relationships between regulated subsidiaries and their affiliates.

1050.0.2 KEY OBJECTIVES FOR, AND APPROACHES TO, CONSOLIDATED SUPERVISION

The Federal Reserve uses a systematic approach to develop an assessment of a BHC on a consolidated basis and of the combined U.S. operations of an FBO. These assessments are reflected in the RFI (Risk-Management, Financial Condition, and Impact) rating assigned to a BHC and the combined U.S. operations rating assigned to an FBO with multiple U.S. operations. The Federal Reserve utilizes three principal processes to understand, supervise, and assess BHCs and FBOs: continuous monitoring activities, discovery reviews, and testing.

6. The RFI rating system for BHCs is discussed in SR-04-18, "Bank Holding Company Rating System" and section 4070.0. RFI ratings are assigned at least annually for BHCs with $1 billion or more in consolidated assets, and are communicated via a comprehensive summary supervisory report that supports the BHC’s assigned ratings and encompasses the results of the entire supervisory cycle.

7. SR-00-14, "Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations," discusses the U.S. combined operations rating for an FBO and other aspects of the FBO Supervision Program. The Federal Reserve’s rating and assessment, as well as a summary of condition analysis describing the strengths and weaknesses of the FBO’s combined U.S. operations, are provided to the head office of each FBO. This information is also shared with the FBO’s home-country supervisor so that it may assess the impact of U.S. operations on the parent banking organization in its role as consolidated supervisor of the banking organization’s global operations.

8. Continuous monitoring activities are nonexamination/inspection supervisory activities primarily designed to develop and maintain an understanding of the organization, its risk profile, and associated policies and practices. These activities also provide information that is used to assess inherent risks and internal control processes. Such activities include meetings with banking organization management; analysis of management information systems (MIS) and other internal and external information; review of internal and external audit findings; and other efforts to coordinate with, and utilize the work of, other relevant supervisors and functional regulators (including analysis of reports filed with, or prepared by, these supervisors or regulators, or appropriate self-regulatory organizations, as well as related surveillance results).

9. A "discovery review" is an examination/inspection activity designed to improve the understanding of a particular business activity or control process—for example, to address a knowledge gap identified during the risk assessment or other supervisory process.

For U.S. operations of FBOs, the U.S. supervisor of a U.S. banking office is referred to as a domestic primary supervisor.

5. See SR-00-13.
The Federal Reserve’s supervisory objectives are the same for all BHCs and FBOs. However, the type and amount of information and the scope and extent of Federal Reserve supervisory and examination work that are necessary to understand, supervise, and develop an assessment of an individual BHC or the U.S. operations of an individual FBO vary. Federal Reserve supervisory activities are tailored for each organization based on a variety of factors, including the organization’s legal entity and regulatory structure; the risks posed by the organization’s specific activities and systems; and the potential effect of weaknesses in control functions on the organization, its subsidiary depository institutions, or key financial markets. For example, additional supervisory activities, including transaction testing in appropriate circumstances, may be conducted when there are information gaps relating to material risks or activities, indications of weaknesses in risk-management systems or internal controls, or indications of violations of consumer protection or other laws, or when a consolidated organization or subsidiary depository institution is in less-than-satisfactory condition.

1050.0.2.1 Key Supervisory Objectives

In fulfilling its responsibilities for supervising a BHC on a consolidated basis and the combined U.S. operations of an FBO, the Federal Reserve is guided by the following key supervisory objectives.

1050.0.2.1.1 Understanding the Bank Holding Company on a Consolidated Basis and the Combined U.S. Operations of an FBO

Supervisory Objective: The Federal Reserve develops a comprehensive understanding of each BHC and the combined U.S. operations of each FBO. Key elements in developing this understanding include

- corporate strategy and significant activities;
- business line, legal entity, and regulatory structure, including interrelationships and dependencies across multiple legal entities;
- corporate governance, risk management, and internal controls for managing risks; and
- for certain organizations, presence in critical or key financial market activities.

1050.0.2.1.2 Assessing the Bank Holding Company on a Consolidated Basis and the Combined U.S. Operations of an FBO

Supervisory Objective: The Federal Reserve supervises each BHC on a consolidated basis and assigns an RFI rating through an evaluation and assessment of the following areas

- key corporate governance, risk management, and control functions (including, where applicable, such functions as they relate to core clearing and settlement activities and activities where the organization has a significant presence in critical or key financial markets);
- the adequacy of the financial condition of the consolidated organization; and
- the potential negative impact of nonbank entities on subsidiary depository institutions.

The Federal Reserve also supervises and assesses the combined U.S. operations of each FBO and assigns a U.S. combined operations rating based on analysis of these same elements.

1050.0.2.1.3 Interagency Coordination

Supervisory Objective: As noted earlier, effective consolidated supervision requires strong, cooperative relationships between the Federal Reserve and relevant domestic and foreign supervisors and functional regulators. To achieve this objective, while limiting the potential for duplication or undue burden, the nature and scope of Federal Reserve work is tailored to the organization’s legal entity and regulatory structure as
well as the risks associated with the organization’s activities. In this regard, the Federal Reserve

• relies to the fullest extent possible on assessments and information developed by other relevant domestic and foreign supervisors and functional regulators;
• focuses supervisory attention on material risks from activities that are not supervised by another supervisor or regulator or that cut across legal entities; and
• participates in the sharing of information among domestic and foreign supervisors and functional regulators, consistent with applicable law, to provide for the comprehensive, consolidated supervision of each banking organization’s global activities.

Since coordination with, and reliance on, the work of other relevant primary supervisors and functional regulators is so central to the Federal Reserve’s conduct of consolidated supervision, direction for achieving these objectives is closely integrated into the attached guidance for understanding and assessing consolidated BHCs and the combined U.S. operations of FBOs.

1050.0.2.2 Risk-Focused Approach to Consolidated Supervision

The Federal Reserve uses a risk-focused approach to supervision of banking organizations in general and to each organization individually. In this regard, the Federal Reserve focuses supervisory activities on identifying the areas of greatest risks to a banking organization and assessing the ability of the organization’s management to identify, measure, monitor, and control these risks. In addition, the Federal Reserve typically is more actively and comprehensively engaged in the supervision of the largest and most complex BHCs and FBOs, as well as those with the most dynamic risk profiles. By paying particular attention to these organizations, the Federal Reserve aims to minimize significant adverse effects on the public (including consumers), the financial markets, and the financial systems in the United States and abroad, as well as on taxpayers, who provide the ultimate resources behind the federal safety net.

The Federal Reserve also focuses special supervisory attention on the risk-management systems and internal controls used by core clearing and settlement organizations or organizations that have a significant presence in key financial markets. In light of the potential for problems in these areas to transmit an adverse impact across the banking and financial system, these activities pose special legal, reputational, and other risks to the banking organization and its depository institution subsidiaries. The Federal Reserve has unique expertise and perspective in these areas based on its broader central bank responsibilities and functions.

Unlike banks, nonbank subsidiaries of a banking organization may not accept FDIC-insured deposits and do not have routine access to the Federal Reserve’s discount window and payment system. As a result, certain laws and supervisory policies that apply to banks (e.g., the prompt-corrective-action framework) do not apply to nonbank subsidiaries, and the manner in which the Federal Reserve supervises the nonbank subsidiaries of a banking organization reflects these differences. The Federal Reserve’s supervision of nonbank subsidiaries under the BHC Act is primarily directed toward, and focused on, ensuring that the nonbank subsidiary does not present material financial, legal, or reputational risks to affiliated depository institutions or to the BHC’s or FBO’s ability to support these depository institutions. The Federal Reserve also may interact with nonbank entities, such as primary dealers in government securities, in connection with its other central bank functions and responsibilities, including conducting monetary policy, fostering financial stability, and deterring or managing financial crises.

As part of the supervisory process, the Federal Reserve reviews the systems and controls used by BHCs and the U.S. operations of FBOs to monitor and ensure that the organization, including its nonbank subsidiaries, complies with applicable laws and regulations, including those related to consumer protection. The Federal Reserve also may interact with nonbank entities, relying to the fullest extent possible on work performed by the relevant functional regulator, if any. While the Federal Reserve routinely conducts examinations of the compliance function at the BHC, including its systems for monitoring and ensuring compliance with consumer and other applicable laws, the Federal Reserve currently does not routinely conduct examinations for the purpose of determining...
compliance with specific consumer laws enforced primarily by other supervisors regarding non-bank subsidiaries of BHCs and FBOs. When consumer compliance-related deficiencies are noted as part of the ongoing supervision of a BHC or FBO, however, consumer compliance examiners may conduct onsite examinations (including transaction testing, if appropriate) of nonbank subsidiaries to resolve significant issues that have the potential for widespread violations or harm to consumers.\footnote{See SR-03-22/CA-03-15, “Framework for Assessing Consumer Compliance Risk at Bank Holding Companies,” and section 2124.01.6.1.2.}

The Federal Reserve also seeks to reinforce market discipline by encouraging public disclosures that balance quantitative and qualitative information with clear discussions about risk-management processes and that reflect evolving disclosure practices for peer organizations.

1050.0.2.3 Supervisory Portfolios

An important aspect of the Federal Reserve’s consolidated supervision programs for BHCs and the combined U.S. operations of FBOs is the assessment and evaluation of practices across groups of organizations with similar characteristics and risk profiles. This “portfolio approach” to consolidated supervision facilitates greater consistency of supervisory practices and assessments across comparable organizations and enhances the Federal Reserve’s ability to identify outlier organizations among established peer groups. The supervisory portfolios that the Federal Reserve currently uses in structuring its supervisory programs for BHCs and the U.S. operations of FBOs are as follows:

**BHC Portfolios:**
- large complex banking organizations (LCBO BHCs)
- regional bank holding companies (regional BHCs)
- community bank holding companies (community BHCs)

**FBO Portfolios:**
- large complex foreign banking organizations (LCBO FBOs)
- multi-office foreign banking organizations (multi-office FBOs)

LCBOs are characterized by the scope and complexity of their domestic and international operations; their participation in large volume payment and settlement systems; the extent of their custody operations and fiduciary activities; and the complexity of their regulatory structures, both domestically and in foreign jurisdictions. To be designated as an LCBO, a banking organization must meet specified criteria to be considered a significant participant in at least one key financial market.

Banking organizations that are not designated as LCBOs belong to the portfolios of regional or community BHCs, or multi-office or single-office FBOs. While there is considerable variety among organizations across these portfolios, the simpler regulatory structure of most non-LCBO organizations increases the likelihood that a single primary supervisor has a substantially complete view of, and ability to address, significant areas of firmwide (or combined U.S. operations for FBOs) activities, risks, risk management, and controls.

1050.0.3 SUPERVISORY GUIDANCE

The guidance attached to SR-08-9/CA-08-12 (e.g., sections 1050.1 and 1050.2) describes how Federal Reserve staff will develop an understanding and assessment of a BHC or the U.S. operations of an FBO through continuous monitoring activities, discovery reviews, and testing activities, as well as through interaction with, and reliance to the fullest extent possible on, other relevant primary supervisors and functional regulators. Because the Federal Reserve’s supervisory activities are tailored in the manner described above, separate guidance documents are provided for four different supervisory portfolios to promote appropriate and consistent supervision of organizations that broadly share similar characteristics and risk profiles. The documents’ guidance addresses

- consolidated supervision of LCBO BHCs (Attachment A.1) (See section 1050.1);
- consolidated supervision of regional BHCs (Attachment A.2) (See section 1050.2);
- supervision of the combined U.S. operations of LCBO FBOs (Attachment B.1); and
- supervision of the combined U.S. operations of multi-office FBOs (Attachment B.2).
As a supplement to these four guidance documents, definitions of key terms for consolidated supervision are provided in Attachment C to SR-08-9/CA-08-12 (See appendix, section 1050.0.4).

Consolidated supervision of community BHCs follows the procedures contained in SR-02-1 and section 5000.0.4.3, “Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less,” while supervision of single-office FBOs follows the procedures contained in SR-00-14.

1050.0.3.1 Overview of Significant Federal Reserve Supervisory Activities

The Federal Reserve will maintain for each BHC and the combined U.S. operations of each FBO

• an understanding of key elements of the banking organization’s strategy, primary revenue sources, risk drivers, business lines, legal entity structure, governance and internal control framework, and presence in key financial markets; and
• an assessment of (1) the effectiveness of risk-management systems and controls over the primary risks inherent in the organization’s activities, (2) the organization’s financial condition, and (3) the potential negative impact of nonbank operations on affiliated depository institutions.

This understanding and assessment will encompass both prudential and consumer compliance supervision and reflect judgments developed by Federal Reserve staff drawing from all available sources, including the work of other relevant primary supervisors and functional regulators and the organization’s internal control functions. Primary areas of focus will include

1. key corporate governance functions, including internal audit;
2. risk management and internal control functions for primary risks of the consolidated organization (or combined U.S. operations for FBOs), and supporting MIS;
3. where applicable, core clearing and settlement activities and related risk management and internal controls of firms that are large-value payment system operators and market utilities;
4. for LCBOs, activities in critical or key financial markets in which the organization plays a significant role, as well as related risk management and internal controls;
5. where applicable, areas of emerging interest with potential financial market consequences;
6. consolidated financial strength (in the case of FBOs, the financial strength of combined U.S. operations);
7. risk management and financial condition of significant nonbank subsidiaries; and
8. parent company and nonbank funding and liquidity (in the case of FBOs, funding and liquidity of U.S. operations).

By their nature, understanding and assessing some areas—such as the risk management and financial condition of significant nonbank subsidiaries that are not functionally regulated—will typically require more independent Federal Reserve supervisory work. Other areas—such as primary firmwide risk management and control functions—typically will require a greater degree of coordination with other relevant primary supervisors or functional regulators, who will likely have information or assessments upon which the Federal Reserve can draw.

The guidance in the attachments to SR-08-9/CA-08-12 outlines when the Federal Reserve will conduct (i.e., participate in or lead) testing activities in order to determine whether a control process is appropriately designed and achieving its objectives or to otherwise validate management assertions. Testing activities are an important element of the Federal Reserve’s consolidated supervision program for BHCs and the combined U.S. operations of FBOs. They supplement ongoing continuous monitoring activities and periodic discovery reviews necessary to maintain an understanding and assessment for each of these key functions.

The guidance in the SR letter’s attachments also discusses in greater detail control processes for several areas subject to testing on at least a three-year cycle, supplemented by a reassessment on at least an annual basis to identify whether changes in inherent risk or control structures, or potential concerns regarding controls, merit interim targeted testing activities. These areas are

• internal audit infrastructure;
• parent company and nonbank funding and liquidity (in the case of FBOs, funding and liquidity of U.S. operations);
• where applicable, core clearance and settlement activities; and,
• where applicable, activities in critical financial markets in which the organization plays a significant role.\textsuperscript{15}

There may also be instances when additional supervisory activities are necessary to improve the understanding and/or to assess the adequacy of key corporate governance functions or risk management or internal control functions for primary risks due to significant changes, potential concerns, or the absence of recent testing.

All cycle times set forth in the guidance for testing represent maximum periods between testing activities. Shorter cycle times should be utilized whenever significant changes occur in, or material concern exists regarding, a key governance, risk-management, or internal control function.

In conducting the activities described in the guidance, the Federal Reserve will rely to the fullest extent possible on the information and assessments of relevant primary supervisors and functional regulators, and will work with such supervisors and regulators to align each agency’s assessment of key corporate governance functions, risk-management and internal control functions for primary risks, financial condition, and other areas of consolidated BHC or combined U.S. FBO operations, as applicable. In addition, because of the specific statutory limitations that apply with respect to functionally regulated subsidiaries of a BHC or FBO, the Federal Reserve will continue to adhere to the procedures and limits described in SR-00-13 (see sections 3900.0 and 1040.0) in conducting any examination of, or requesting a specialized report from, a functionally regulated subsidiary of a BHC or FBO.\textsuperscript{16} Under these provisions, for example, the Federal Reserve may conduct an examination of a functionally regulated subsidiary if, after reviewing relevant reports, it reasonably determines that the examination is necessary to adequately inform the Federal Reserve about the systems used to monitor and control financial and operational risks within the consolidated organization that may pose a direct or indirect threat to the safety and soundness of a depository institution subsidiary.

1050.0.3.2 Application of Supervisory Guidance

As a general matter, the supervisory expectations and processes of the guidance documents that are attached to SR-08-9/CA-08-12 are intended for use in supervising BHCs and the combined U.S. operations of FBOs in circumstances where both the banking organization and its subsidiary depository institutions are in at least satisfactory condition and there are no indications of material weakness in the organization’s risk management or internal controls. Additional Federal Reserve supervisory activities may be necessary or appropriate if the banking organization is facing, or is expected to face, material financial, managerial, operational, legal, or reputational difficulties, or is the subject of an investigation or formal or informal enforcement action.

Section IV of each of the documents attached to SR-08-9/CA-08-12 (see sections 1050.1.4 and section 1050.2.4) provides additional guidance on the steps the Federal Reserve will take to coordinate with other supervisors in certain special situations. This guidance does not limit any authority that the Federal Reserve may have under applicable law and regulations, including the authority to obtain reports or conduct examinations or inspections. Moreover, because this guidance relates to supervisory practices, it does not address or limit the circumstances under which the Federal Reserve may take formal or informal enforcement action against a banking organization or other person.

This supervisory guidance is not intended to comprehensively describe all elements of an effective supervision program for BHCs or U.S. operations of FBOs. Rather, the guidance supplements, and should be used in conjunction with, existing Federal Reserve guidance, including among others the Bank Holding Company Supervision Manual; the Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations; SR-04-18; SR-03-22/CA-03-15; SR-00-14; and SR-00-13.
1050.0.4 APPENDIX—DEFINITIONS OF KEY TERMS FOR CONSOLIDATED SUPERVISION

1050.0.4.1 Supervisory Objectives

Assessing: To go beyond developing an understanding by making supervisory judgments regarding the degree of inherent risks or evaluating whether risk-management and internal control practices are functioning as intended, and whether they are adequate relative to the risk taken. It is often necessary for bank supervisors or functional regulators to conduct testing activities as a means to arrive at an assessment.

Understanding: To gain comprehensive insight into the nature of a business activity, its related risks, and the design of risk-management and compensating controls. Understanding also involves comprehending the significance of such activities, risks, and controls for the institution’s safety and soundness. Continuous monitoring or discovery reviews are often utilized to develop an understanding of a banking organization’s operations and the related inherent risk and controls.

1050.0.4.2 Supervisory Activities

Active participation: When the Federal Reserve has input into determining the objectives, final conclusions, and related communications to institution management for an examination led by another relevant primary supervisor or functional regulator.

Continuous monitoring: Non-examination/inspection supervisory activities primarily designed to develop and maintain an understanding of the organization, its risk profile, and associated policies and practices. These activities also provide information that is used to assess inherent risks and internal control processes. Such activities include meetings with banking organization management; analysis of management information systems (MIS) and other internal and external information; review of internal and external audit findings; and other efforts to coordinate with, and utilize the work of, other relevant supervisors and functional regulators, including analysis of reports filed with, or prepared by, these supervisors or regulators, or appropriate self-regulatory organizations, as well as related surveillance results.

Discovery review: An examination/inspection supervisory activity designed to improve the understanding of a particular business activity or control process—for example, to address a knowledge gap identified during the risk assessment or other supervisory process. If questions regarding the adequacy of practices or sufficiency of information are raised during this review, it will likely be necessary to conduct further and more in-depth examination activity (e.g., testing).

Examination/inspection: Examination activities are applicable to the supervision of banks and other depository institutions, as well as U.S. banking offices of FBOs, and inspection activities are applicable to the supervision of BHCs and nonbank subsidiaries and affiliates. Examination and inspection activities are generally described as examinations throughout this guidance.

Testing: An examination/inspection supervisory activity designed to go beyond a discovery review, as it will result in an assessment of whether a control process is appropriately designed and achieving its objectives, or validation of a management assertion about an organization’s operations. Such activities may include the review and validation of internal MIS, such as business records related to an internal control process; audit findings and processes; or a sample of transactions that have been entered into by a banking organization.

1050.0.4.3 Foreign Banking Organization Supervision

Booked in: Recorded on the books and records of the legal entity in question. For supervisory purposes, the U.S. operations of FBOs include activities that are booked in or traded through U.S. operations.

Comprehensive, consolidated supervision: An FBO is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the FBO (including the relationship of the bank to any affiliate) to assess the FBO’s overall financial condition and compliance with law and regulation. The Foreign Bank Supervision Enhancement Act of 1991 introduced the requirement that the Federal Reserve approve...
the establishment of all U.S. banking offices of FBOs, and in that connection, take into account whether the FBO is subject to comprehensive, consolidated supervision by its home-country supervisor.

**Multi-office foreign banking organizations:** All FBOs except for (1) those that are designated as being part of the portfolio of LCBOs and (2) FBOs whose U.S. operations consist solely of a single U.S. banking office.

**National treatment:** As established by the International Banking Act of 1978 (IBA), a policy that requires nondiscrimination between domestic and foreign firms or treatment of foreign entities that is no less favorable than that accorded to domestic enterprises in like circumstances. This policy generally gives foreign banks operating in the United States the same powers as U.S. banking organizations and subjects them to the same restrictions and obligations.

**Net due to / from positions:** Net due to and from positions refer to the flow of funds between a U.S. branch or agency and its parent FBO (including other affiliated depository institutions). For example, a U.S. branch is in a net due from position with its parent FBO if the parent owes funds to the branch once all transactions between the branch and the parent are netted.

**Qualifying foreign banking organizations (QFBOs):** FBOs that are entitled to certain exemptions from the nonbanking activities restrictions of the Bank Holding Company Act, including for certain limited commercial and industrial activities in the United States. The Federal Reserve does not examine or supervise these commercial/industrial activities. The Federal Reserve monitors the extensions of credit by U.S. banking offices of foreign banks to U.S. companies held directly under this authority to ensure that such loans are made on market terms.

**Traded through:** Transacted or arranged by the personnel of the institution in question (in an agent role), but booked at a different related legal entity. For supervisory purposes, the U.S. operations of FBOs include activities that are booked in or traded through U.S. operations.

**U.S. banking offices:** U.S. depository institution subsidiaries of FBOs and branches/agencies of FBOs.

**U.S. nonbank affiliates of U.S. banking offices:** U.S. BHC parent companies and their nonbank subsidiaries, as well as other U.S. nonbank affiliates and representative offices held directly by the FBO.

### 1050.0.4.4 Other Terms

**Banking Organization National Desktop (BOND):** A Federal Reserve information technology platform providing secure interagency access to documents, supervisory and financial data, and other information utilized in the consolidated supervision of individual BHCs and FBOs, and in developing comparative analyses of institutions with similar business lines and risk characteristics.

**College of supervisors:** A multilateral group of supervisors that discusses issues related to specific internationally active banking organizations. The Federal Reserve participates in colleges of supervisors as both a home-country supervisor of internationally active U.S. BHCs and as a host-country supervisor of the U.S. operations of FBOs.

**Consolidated supervision (also known as “umbrella” or “groupwide” supervision):** Supervision of a BHC on a groupwide basis, including its nonbanking subsidiaries, providing important protection to its subsidiary banks and to the federal safety net beyond that afforded by supervision of a bank individually. Consolidated supervision allows the Federal Reserve to understand the financial and managerial strength and risks within the consolidated organization as a whole, providing the ability to address significant management, operational, capital, or other deficiencies within the overall organization before they pose a threat to subsidiary banks.

**Core clearing and settlement organizations:** As defined in the “Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System” (SR-03-9), two groups of organizations that provide clearing and settlement services for critical financial markets or act as large-value payment system operators, and present the potential for systemic risk should they be unable to perform. The first group consists of market utilities (government-sponsored services or industry-owned organizations), whose
primary purpose is to clear and settle transactions for critical markets or transfer large-value wholesale payments. The second group consists of those private-sector firms that provide clearing and settlement services that are integral to a critical market (i.e., their aggregate market share is significant enough to present the potential for systemic risk in the event of their sudden failure to carry out those activities because there are no viable immediate substitutes).

Critical financial markets: As defined in the “Interagency Paper on Sound Practices to Strengthen the Resilience of the U. S. Financial System,” the markets for federal funds, foreign exchange, and commercial paper; U.S. government and agency securities; and corporate debt and equity securities.

Domestic BHC: A BHC incorporated in the United States that is not controlled by an FBO.

Double leverage: Situations in which debt is issued by the parent company and the proceeds are invested in subsidiaries as equity.

Financial instability: When external events or market behavior in the financial system are substantial enough to significantly distort or impair national or global financial markets or to create significant risks for real aggregate economic performance. Banking organizations with a considerable presence in activities that are potentially vulnerable to such externalities—or that are capable of contributing to financial instability if not adequately managed—require supervisors to develop an understanding of these activities and their risk profile.

Functional regulator: With respect to domestic authorities, the appropriate federal (examples include the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission) or state regulator for a functionally regulated nondepository subsidiary or affiliate of a BHC or FBO.

Key corporate governance functions: Primary firmwide governance mechanisms relied upon by the board of directors and senior management. This includes the board and its committees, senior management and its executive committees, internal audit, and other functions (e.g., corporate finance and treasury functions), whose effectiveness is essential to sustaining the consolidated organization as well as a firm’s business resiliency and crisis management capabilities.

Key financial markets: Includes critical financial markets as well as (1) broader U.S. capital market activity, including underwriting, securitization, derivatives, and trading; (2) retail financial services; and (3) international financial markets.

Key models and processes: Those where evaluation of the model/process will influence the Federal Reserve’s assessment of the activity or control area that is supported by the model/process.

Large complex banking organizations (LCBOs): LCBOs are characterized by the scope and complexity of their domestic and international operations; their participation in large volume payment and settlement systems; the extent of their custody operations and fiduciary activities; and the complexity of their regulatory structure, both domestically and in foreign jurisdictions. To be designated as an LCBO, a banking organization must meet specified criteria to be considered a significant participant in at least one key financial market.

Material portfolios or business lines: Portfolio risk areas (such as retail or wholesale credit risk) or individual business lines (such as mortgage lending or leveraged lending) that are primary drivers of risk or revenue for the BHC, or that otherwise materially contribute to understanding inherent risk or assessing related controls for a broader corporate function (such as consolidated credit-risk management). When identifying these areas during the development of the institutional overview and risk assessment, as well as during other supervisory processes, consideration is given to all associated risk elements, including legal and compliance risks.

Net debit cap: The maximum dollar amount of uncollateralized daylight overdrafts that an institution may incur in its Federal Reserve account.

Nonmaterial business lines: Business lines that are not primary drivers of risk or revenue for the BHC, and are not principal contributing factors to either understanding risk inherent in a broader corporate function or to assessing related controls.

Nontraditional BHCs: BHCs in which most or all of the organization’s significant nondepository subsidiaries are regulated by a functional
regulator, and subsidiary depository institution(s) are small in relation to nondepository subsidiaries.

Other relevant primary supervisors: Primary bank or thrift supervisors of BHC subsidiaries, including host-country supervisors (or home-country supervisors for FBOs), whose understanding and assessments are key to effective firmwide consolidated supervision.

Primary firmwide risk management and control functions: Mechanisms relied upon by the board of directors and senior management for identifying, measuring, monitoring, and controlling primary risks to the consolidated organization. This includes risk management and control functions for primary credit, legal and compliance, liquidity, market, operational, and reputational risks for the consolidated organization.

Primary supervisor: The primary federal banking or thrift supervisor (for example, the Office of the Comptroller of the Currency for a nationally chartered bank) of a depository institution subsidiary of a BHC, or of a U.S. banking office of an FBO. For state-chartered depository institutions or banking offices, this term also includes the relevant bank supervisory authority of the institution’s chartering/licensing state. Where a BHC has multiple depository institution subsidiaries, or an FBO has multiple U.S. banking offices, there may also be multiple primary banking supervisors, depending on how the subsidiaries are chartered/licensed. For U.S. operations of FBOs, the U.S. supervisor of a U.S. banking office is referred to as a domestic primary supervisor.

Regional bank holding companies: BHCs with $10 billion or more in consolidated assets (including nontraditional BHCs) that are not designated as LCBOs.

Regulatory structure: The various legal entities within the organization that are subject to oversight by different domestic and foreign primary supervisors or functional regulators.

Significant nonbank activities and risks: Where the parent company or nonbank subsidiaries engage in risk-taking activities or hold exposures that are material to the risk management or financial condition of the consolidated organization or a depository institution affiliate.

Specialized report from a functionally regulated subsidiary: As discussed in the GLBA, a report that the functionally regulated subsidiary is not required to prepare by another federal or state regulatory authority or an appropriate self-regulatory organization.

Systemic risk: The risk that the failure of one participant to meet its required obligations in a transfer system or financial market will cause other participants to be unable to meet their obligations when due, causing significant liquidity or credit problems or threatening the stability of national or global financial markets.
What’s New in This Revised Section

Effective January 2015, this section is revised for the adoption of a new consolidated supervision framework for large banking organizations. Refer to SR-12-17/CA-12-14, “Consolidated Supervision Framework for Large Financial Institutions.” SR-99-15 was superseded by SR-12-17/CA-12-14.

1050.1.1 Activities of the Federal Reserve and Other Supervisors and Regulators, and Functional Regulation

In 1999, the Federal Reserve established its supervisory program for large complex banking organizations (LCBOs). LCBOs are characterized by the scope and complexity of their domestic and international operations; their participation in large volume payment and settlement systems; the extent of their custody operations and fiduciary activities; and the complexity of their regulatory structure, both domestically and in foreign jurisdictions. To be designated as an LCBO, a banking organization must meet specified criteria to be considered a significant participant in at least one key financial market.

As outlined in the following sections, a range of continuous monitoring activities is utilized, along with discovery reviews and testing activities (examination/inspection activities), to develop and maintain an understanding and assessment of each domestic bank holding company (BHC) that is an LCBO. These organizations are collectively referred to as large complex BHCS.

1. With the implementation of the “Consolidated Supervision Framework for Large Financial Institutions” (refer to SR-12-17/CA-12-14), SR-99-15, “Risk-Focused Supervision of Large Complex Banking Organizations,” was superseded. (Refer to section 2124.05 of this manual).

2. See section 1050.0.4, Appendix, for the definitions of terms commonly used in this section and sections 1050.1 and 1050.2.

3. The term “examination” is generally used throughout this guidance to refer to both commercial bank examination and BHC inspection activities.

4. The term “domestic BHC” refers to a BHC incorporated in the United States that is not controlled by a foreign banking organization (FBO). Attachment B.1 to SR-08-9/CA-08-12 addresses—in the context of supervising the combined U.S. operations of FBOs—how the Federal Reserve will develop and maintain an understanding and assessment of a BHC that is, or is controlled by, an FBO that is itself an LCBO.

1050.1.1.1 Federal Reserve Activities and Those Activities of Other Supervisors and Regulators

The nature and scope of independent Federal Reserve supervisory work required to develop and maintain an understanding and assessment of a large complex BHC depends largely on the extent to which other relevant primary supervisors or functional regulators have information or assessments upon which the Federal Reserve can draw. By their nature, understanding and assessing some areas—such as the risk management and financial condition of significant nonbank subsidiaries that are not functionally regulated—typically will require more independent Federal Reserve supervisory work. Other areas—such as primary firmwide risk-management and control functions—typically will require a greater degree of coordination with other relevant primary supervisors or functional regulators, who will likely have information or assessments upon which the Federal Reserve can draw.

The following sections provide further detail on how the Federal Reserve will develop, working in coordination with other relevant primary supervisors and functional regulators, an understanding and assessment of a large complex BHC. In conducting the activities described throughout this document, the Federal Reserve will, to the fullest extent possible

- rely on the information and assessments of relevant primary supervisors and functional regulators, including the information and assessments reflected in the reports of examination of such supervisors and regulators;
- focus its supervisory activities on the bank holding company, as well as on those of its nonbank subsidiaries that could have a direct or indirect materially adverse effect on the safety and soundness of a depository institution subsidiary of the BHC due to the size, condition, or activities of the nonbank subsidiary, or the nature or size of its transactions with the depository institution; and
- use publicly reported information (including externally audited financial statements), as well as reports that a large complex BHC or a subsidiary prepares for other primary supervisors, functional regulators, or self-regulatory organizations.
### 1050.1.1.2—Functionally Regulated Subsidiaries

As discussed below, in certain situations, the Federal Reserve may find it necessary to conduct an examination of a functionally regulated nonbank subsidiary in order to fulfill the Federal Reserve’s responsibilities as supervisor of the consolidated organization. In any such case, the Federal Reserve will continue to adhere to the procedural and other requirements governing examinations of, or requests for a specialized report from, a functionally regulated subsidiary as discussed in SR-00-13 and sections 1040.0 and 3900.0. Under these provisions, for example, the Federal Reserve may conduct an examination of a functionally regulated subsidiary if, after reviewing relevant reports, it reasonably determines that the examination is necessary to adequately inform the Federal Reserve about the systems used to monitor and control financial and operational risks within the consolidated organization that may pose a direct or indirect threat to the safety and soundness of a depository institution subsidiary.⁵

### 1050.1.2 UNDERSTANDING THE ORGANIZATION

For each large complex BHC, the Federal Reserve will develop an understanding of the legal, operating, and corporate governance structure of the organization and its primary strategies, business lines, and risk-management and internal control functions.⁶ This understanding will inform the development of a risk assessment and supervisory plan for the BHC. Typically, the information necessary to gain this understanding may be obtained from the organization’s management, public reports, regulatory reports, surveillance screens, third-party sources (e.g., credit rating agency and market analyst reports), and other relevant primary supervisors or functional regulators. Key elements that should be identified and understood include the following:

- **Corporate strategy.** Primary business strategies; institutional risk tolerance; key changes in strategic direction or risk profile; significant new business activities, areas of growth and emerging areas with potential to become primary drivers of risk or revenue; and plans for expansion through mergers or acquisitions.

- **Significant activities.** Key revenue and risk drivers; primary business lines; product mix; budget and internal capital allocations; market share for revenue and customers served; key external trends, including competitive pressures; and areas that are vulnerable to volatility in revenue, earnings, capital, or liquidity.

- **Structure.** Business line and legal entity structure; domestic and foreign regulatory responsibilities for legal entities and business lines; key interrelationships and dependencies between depository institution subsidiaries and nonbank affiliates; material business lines operated across multiple legal entities for accounting or risk-management purposes; and the activities and risk profiles of Edge and agreement corporation subsidiaries.

- **Corporate governance, risk management, and internal controls for primary risks.** Board of directors (board) and executive-level committees; senior management and management committees; key risk-management and internal control functions, and associated management information systems (MIS), relied upon by the board, senior management, and senior risk managers and committees; and consistency of public disclosures with how the board and senior management assess and manage risks.

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⁵ The Federal Reserve also may examine a functionally regulated subsidiary of a large complex BHC if, after reviewing relevant reports and other information, it has reasonable cause to believe that the subsidiary is engaged in an activity that poses a material risk to an affiliated depository institution, or that the subsidiary is not in compliance with any federal law that the Federal Reserve Board has specific jurisdiction to enforce against the subsidiary (and the Federal Reserve cannot determine compliance by examining the BHC or its affiliated depository institutions).

Simultaneously, before requiring a specialized report from a functionally regulated subsidiary, the Federal Reserve first will request that the subsidiary’s appropriate functional regulator obtain the report and make it available to the Federal Reserve. In the event that the report is not obtained or made available as requested, the Federal Reserve may, consistent with the Bank Holding Company Act, obtain the report directly from the functionally regulated subsidiary if the report is necessary to allow the Federal Reserve to adequately assess (1) a material risk to the BHC or any of its depository institution subsidiaries, (2) the systems used to monitor and control financial and operational risks within the consolidated organization that may pose a threat to the safety and soundness of a depository institution subsidiary, or (3) compliance with any federal law that the Federal Reserve Board has specific jurisdiction to enforce against the BHC or a subsidiary.

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⁶ This understanding is formally documented during development of the institutional overview, which coincides with creation of the annual risk assessment, SR-97-24, “Risk-Focused Framework for Supervision of Large Complex Institutions” (see section 2124.01), describes processes for developing an institutional overview, risk assessment, and supervisory plan. Each of these products is kept current to reflect significant changes in an organization’s risks or activities.
• Presence in critical or key financial markets.\(^7\)
Core clearing and settlement activities; business lines with a significant presence in critical or key national or global financial markets; and related risk-management and disclosure practices.

To ensure the quality and consistency of consolidated supervision across the large complex BHC portfolio, it also is necessary to understand how these key elements compare with industry trends and with evolving practices of well-managed organizations with similar characteristics.

1050.1.3 ASSESSING THE LARGE COMPLEX BHC ON A CONSOLIDATED BASIS

The Federal Reserve uses a systematic approach to develop an assessment of a BHC on a consolidated basis. This assessment is reflected in the RFI (Risk Management, Financial Condition, and Impact) rating assigned to a BHC.\(^8\)

1050.1.3.1 Risk Management

1050.1.3.1.1 Key Corporate Governance Functions

Objectives: One of the primary areas of focus for consolidated supervision of large complex BHCs is the adequacy of governance provided by the board and senior management. The culture, expectations, and incentives established by the highest levels of corporate leadership set the tone for the entire organization and are essential determinants of whether a banking organization is capable of maintaining fully effective risk-management and internal control processes.

The board and its committees should have an ongoing understanding of key inherent risks, associated trends, primary control functions, and senior management capabilities. Primary expectations for the board and its committees include

1. selecting competent senior managers, ensuring that they have the proper incentives to operate the organization in a safe and sound manner, and regularly evaluating senior managers’ performance;
2. establishing, communicating, and monitoring (for example, by reviewing comprehensive MIS reports produced by senior management) institutional risk tolerances and a corporate culture that emphasizes the importance of compliance with the law and ethical business practices;
3. approving significant strategies and policies;
4. demonstrating leadership, expertise, and effectiveness;
5. ensuring the organization has an effective and independent internal audit function;
6. ensuring the organization has appropriate policies governing the segregation of duties and avoiding conflicts of interest; and
7. ensuring that public disclosures
• are consistent with how the board and senior management assess and manage the risks of the organization,
• balance quantitative and qualitative information with clear discussions about risk-management processes, and
• reflect evolving disclosure practices for peer organizations.

A large complex BHC’s senior management and its committees should be able to clearly communicate risk tolerances and measures, control risks, hire and retain competent staff, and respond to changes in the organization’s risk profile and the external environment. Members of senior management are expected to have qualifications and experience commensurate with the size and complexity of the organization. Primary expectations for senior management include

1. establishing effective oversight and an appropriate risk culture;
2. appropriately delegating authority and overseeing the establishment and implementation of effective policies for the proper segregation of duties and for the avoidance or management of conflicts of interest;
3. establishing and implementing an effective risk-management framework capable of identifying and controlling both current and emerging risks, and effective independent control functions that ensure risk taking is consistent with the organization’s established risk appetite;
4. establishing and implementing incentives for

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\(^7\) See sections 1050.1.3.1.6 and 1050.1.3.1.7 for definitions of “critical financial markets” and “key financial markets.”

\(^8\) The RFI rating system for BHCs is discussed in SR-04-18, “Bank Holding Company Rating System” (see section 4070.0). RFI ratings are assigned for BHCs that are complex or that have $1 billion or more in consolidated assets, and are communicated via a comprehensive summary supervisory report that supports the BHC’s assigned ratings and encompasses the results of the entire supervisory cycle.
personnel that are consistent with institutional risk tolerances, compliance with the law, and ethical business practices;
5. promoting a continuous dialogue between and across business areas and risk-management functions to help align the organization’s established risk appetite and risk controls;
6. ensuring that the board and its committees are provided with timely, accurate, and comprehensive MIS reports that are adaptive to changing circumstances regarding risks and controls; and
7. ensuring timely resolution of audit, compliance, and regulatory issues.

An effective internal audit function plays an essential role by providing an independent and objective evaluation of all key governance, risk-management, and internal control processes. As the complexity of financial products and supporting technology has grown, in combination with greater reliance on third-party service providers, the importance of internal audit’s role in identifying risks and testing internal controls has increased.

In addition, the extent to which supervisors can rely on or utilize the work of internal audit is an essential determinant of the risk-focused supervisory program that is tailored to the activities and risks of each large complex BHC.

**Supervisory Activities:** For each large complex BHC, the Federal Reserve will understand and assess the adequacy of oversight provided by the board and senior management, as well as the adequacy of internal audit and associated MIS. The Federal Reserve also will understand and assess other key corporate governance functions (e.g., corporate finance and treasury functions), whose effectiveness is essential to sustaining consolidated holding company operations, as well as the organization’s business resiliency and crisis management capabilities.

- **Board, senior management, and other key corporate governance functions.** Continuous monitoring activities—which draw from all available sources, including internal control functions, the work of other relevant primary supervisors and functional regulators, regulatory reports, and related surveillance results—will be used to understand and assess the effectiveness of board and senior management resources and oversight.

The results of continuous monitoring activities, as documented in the institutional overview, risk assessment, and other supervisory products, may identify certain corporate governance functions that will require more intensive supervisory focus due to (1) significant changes in corporate strategy, activities, organizational structure, oversight mechanisms, or key personnel; (2) potential concerns regarding the adequacy of a specific governance function; or (3) the absence of sufficiently recent examination activities for a key function by the Federal Reserve or another primary supervisor or functional regulator.

- **Internal audit.** Continuous monitoring and examination activities will be used to understand and assess key elements of internal audit governance for the organization on a consolidated basis, including (1) the adequacy and independence of the audit committee; (2) the independence, professional competence, and quality of the internal audit function; (3) the quality and scope of the audit methodology, audit plan, and risk-assessment process; and (4) the adequacy of audit programs and workpaper standards. On at least an annual basis, the results of these supervisory activities will be reviewed to determine whether there have been significant changes in the internal audit infrastructure or whether there are potential concerns regarding the adequacy of key elements of internal audit. In addition to this periodic audit infrastructure review, testing activities for specific control functions or business lines should include an assessment of internal audit’s recent work in these areas to the extent possible as a means of validating internal audit’s findings.

- **Additional supervisory activities.** If continuous monitoring activities identify a key corporate governance function or element of internal audit requiring more intensive supervisory focus due to significant changes, potential concerns, or the absence of sufficiently recent examination activities, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) in developing discovery reviews or testing activities focusing on the area of concern. In situations where another primary supervisor or functional regulator leads the examination activities, the Federal Reserve will participate as actively as appropriate in those activities.9

9. Active participation by the Federal Reserve in an examination led by another primary supervisor or functional regula-
If the area of concern is not within the oversight of another primary supervisor or functional regulator, or if the supervisor or regulator does not conduct or coordinate the examination activities in a reasonable period.

1050.1 Guidance for the Consolidated Supervision of Domestic BHCs That Are LCBOs
of time, the Federal Reserve will lead the necessary examination activities in coordination with other relevant primary supervisors and functional regulators to the extent possible.

• Additional required audit testing activities. In all instances, the Federal Reserve will conduct testing activities as part of its audit infrastructure review (either by leading the activities and coordinating with other relevant primary supervisors or functional regulators or participating as actively as appropriate in activities led by other relevant supervisors or regulators) on at least a three-year cycle to ensure that the internal audit program is appropriately designed and achieving its objectives.

In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.1.1.2.

1050.1.3.1.2 Risk Management and Internal Control Functions for Primary Risks to the Consolidated Organization

Objectives: Underlying the risk-focused approach to consolidated supervision of large complex BHCs is the premise that it is each organization’s responsibility to develop an appropriate control structure for identifying, measuring, monitoring, and controlling key risks as measured against supervisory standards and expectations, applicable laws and regulations, and evolving practices of well-managed organizations.

The Federal Reserve will understand and assess risk-management and control functions for primary risks to the consolidated organization (primary firmwide risk-management and control functions), and associated MIS, for each large complex BHC. This will include risk-management and control functions for primary credit, legal and compliance, liquidity, market, operational, and reputational risks for the consolidated organization. The Federal Reserve also will understand and assess other risk-management and control functions that, based on the specific characteristics and activities of the individual BHC, relate to primary risks to the organization as a whole.

For example, for large complex BHCs with particularly dynamic corporate strategies, the Federal Reserve will understand and assess the adequacy of the control mechanisms relevant to such strategies, including strategic planning, merger integration, new business approval, and processes for ensuring that risk management and controls keep pace with areas of growing inherent risk. Furthermore, large complex BHCs operating across a range of financial intermediary activities are more likely to face potential conflicts of interest due to their greater likelihood of acting as agents for both issuers and investors. For these holding companies, it is necessary to assess the adequacy of processes for identifying and avoiding or managing conflicts of interest.

In all instances, the adequacy of each primary firmwide risk management or control mechanism depends on the appropriateness of the following:

1. control infrastructure and governance, including degree of oversight by the board and senior management;
2. development, maintenance, and communication of appropriate policies, procedures, and internal controls;
3. risk identification and measurement systems and processes, and associated MIS, that are adaptive to changing circumstances and capable of providing timely, accurate, and comprehensive information to senior management and the board;
4. monitoring and testing the effectiveness of controls;
5. processes for identifying, reporting, and escalating issues and emerging risks;
6. ability to implement corrective actions in a timely manner;
7. appropriate authority and independence of staff to carry out responsibilities; and
8. integration of risk-management and control objectives within management goals and the organization’s compensation structure.

Most large complex BHCs have evolved toward comprehensive, consolidated risk management to measure and assess the range of their exposures and the way these exposures interrelate. Nonetheless, a variety of control structures are in place across this portfolio, and in some instances there is not a firmwide mechanism in place to oversee and manage a key control function across the organization’s business lines and

10. Federal Reserve processes for understanding and assessing legal and compliance risk management apply to the domestic and international operations of large complex BHCs and, as described in SR-03-22/CA-03-15, “Framework for Assessing Consumer Compliance Risk at Bank Holding Companies.” (see section 2124.01) encompass consumer compliance risk inherent in the organization’s business activities.
In all instances, the Federal Reserve will focus on individual control structures in place for primary business lines or legal entities as needed to reach an understanding and assessment of the consolidated organization. When applicable, the Federal Reserve also will assess whether a decentralized approach to a key control function is sufficient by evaluating the effectiveness of such an approach in controlling primary risks to the consolidated organization.\textsuperscript{11}

**Supervisory Activities:** The Federal Reserve will use continuous monitoring activities to understand and assess each primary firmwide risk-management or control function. This process begins with the overarching design and architecture of each primary firmwide risk-management or control function, and drills down, as appropriate, through analysis of risk management and controls for material portfolio areas and business lines (described in section 1050.1.3.1.3 below). Activities will verify the sufficiency of fundamental aspects of internal controls in relation to the holding company’s current risk profile and in comparison with supervisory expectations and evolving sound practices and assess the capability of these primary functions (whether centralized or decentralized) to remain effective in the face of growth, changing strategic direction, significant market developments, and other internal or external factors.

The results of continuous monitoring activities, as documented in the institutional overview, risk assessment, and other supervisory products, may identify certain primary firmwide risk-management or control functions that require more intensive supervisory focus due to (1) significant changes in inherent risk, control processes, or key personnel; (2) potential concerns regarding the adequacy of controls; or (3) the absence of sufficiently recent examination activities for a primary firmwide risk-management or control function by the Federal Reserve or another relevant primary supervisor or functional regulator.

In these instances, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) to develop discovery reviews or testing activities focusing on the area of concern. In situations where another primary supervisor or functional regulator leads the examination activities, the Federal Reserve will participate as actively as appropriate in those activities.

If the primary firmwide risk-management or control function is not within the oversight of another primary supervisor or functional regulator, or if the primary supervisor or functional regulator does not conduct or coordinate the examination activities in a reasonable period of time, the Federal Reserve will lead the necessary examination activities in coordination with other relevant supervisors and regulators to the extent possible. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.1.1.2.

### 1050.1.3.1.3 Risk Management of Material Portfolios and Business Lines

**Objectives:** For each large complex BHC, there are selected portfolio risk areas (such as retail or wholesale credit risk) or individual business lines (such as mortgage lending or leveraged lending) that are primary drivers of risk or revenue, or that otherwise materially contribute to understanding inherent risk or assessing controls for a broader corporate function (such as consolidated credit-risk management).

During the development of the institutional overview and risk assessment, as well as during other supervisory processes, the Federal Reserve will analyze external factors and internal trends in the BHC’s strategic initiatives—as evidenced by budget and internal capital allocations and other factors—to identify significant activities and areas vulnerable to volatility in revenue, earnings, capital, or liquidity that represent material risks of the organization. This determination of material portfolios and business lines considers all associated risk elements, including legal and compliance risks. For example, when evalu-
ating whether retail activities such as mortgage or credit card lending are material to a banking organization, the extent of inherent consumer compliance and reputational risks, as well as credit and market risks, should be considered.

**Supervisory Activities:** Because an understanding of material risks and activities is needed to assess the primary firmwide risk-management and control functions (as discussed in preceding section 1050.1.3.1.2), the Federal Reserve will maintain an understanding of inherent risk and assess the adequacy of risk-management and internal controls for material portfolios and business lines. To form this understanding and assessment, the Federal Reserve will rely primarily on continuous monitoring activities, supplemented as appropriate by examination activities.

To the fullest extent possible, the Federal Reserve will draw its understanding and assessment of these risks and risk-management practices from the information and assessments of a primary supervisor or functional regulator where the BHC’s legal and operating structure provides the supervisor or regulator a sufficient view of these areas. In these instances, the Federal Reserve will undertake continuous monitoring and participate in activities led by primary supervisors and functional regulators as necessary to maintain an understanding and assessment of related firmwide risk-management and control functions.

Many activities of large complex BHCs span legal entities that are subject to oversight by multiple supervisors or regulators or that are outside the oversight of other supervisors or regulators. If this is the case, or if the primary supervisor or functional regulator does not conduct or coordinate the necessary continuous monitoring or examination activities in a reasonable period of time, the Federal Reserve will initiate and lead these activities in coordination with other relevant primary supervisors and functional regulators to the extent possible. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.1.1.2.

**1050.1.3.1.4 Risk Management of Nonmaterial Business Lines**

**Objectives:** For nonmaterial business lines identified during the development of the institutional overview and risk assessment, as well as during other supervisory processes, the Federal Reserve’s focus will be on identifying and understanding those business lines that are increasing in importance and have the potential to become material.

**Supervisory Activities:** When a primary supervisor or functional regulator has a sufficient view of nonmaterial business lines, the Federal Reserve will, to the fullest extent possible, use information developed by that supervisor or regulator to monitor areas of increasing importance with the potential to become material. The Federal Reserve also will maintain an ability to access internal MIS for these businesses to facilitate a more in-depth analysis of a business line, if appropriate, to understand its growing importance to the organization.

For nonmaterial business lines that are not subject to oversight by a single primary supervisor or functional regulator, the Federal Reserve will engage in continuous monitoring activities to identify meaningful trends in risks and risk-management practices, initiate discovery reviews (in coordination with relevant primary supervisors or functional regulators as appropriate and in accordance with section 1050.1.1.2 above if relevant) to increase understanding of selected business lines that have the potential to become material, and maintain an understanding of associated MIS to facilitate more in-depth analysis of a business line, if appropriate, to understand its growing importance to the organization.

12. Core clearing and settlement organizations, as defined in the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System* (interagency sound practices paper, see SR-03-9), consist of two groups of organizations that provide clearing and settlement services for critical financial markets or act as large-value payment system operators, and that present the potential for systemic risk should they be unable to perform. These organizations are (1) market utilities (government-sponsored services or industry-owned organizations) whose primary purpose is to clear and settle transactions for critical markets (see section 1050.1.3.1.6) or transfer large-value wholesale payments, and (2) private-sector firms that provide clearing and settlement services that are integral to a critical market (i.e., their aggregate market share is significant enough to present the potential for systemic risk in the event of their sudden failure to carry out...
of the potential for problems in these areas to transmit an adverse impact across the banking and financial system, and given the Federal Reserve’s unique expertise and perspective with respect to these activities, the Federal Reserve focuses special supervisory attention on the risk-management and internal control practices and the public disclosures made by an organization with respect to these activities.

Supervisory Activities: Continuous monitoring and examination activities will be used to maintain an understanding of inherent risk and assess risk-management and internal controls, including related credit risk-management practices. On at least an annual basis, the results of these supervisory activities will be reviewed to determine whether there is (1) a significant change in inherent risk for core clearing and settlement activities stemming from changing strategies or activities; (2) a significant change in organizational structure, oversight mechanisms, key personnel, or other key elements of related risk-management or internal controls; or (3) any potential concern regarding the adequacy of related risk-management or internal controls.

If significant changes or potential concerns are identified, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) to design testing activities focused on understanding and assessing areas of change and/or concern, as well as ensure that risk-management and control functions are appropriately designed and achieving their intended objectives. In situations where another primary supervisor or functional regulator leads the discovery review or testing activities, the Federal Reserve will participate as actively as appropriate in those activities.

If the area of change and/or concern is not within the oversight of another primary supervisor or functional regulator, or if the primary supervisor or functional regulator does not conduct or coordinate the examination activities in a reasonable period of time, the Federal Reserve will lead the examination activities in coordination with other relevant primary supervisors and functional regulators to the extent possible.

In all instances, the Federal Reserve will conduct testing activities (either by leading the activities and coordinating with other relevant primary supervisors or functional regulators, or participating as actively as appropriate in activities led by other relevant supervisors or regulators) on at least a three-year cycle to ensure that these control mechanisms are appropriately designed and achieving their objectives. In addition to assessing the adequacy of risk-management and internal controls, testing activities will focus on assessing the contribution of the organization to the resilience or fragility of the clearance and settlement system as a whole, and on the organization’s adherence to the expectations of the interagency sound practices paper. Key expectations include geographic diversity and resiliency of data centers and operations, testing of recovery and resumption arrangements, and identification of downstream implications of failure of a major counterparty or clearing organization.

In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.1.1.2.

1050.1.3.1.6 Significant Presence in Critical Financial Markets (Where Applicable)

Objectives: The Federal Reserve will understand and assess the adequacy of risk management and controls for LCBO business lines with a significant presence in critical financial markets.

“Critical financial markets” are defined in the interagency sound practices paper as the markets for federal funds, foreign exchange, and commercial paper; U.S. government and agency securities; and corporate debt and equity securities. A business line may have a significant presence in a critical financial market even though the business line accounts for a relatively small portion of the organization’s total consolidated assets or revenues. These business lines are subject to special supervisory focus by the Federal Reserve in light of their potential to transmit a collective adverse impact across multiple firms and financial markets and the resulting significant reputational and other risks they pose to the organization.

Supervisory Activities: Continuous monitoring and examination activities will be used to understand inherent risk and assess risk-management and internal controls for business lines with a significant presence in a critical financial market. On at least an annual basis, the results of these supervisory activities will be reviewed to determine whether there is (1) a significant
change in inherent risk stemming from changing strategies or activities; (2) a significant change in organizational structure, oversight mechanisms, key personnel, or other key elements of related risk-management or internal controls; or (3) any potential concern regarding the adequacy of related risk-management or internal controls.

If significant changes or potential concerns are identified in these business lines, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) to design testing activities focused on understanding and assessing areas of change and/or concern, as well as ensure that risk-management and control functions are appropriately designed and achieving their intended objectives. In situations where another primary supervisor or functional regulator leads the testing activities, the Federal Reserve will participate as actively as appropriate in those activities.

If the area of change and/or concern is not within the oversight of another primary supervisor or functional regulator, or if the primary supervisor or functional regulator does not conduct or coordinate the examination activities in a reasonable period of time, the Federal Reserve will lead the testing activities and will coordinate these activities with other relevant primary supervisors and functional regulators to the extent possible.

In all instances, the Federal Reserve will conduct testing activities (either by leading the activities and coordinating with other relevant primary supervisors or functional regulators, or participating as actively as appropriate in activities led by other relevant supervisors or regulators) on at least a three-year cycle. These activities will focus on the organization’s adherence to the expectations set forth in the interagency sound practices paper, including geographic diversity and resiliency of data centers and operations, and testing of recovery and resumption arrangements.

In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.1.1.2.

1050.1.3.1.7 Risk Management of Activities in Key Financial Markets

Objectives: To be designated as an LCBO by the Federal Reserve, a banking organization must meet specified criteria as a significant participant in at least one key financial market. For each key financial market activity where the large complex BHC is a significant participant, the Federal Reserve will maintain an understanding of inherent risk, assess the adequacy of related risk-management and internal controls (including the sufficiency of business continuity planning), and understand the organization’s potential impact on the overall functioning of the market.

Supervisory Activities: Continuous monitoring and examination activities will be used to understand inherent risk for key financial market activities and assess related risk-management and internal controls.

To the fullest extent possible, the Federal Reserve will draw its understanding and assessment of these risks and risk-management practices from the information and assessments of a primary supervisor or functional regulator where the BHC’s legal and operating structure provides the supervisor or regulator a sufficient view of these areas. In these instances, the Federal Reserve will undertake continuous monitoring and participate in activities led by primary supervisors and functional regulators as necessary to maintain an understanding and assessment of risk-management and control functions for key financial market activities.

For activities that span legal entities subject to oversight by multiple supervisors or regulators, or that are outside the oversight of other supervisors or regulators, the Federal Reserve will develop and conduct—in coordination with other relevant primary supervisors and functional regulators to the extent possible and in accordance with the provisions described above in section 1050.1.1.2 if relevant—testing and discovery review activities as necessary to complement continuous monitoring work.

1050.1.3.1.8 Issues and Developments in Areas of Emerging Interest with Potential Financial Market Consequences

Objectives: The Federal Reserve will use information obtained in the course of supervising LCBOs, as well as information and analysis

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13. “Key financial markets” include the critical financial markets defined in section 1050.1.3.1.6 above as well as (1) broader U.S. capital market activity, including underwriting, securitization, derivatives, and trading; (2) retail financial services; and (3) international financial markets. Each LCBO meets at least one of these key market thresholds.
obtained through relationships with other domestic and foreign supervisors and regulators or other sources, to

1. identify potential vulnerabilities across the portfolio of LCBOs and their nonbank peers—such as the operational infrastructure that underpins the credit derivatives market—that have the potential to affect banking organizations generally, financial stability, systemic risk, or domestic or global financial markets;

2. identify areas of supervisory focus—such as counterparty credit risk-management practices—to further the Federal Reserve’s understanding of markets, their linkages with banking organizations, and potential implications for financial stability;

3. understand the activities of nonbank counterparties of LCBOs and the implications of such activities on the risks, risk management, and internal controls of banking organizations; and

4. enhance the Federal Reserve’s ability to act effectively during periods of financial stress by combining timely and reliable information on conditions in the banking system and capital markets that is obtained through its supervisory activities with information obtained through the Federal Reserve’s monetary policy and payments activities.

Supervisory Activities: During each supervisory planning cycle, and more frequently as required, continuous monitoring opportunities will be identified that utilize information gained through LCBO supervision to further the Federal Reserve’s understanding of markets, their linkages with banking organizations, and potential implications for financial stability.

These activities also will be used to review areas of specific supervisory interest; answer ad hoc information requests related to areas of emerging interest or concern; help in understanding the contribution of the entity to the resilience or fragility of key markets as a whole; and provide insights into interdependencies across firms, markets, and the real economy. During periods of financial stress, this information will be combined with knowledge obtained from other Federal Reserve functions, such as monetary policy and payments activities, to help mitigate the likelihood or consequences of a financial crisis and to help develop sound policy responses to market developments. Periodic examination activities also may be used to review a specific activity or risk-management practice across a group of peer organizations to obtain a more complete understanding of industry practice. These activities will be designed and conducted in coordination with other relevant primary supervisors and functional regulators to the fullest extent possible and in accordance with the provisions described above in section 1050.1.1.2, where relevant. Coordination opportunities, however, may be limited in special circumstances, such as when addressing urgent matters with potentially adverse financial market consequences, due to the inherent time constraints when information must be gathered quickly.

1050.1.3.2 Financial Condition

Objectives: The Federal Reserve’s evaluation of a large complex BHC’s consolidated financial condition focuses on the ability of the organization’s resources to support the level of risk associated with its activities. Assessments are developed for each “CAEL” subcomponent—Capital Adequacy (C), Asset Quality (A), Earnings (E), and Liquidity (L).

In developing this evaluation, the Federal Reserve’s primary focus is on developing an understanding and assessment of

1. the sufficiency of the BHC’s consolidated capital to support the level of risk associated with the organization’s activities and provide a sufficient cushion to absorb unanticipated losses;

2. the capability of liquidity levels and funds-management practices to allow reliable access to sufficient funds to meet present and future liquidity needs; and

3. other aspects of financial strength that need to be assessed on a consolidated basis across the organization’s various legal entities, or that relate to the financial soundness of the parent company and significant nonbank sub-

BHC Supervision Manual January 2009
Page 10

14. In order to minimize burden while obtaining information necessary to understand market developments, these activities will focus on those organizations that are most active in the area of interest or concern.

15. See SR-04-18 and section 4070.0.2.3.1 for more information about the CAEL subcomponents.
In assessing consolidated regulatory capital, the Federal Reserve looks to ensure that the BHC demonstrates the effectiveness of its framework for complying with relevant capital adequacy guidelines and meeting supervisory expectations, and focuses on analyzing key models and processes7 that influence this assessment. This assessment utilizes results from examinations led by the Federal Reserve or other primary supervisors or functional regulators, as well as information gained from the BHC’s internal control functions and from market-based assessments.

Capital planning activities for large complex BHCs should be forward looking and provide for a sufficient range of stress scenarios commensurate with the organization’s activities. Many LCBOs require more rigorous and structured internal processes for assessing capital adequacy beyond regulatory capital measures, as these measures often do not adequately capture the full spectrum of risk-taking activities for these organizations.8 For these organizations, the Federal Reserve focuses on whether internal processes for assessing capital adequacy ensure that all risks are properly identified, reliably quantified (where possible) across the entire organization, and supported by adequate capital.

When assessing the adequacy of a BHC’s liquidity levels and funds management practices, areas of focus include9

1. the extent to which the treasury function is aligned with risk-management processes, and whether incentives are in place for business lines to compile and provide information on expected liquidity needs and contingency funding plans so that the treasury function is able to develop a firmwide perspective and incorporate business-line information into assessments of actual and contingent liquidity risk;
2. whether funds management practices provide sufficient funding flexibility to respond to unanticipated, evolving, and potentially correlated market conditions for the organization and/or across financial markets; and
3. the sufficiency of liquidity planning tools, such as stress testing, scenario analysis, and contingency planning efforts, including (1) whether liquidity buffers—comprised of unencumbered liquid assets as well as access to stable funding sources—adequately reflect the possibility and duration of severe liquidity shocks; (2) the reasonableness of assumptions about the stability of secured funding in circumstances in which the liquidity of markets for the underlying collateral becomes impaired; and (3) whether these efforts adequately reflect the potential for the organization to be called on in stressed environments to provide contingent liquidity support to off-balance-sheet entities or bring additional assets on the balance sheet (even if not legally or contractually obligated to do so).

Beyond capital adequacy and liquidity, the nature of independent Federal Reserve supervisory work required to evaluate a large complex BHC’s consolidated financial condition depends largely on the extent to which other relevant primary supervisors or functional regulators have information or assessments upon which the Federal Reserve can draw. For example, more independent Federal Reserve work typically will be required to assess consolidated asset quality or earnings for large complex BHCs with significant nonbank activities that are not functionally regulated. However, where all material holding company assets are concentrated in a single depository institution subsidiary, a minimal level of incremental Federal Reserve efforts typically will be required to assess consolidated asset quality and earnings.

**Supervisory Activities:** The Federal Reserve will primarily utilize continuous monitoring activities to assess a large complex BHC’s financial strength. Such activities will include periodic meetings with BHC management (such as the chief financial officer); review of regulatory reports, surveillance screens, and internal MIS; and analysis of market indicators, including external debt ratings, subordinated debt spreads, and credit default swap spreads. Testing and discovery activities will be used as necessary to assist in the understanding and assessment of areas of concern.

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7. "Key models and processes": are those where evaluation of the model/process will influence the Federal Reserve’s assessment of the activity or control area that is supported by the model/process.

8. Footnote reserved.

9. Assessing liquidity levels and funding practices for a consolidated BHC also incorporates elements presented in section 1050.1.3.2, “Parent company and nonbank funding and liquidity.”
Testing and discovery activities also will be used to understand and assess the sufficiency of the BHC’s consolidated capital and liquidity positions to support the level of risk associated with its activities, including (1) regulatory capital calculation methodologies and internal assessments of capital adequacy and (2) funds management and liquidity planning tools and practices. The Federal Reserve will work with other relevant primary supervisors and functional regulators to participate as actively as appropriate in or, if necessary, to coordinate activities designed to analyze key capital and liquidity models or processes of a depository institution or functionally regulated subsidiary that are of such significance that they will influence the Federal Reserve’s assessment of these areas. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.1.1.2.

1050.1.3.3 Impact

1050.1.3.3.1 Risk Management and Financial Condition of Significant Nonbank Subsidiaries

Objectives: Most large complex BHCs engage in activities and manage control functions on a firmwide basis, spanning depository institution and nonbank legal entities. These BHCs often have considerable intra-group exposures and servicing arrangements across affiliates, presenting increased potential risks for depository institution subsidiaries and a higher likelihood of aggregate risk concentrations across the organization’s legal entities. Common interactions between a large complex BHC’s depository institution subsidiaries and their nonbank affiliates (including the parent company) include assets originating in, or being marketed by, a nonbank affiliate that are booked in the depository institution; a depository institution providing funding for nonbank affiliates; and risk-management or internal control functions being shared between depository and nonbank operations.

Due to these interrelationships, financial, legal, compliance, or reputational troubles in one part of a BHC can spread rapidly to other parts of the organization. Even absent these interactions, the parent or nonbank subsidiaries of an organization may present financial, legal, compliance, or reputational risk to the consolidated entity, and thus directly or indirectly to its depository institution subsidiaries. As the federal banking agency charged with supervising the organization on a consolidated basis, the Federal Reserve is responsible for understanding and assessing the risks that the parent bank holding company and its nonbank subsidiaries may pose to the BHC itself or its depository institution subsidiaries.

The primary objectives of Federal Reserve supervision of the nonbank subsidiaries of a bank holding company are to

1. identify significant nonbank activities and risks—where the parent company or nonbank subsidiaries engage in risk-taking activities or hold exposures that are material to the risk management or financial condition of the consolidated organization or a depository institution subsidiary—by developing an understanding of the size and nature of primary activities and key trends, and the extent to which business lines, risks, or control functions are shared with or may impact a depository institution affiliate;
2. evaluate the financial condition and the adequacy of risk-management practices of the parent and significant nonbank subsidiaries, including the ability of nonbank subsidiaries to repay advances provided by the parent, using benchmarks and analysis appropriate for those businesses;
3. evaluate the degree to which nonbank entity risks may present a threat to the safety and soundness of subsidiary depository institutions, including through transmission of legal, compliance, or reputational risks;
4. identify and assess any intercompany relationships, dependencies, or exposures—or aggregate firmwide concentrations—with the potential to threaten the condition of a depository institution affiliate; and
5. evaluate the effectiveness of the policies, procedures, and systems that the holding company and its nonbank subsidiaries use to ensure compliance with applicable laws and

19. Assessments of the adequacy of regulatory capital for large complex BHCs that have received Federal Reserve supervisory approval to use internal estimates of risk in their regulatory capital calculations should include, among other things, regular verification that these organizations continue to meet on an ongoing basis all applicable requirements associated with internal estimates. See, for example, the capital adequacy guidelines for market risk at BHCs (Regulation Y: 12 C.F.R. 225, Appendix E) and the new advanced capital adequacy framework for BHCs (Regulation Y: 12 C.F.R. 225, Appendix G).
4. identify and assess key interrelationships and dependencies between depository institution subsidiaries and nonbank affiliates, utilizing regulatory structure reports, internal MIS, and other information sources;

5. understand the scope of intercompany transactions and aggregate concentrations, and assess the adequacy of risk-management processes, accounting policies, and operating procedures to measure and manage related risks;

6. identify and assess key interrelationships and dependencies between subsidiary depository institutions and nonbank affiliates, such as the extent to which a depository institution subsidiary is reliant on services provided by the parent company or other nonbank affiliates and the reasonableness of associated management fees;

7. identify those nonbank subsidiaries whose activities present material financial, legal, compliance, or reputational risk to the consolidated entity and/or a depository institution subsidiary;

8. understand and assess the sufficiency, reliability, and timeliness of associated MIS relied upon by the board, senior management, and senior risk managers and committees to monitor key nonbank activities and risks.

Periodic testing may be used to supplement continuous monitoring and discovery reviews to (1) ensure that key risk-management and internal control practices conform to internal policies and/or are designed to ensure compliance with the law and (2) understand and assess operations presenting a moderate or greater likelihood of significant negative impact to a subsidiary depository institution or the consolidated organization. Areas of potential negative impact include financial or operational risks that pose a potential threat to the safety and soundness of a depository institution subsidiary, or to the holding company’s ability to serve as a source of financial and managerial strength to its depository institution subsidiaries. Testing will focus on controls for identifying, monitoring, and controlling such risks. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.1.1.2.

1050.1.3.3.2 Parent Company and Nonbank Funding and Liquidity

Objectives: One of the Federal Reserve’s primary responsibilities as consolidated supervisor is to help ensure that the parent company and its nonbank subsidiaries do not have an adverse impact on the organization’s depository institution subsidiaries. To meet this objective, the Federal Reserve will assess the extent to which funding and liquidity policies and practices of the parent company or nonbank subsidiaries may undermine the BHC’s ability to act as a source of strength to the organization’s depository institution subsidiaries.

Areas of focus will include an assessment of

1. the ability of the parent company and nonbank subsidiaries to maintain sufficient liquidity, cash flow, and capital strength to service their debt obligations and cover fixed charges;

2. the likelihood that parent company or nonbank funding strategies could undermine pub-

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20. The Federal Reserve’s supervisory objectives and activities related to the effectiveness of consumer compliance policies, procedures, and systems at nonbank subsidiaries of a BHC currently are under review, and additional or modified guidance on this topic may be issued in the future.
lic confidence in the liquidity or stability of subsidiary depository institutions;
3. policies and practices that are aimed at ensuring the stability of parent company funding and liquidity, as evidenced by the utilization of long-term or permanent financing to support capital investments in subsidiaries and other long-term assets, and the degree of dependence on short-term funding mechanisms such as commercial paper;
4. the extent of “double leverage”21 and the organization’s capital-management policies, including the distribution and transferability of capital across jurisdictions and legal entities;
5. the parent company’s ability to provide financial and managerial support to its depository institution subsidiaries during periods of financial stress or adversity, including the sufficiency of related stress testing, scenario analysis, and contingency planning efforts; and
6. intraday liquidity management policies and practices, and compliance with the “Federal Reserve Policy on Payments System Risk,”22 including expectations for depository institutions with a self-assessed net debit cap (the maximum dollar amount of uncollateralized daylight overdrafts that the institution may incur in its Federal Reserve account).

The Federal Reserve also will remain apprised of the funding profile and market access of material depository institution subsidiaries, as in most instances these entities represent the consolidated BHC’s primary and most active vehicles for external funding and liquidity management. The primary supervisor retains responsibility for assessing liquidity risk-management practices with respect to the depository institution subsidiary.

Supervisory Activities: The Federal Reserve will use continuous monitoring activities—including monitoring market conditions and indicators where available—and discovery reviews to understand and assess parent company and nonbank subsidiary funding and liquidity policies and practices, as well as any potential negative impact these policies and practices might have on a subsidiary depository institution or the consolidated organization. On at least an annual basis, the results of these supervisory activities will be reviewed to determine whether there is (1) a significant change in inherent funding or liquidity risk stemming from changing strategies or activities; (2) a significant change in organizational structure, oversight mechanisms, key personnel, or other key elements of related risk-management or internal controls; or (3) any potential concern regarding the adequacy of related risk-management or internal controls.

If significant changes or potential concerns are identified, the Federal Reserve will design and conduct testing activities focused on understanding and assessing the areas of change and/or concern in order to ensure that funding and liquidity risk-management and control functions are appropriately designed and achieving their intended objectives.

In all instances the Federal Reserve will undertake testing activities on at least a three-year cycle, assessing the individual elements of risk management for parent company and nonbank funding and liquidity: board and senior management oversight; policies, procedures, and limits; risk-monitoring and management information systems; and related internal controls.

For large complex BHCs with a depository institution that has a self-assessed net debit cap, the Federal Reserve will conduct an annual review of the self-assessment file to ensure that the institution has appropriately applied the payment system risk guidelines. The Federal Reserve will either lead this review and coordinate its activities with other relevant primary supervisors or participate as actively as appropriate in the related work of such supervisors. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.1.1.2.

21. “Double leverage” refers to situations in which debt is issued by the parent company and the proceeds are invested in subsidiaries as equity.
22. This policy statement is available on the Board’s public website at www.federalreserve.gov/paymentsystems/psr.

1050.1.4 INTERAGENCY COORDINATION
1050.1.4.1 Coordination and Information Sharing Among Domestic Primary Bank Supervisors and Functional Regulators

Objective: Effective consolidated supervision requires strong, cooperative relationships between the Federal Reserve and other relevant domestic primary bank supervisors and functional regulators.23 To achieve this objective, the Federal Reserve has worked over the years to enhance

23. Section 1050.1.4.2 discusses cross-border cooperation and information sharing among foreign supervisors.
interagency coordination through the development and use of information-sharing protocols and mechanisms. These protocols and mechanisms respect the individual statutory authorities and responsibilities of the respective supervisors and regulators, provide for appropriate information flows and coordination to limit unnecessary duplication or burden, comply with restrictions governing access to information, and ensure that the confidentiality of information is maintained. For example, the Federal Reserve and the U.S. Securities and Exchange Commission entered into a memorandum of understanding (MOU) in July 2008 that, among other things, provides for the parties to share specific types of information concerning entities under the parties’ respective supervision as well as information on other areas of mutual regulatory or supervisory interest.

As discussed in section 1050.1.3, in understanding and assessing the activities and risks of the organization as a whole, the Federal Reserve will rely to the fullest extent possible on the examination and other supervisory work conducted by the domestic primary bank supervisors and functional regulators of a BHC’s subsidiaries. In addition, the Federal Reserve will seek to coordinate its supervisory activities with relevant supervisors and regulators and will work to align each agency’s assessment of key corporate governance functions, risk management and internal control functions for primary risks, financial condition, and other areas of the consolidated BHC’s operations as applicable.

**Supervisory Activities.** The Federal Reserve will continue to work with the relevant primary supervisors and functional regulators of a large complex BHC’s subsidiaries to ensure that the necessary information flows and coordination mechanisms exist to permit the effective supervision of the BHC on a consolidated basis. The Federal Reserve will continue to share information, including confidential supervisory information, obtained or developed through its consolidated supervisory activities with other relevant primary supervisors or functional regulators when appropriate and permitted by applicable laws and regulations.24

The Federal Reserve also will continue to use a variety of formal and informal channels to facilitate interagency information sharing and coordination consistent with the principles outlined above, including:

- supervisory protocols, agreements, and MOUs with primary supervisors and functional regulators that allow the coordination of supervisory activities and that permit the ongoing exchange of information, including confidential information on a confidential basis;
- bilateral exchanges of letters to facilitate information sharing on a situation-specific basis;
- periodic and as-needed contacts with primary supervisors and functional regulators to discuss and coordinate matters of common interest, including the planning and conduct of examinations and continuous monitoring activities;
- the use of information technology platforms, such as the Banking Organization National Desktop (BOND),25 to provide secure automated access to examination/inspection reports and other supervisory information prepared by the Federal Reserve and other relevant supervisors and regulators; and
- participation in a variety of interagency forums that facilitate the discussion of broad industry issues and supervisory strategies, including the Federal Financial Institutions Examination Council, the President’s Working Group on Financial Markets, and the Federal Reserve-sponsored cross-sector meetings of financial supervisors and regulators.

1050.1.4.1.1 Coordination of Examination Activities at a Supervised BHC Subsidiary

As discussed in section 1050.1.3, the Federal Reserve will seek to work cooperatively with the relevant primary supervisor or functional regulator to address information gaps or indications of weakness or risk identified in a supervised BHC subsidiary that are material to the Federal Reserve’s understanding or assessment of the consolidated organization’s risks, activi-

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24. Among the federal laws that may limit the sharing of information among supervisors are the Right to Financial Privacy Act (12 U.S.C. 3401 et seq.) and the Trade Secrets Act (18 U.S.C. 1905). The Federal Reserve has established procedures to authorize the sharing of confidential supervisory information, and Federal Reserve staff must ensure that appropriate approvals are obtained prior to releasing such information. See Subpart C of the Board’s Rules Regarding the Availability of Information (12 C.F.R. 261.20 et seq.).

25. BOND is a Federal Reserve information technology platform providing secure interagency access to documents, supervisory and financial data, and other information utilized in the consolidated supervision of individual BHCs and FBOs, and in developing comparative analyses of organizations with similar business lines and risk characteristics.
ties, or key corporate governance, risk-management, or control functions. Prior to conducting discovery reviews or testing activities at a depository institution (other than where the Federal Reserve is the primary federal supervisor) or functionally regulated subsidiary of a BHC, the Federal Reserve will

- review available information sources as part of its continuous monitoring activities, including examination reports and the BHC’s internal MIS, to determine whether such information addresses the Federal Reserve’s information needs or supervisory concerns; and
- if needed, seek to gain a better understanding of the primary supervisor’s or functional regulator’s basis for its supervisory activities and assessment of the subsidiary. This may include a request to review related examination work.

If, following these activities, the Federal Reserve’s information needs or supervisory concerns remain, the Federal Reserve will work cooperatively with the relevant primary supervisor or functional regulator in the manner discussed in section 1050.1.3 above. 26

1050.1.4.2 Cooperation and Information Sharing With Host-Country Foreign Supervisors

Objectives: Many large complex BHCs have considerable international banking and other operations that are licensed and supervised by foreign host-country authorities. As home-country supervisor for domestic BHCs, the Federal Reserve is responsible for the comprehensive, consolidated supervision of these global organizations, while each host country is responsible for supervision of the legal entities (including foreign subsidiaries of U.S. BHCs) in its jurisdiction.

Information sharing among domestic and foreign supervisors, consistent with applicable laws, is essential to ensure that a large complex BHC’s global activities are supervised on a consolidated basis. Cross-border information sharing is often facilitated by an MOU that establishes a framework for bilateral relationships and includes provisions for cooperation during the licensing process, in the supervision of ongoing activities, and in the handling of problem institutions. The Federal Reserve has established bilateral and multilateral information-sharing MOUs and other arrangements with numerous host-country foreign supervisors. The Federal Reserve also monitors changes in foreign bank regulatory and supervisory systems and seeks to understand how these systems affect supervised banking organizations. In addition to its longstanding cooperative relationships with home- and host-country foreign supervisors, the Federal Reserve expects to increasingly lead and participate in “colleges of supervisors” and other multilateral groups of supervisors that discuss issues related to specific internationally active banking organizations.

The Federal Reserve also is a member of the Basel Committee on Banking Supervision, which is a forum for supervisors from member countries to discuss important supervisory issues, foster consistent supervision of organizations with similar business and risk profiles, promote the sharing of leading supervisory practices, and formulate guidance to enhance and refine banking supervision globally.

The Federal Reserve’s processes for understanding and assessing firmwide legal and compliance risk management, as described earlier, encompass both domestic and international operations. Most areas of supervisory focus for management of legal and compliance risks are applicable to both domestic and international entities, and include proper oversight of licensed operations, compliance with supervisory and regulatory requirements, and the sufficiency of associated MIS.

There are, however, areas of focus for the Federal Reserve that are unique to a holding company’s international operations. For example, some host-country legal and regulatory structures and supervisory approaches are fundamentally different from those in the United States. As a result, the banking organization often must devote additional resources to maintain expertise in local regulatory requirements. In some instances, privacy concerns have led to limits on the information a BHC’s foreign office may share with its parent company, thereby limiting the parent company’s ability to exercise consolidated risk management on a global basis. Additionally, while considerable progress has been made to strengthen supervisory cross-border cooperation and information sharing, the Federal Reserve and other U.S. supervisors have,

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26. As outlined in section 1050.1.3, certain Federal Reserve examination activities are to be conducted on a minimum three-year cycle to verify, through testing, the sufficiency of key control processes. These activities are to be conducted regardless of whether or not there is an information gap or indication of weakness or risk.
at times, faced challenges in accessing information on a bank’s or BHC’s foreign operations or in carrying out examinations of cross-border or foreign activities. These circumstances are to be taken into account when developing a supervisory strategy for a large complex BHC with cross-border or foreign operations.

Supervisory Activities: Continuous monitoring will be used to understand and assess each large complex BHC’s international strategy, trends, operations, and legal entity structure, as well as related governance, risk-management, and internal controls. For a large complex BHC with significant international operations or risks, an assessment of cross-border and foreign operations will be incorporated into the evaluation of key corporate governance functions and primary firmwide risk-management and internal control functions, including legal and regulatory risk management.

Continuous monitoring activities will include review of materials prepared by host-country supervisors, including examination reports and assessments, and ongoing communication with relevant foreign and domestic supervisors regarding trends and assessments of cross-border and foreign operations. These continuous monitoring activities may be supplemented, as appropriate, by examination activities to understand and assess the large complex BHC’s international strategy, trends, operations, and legal entity structure, as well as related governance, risk-management, and internal controls.

When assessing the sufficiency of a large complex BHC’s management of its international operations, consideration is given to the extent that foreign laws restrict the transmission of information to the BHC’s head office. Impediments to sharing information imposed by a host country may constrain the BHC’s ability to effectively oversee its international operations and globally manage its risks, and the materiality of such impediments should be a determinant of whether the organization should be conducting operations in that host country.

In addition, any limits placed on the Federal Reserve’s ability to access information on host-country operations, or to engage in onsite activities at the organization’s operations in the host country, should be considered when assessing whether the organization’s activities in that jurisdiction are appropriate.

1050.1.4.3 Indications of Weakness or Risk Related to Subsidiary Depository Institutions

Objectives: For areas beyond those specifically addressed in section 1050.1.3, there may be circumstances where the Federal Reserve has indications of material weakness or risk in a depository institution subsidiary of a BHC that is supervised by another primary supervisor, and it is not clear that the weakness or risk is adequately reflected in the assessment or supervisory activities of that supervisor. Because a primary objective of consolidated supervision is to protect the BHC’s depository institution subsidiaries, the Federal Reserve will follow up with the appropriate primary supervisor in these circumstances to help ensure that, to the extent that a material weakness or risk exists, it is addressed appropriately.

Supervisory Activities: The Federal Reserve will take the following steps if it has indications of material weakness or risk in a depository institution subsidiary (other than where the Federal Reserve is the primary federal supervisor) in an area beyond those specifically addressed in section 1050.1.3, and it is not clear that the weakness or risk is adequately reflected in the assessment or supervisory activities of the depository institution’s primary supervisor.

- The Federal Reserve will first review available information sources, discuss the areas of concern with the primary supervisor, and seek to review the supervisor’s related work.
- If concerns remain following these activities, the Federal Reserve will request that the primary supervisor conduct a discovery review or testing activity at the depository institution to address the area of concern.
- In the event the primary supervisor does not undertake activities to address the concern in a reasonable period of time, the Federal Reserve will design and lead an examination of the depository institution to address the matter in consultation with the primary supervisor. A senior Federal Reserve official will communicate this decision in writing to a senior official of the primary supervisor.
1050.1.4.4 Condition or Management of BHC Subsidiary is Less-than-Satisfactory

**Objectives:** As noted above, a primary responsibility of the Federal Reserve as consolidated BHC supervisor is to ensure that a holding company’s activities, policies, and practices do not undermine its ability to serve as a source of financial and managerial strength to its depository institution subsidiaries. In situations where the condition or management of a supervised or functionally regulated BHC subsidiary is determined to be less-than-satisfactory, the Federal Reserve’s focus as consolidated supervisor is on complementing the efforts of the primary supervisor or functional regulator. In doing so, the Federal Reserve will seek to ensure that the parent company provides appropriate support to the subsidiary and does not take actions that may further weaken the parent company’s depository institution subsidiaries or its ability to act as a source of strength for such subsidiaries.

Beyond the specific activities noted below, these circumstances also may require the Federal Reserve to enhance the activities addressed in section 1050.1.3 for understanding and assessing key corporate governance functions or primary firmwide risk-management and internal controls. In addition, the Federal Reserve will adjust its supervisory activities as necessary when the consolidated BHC is in weakened condition or when there are questions regarding the capabilities of the holding company’s management.

**Supervisory Activities:**

- **Depository institution subsidiary.** In instances when a depository institution subsidiary’s condition or management is rated less than satisfactory, or when the depository institution subsidiary otherwise faces financial stress or material risks, the Federal Reserve’s primary supervisory objectives as consolidated supervisor are to ensure that the parent company (1) provides appropriate support to the depository institution and (2) does not take action that could harm the depository institution. The Federal Reserve will work closely with the primary supervisor to understand whether the BHC or a nonbank affiliate has contributed to the depository institution’s weakened condition, to understand the impact of the depository institution on the BHC’s condition, and to determine if the holding company is providing appropriate support to the depository institution. The Federal Reserve will coordinate its activities with those of the primary supervisor to the extent appropriate.

- **Nonbank subsidiary.** When any nonbank subsidiary faces financial stress or material risks, the Federal Reserve will seek to ensure that its condition and activities do not jeopardize the safety and soundness of the BHC or its depository institution subsidiaries, as discussed above in sections 1050.1.3.3.1, “Risk Management and Financial Condition of Significant Nonbank Subsidiaries” and 1050.1.3.3.2, “Parent Company and Nonbank Funding and Liquidity.” The Federal Reserve also will take appropriate steps to ensure that any actions taken by the parent company to assist a nonbank subsidiary do not impair the BHC’s continuing ability to serve as a source of strength to its depository institution subsidiaries. The Federal Reserve will coordinate its activities with those of any relevant functional regulator to the extent appropriate.

1050.1.4.5 Edge and Agreement Corporations

**Objectives:** Many large complex BHCs control an Edge or agreement corporation subsidiary. The Federal Reserve serves as the primary supervisor of each Edge and agreement corporation subsidiary in addition to its role as consolidated BHC supervisor.27 When the Edge or agreement corporation is held by a U.S. bank, the primary supervisor often relies on information provided by the Federal Reserve in developing its own understanding and assessment of the parent bank.

During each calendar year, the Federal Reserve performs an examination of each Edge and agreement corporation, assesses the Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program, and assigns a CAMEO rating. In addition, the Federal Reserve periodically conducts assessments of Edge and agreement corporations to determine whether a consumer compliance examination is warranted, in which case a compliance

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27. The Federal Reserve is solely responsible for approving, and supervising the activities of, U.S. Edge and agreement corporations. As discussed in SR-90-21, “Rating System For International Examinations,” one of the Federal Reserve’s supervisory responsibilities is the assignment of a CAMEO rating (Capital, Asset Quality, Management, Earnings, and Operations and Internal Controls) to each Edge and agreement corporation.
examination is conducted and a consumer compliance rating is assigned.

The Federal Reserve will coordinate the conduct of its activities as Edge and agreement corporation supervisor with its activities as consolidated supervisor. To this end, the extent and scope of Federal Reserve supervisory work related to an Edge or agreement corporation will be tailored to the entity’s activities, risk profile, and other attributes. A number of specific elements will be considered when developing a supervisory approach, including:

1. structure and attributes, including whether the Edge or agreement corporation is a banking or investment organization;
2. the size, nature, and location of its primary activities, as well as key financial and other trends;
3. the business lines and risks, and associated trends, of the Edge or agreement corporation’s primary activities on a standalone basis, as well as their significance to the risk profile of the parent bank (if applicable) and BHC;
4. the extent to which risk-management and internal control functions are unique to the Edge or agreement corporation, or are shared with a parent bank, another affiliate, or the consolidated BHC;
5. any potential Regulation K limitations or other U.S. compliance issues, and the adequacy of processes to ensure ongoing compliance; and
6. the adequacy of processes for ensuring compliance with all applicable laws and regulations imposed by host-country supervisors for the Edge or agreement corporation’s international operations.

Supervisory Activities: The Federal Reserve will maintain an understanding and perform an annual examination of each Edge and agreement corporation. While the examination scope will be risk focused to reflect the organization’s scale, activities, and risk profile, in all cases the Federal Reserve will assess the adequacy of processes to ensure compliance with BSA/AML requirements and other applicable U.S. laws and regulations and with applicable foreign laws and regulations.

In developing its supervisory strategy, the Federal Reserve will identify those elements that are unique to the Edge or agreement corporation and those that are shared with the parent bank or BHC and will coordinate fulfillment of the Federal Reserve’s responsibilities as Edge and agreement corporation supervisor with execution of its consolidated supervision role. This strategy will reflect the extent to which reliance can be placed on (1) the Federal Reserve’s understanding and assessments of key corporate governance, risk-management, and control functions, as well as material portfolios and business lines, of the consolidated BHC; (2) assessments developed by the primary supervisor (when applicable) for business lines, risk management, control functions, or financial factors that are common to the Edge or agreement corporation and its parent bank; and (3) findings developed by host-country supervisors for activities under their jurisdiction.

In addition, where the primary supervisor of an Edge or agreement corporation’s parent bank relies on the Federal Reserve’s understanding and assessment in order to develop its CAMELS rating, the Federal Reserve will work to fulfill that supervisor’s information needs.

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Guidance for the Consolidated Supervision of Regional Bank Holding Companies

Section 1050.2

WHAT’S NEW IN THIS REVISED SECTION

Effective July 2016, this section is revised to include SR-16-4, “Relying on the Work of the Regulators of the Subsidiary Insured Depository Institutions of Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of Less than $50 Billion.” This guidance provides an explanation of the Federal Reserve’s expectations for its examiners’ reliance on the work of the regulators of insured depository institution subsidiaries (IDI regulators) in the supervision of bank holding companies (BHCs) and savings and loan holding companies (SLHCs). SR-16-4 presents a tailored supervisory approach for regional banking organizations (RBOs), which are defined as companies with total consolidated assets between $10 billion and $50 billion.

1050.2.1 ACTIVITIES OF THE FEDERAL RESERVE AND OTHER SUPERVISORS AND REGULATORS, AND FUNCTIONAL REGULATION

The objectives of the Federal Reserve’s consolidated supervision program for the portfolio of regional bank holding companies (“regional BHCs,” defined as non-LCBO BHCs with $10 billion or more in total consolidated assets, including nontraditional organizations1) are the same as those applicable to other portfolios. The manner in which the Federal Reserve achieves these objectives, however, is tailored to the characteristics and risk profiles of regional bank holding companies.2

As outlined in the following sections, a range of continuous monitoring activities is utilized, along with discovery reviews and testing activities (examination activities),3 to develop and maintain an understanding and assessment of each regional BHC. For organizations within this portfolio, continuous monitoring activities typically take the form of meetings with BHC management, analysis of internal management information system (MIS) reports and regulatory reports, review of surveillance screens, and discussions and coordination with other relevant primary supervisors and functional regulators and review of their work. The scale and frequency of monitoring activities will differ by organization. For many regional BHCs that are in sound condition, monitoring activities typically are performed on a periodic or quarterly basis, supplemented by more frequent or intensive activities as necessary, and, in most instances, Federal Reserve staff do not maintain a day-to-day onsite presence at the organization.

1050.2.1.1 Federal Reserve Activities and Those Activities of Other Supervisors and Regulators

The nature and scope of independent Federal Reserve supervisory work required to develop and maintain an understanding and assessment of a regional BHC depend largely on the extent to which other relevant primary supervisors or functional regulators have information or assessments upon which the Federal Reserve can draw. Many regional BHCs conduct the majority of their business operations through a single bank subsidiary, increasing the likelihood that a single primary supervisor has a complete view of, and ability to address, major aspects of the organization’s business activities and related risks, risk management, and controls. In these instances, the Federal Reserve typically will be able to use the information and assessments developed by this primary supervisor to develop its understanding and assessment of significant aspects of the consolidated organization. Similarly, for regional BHCs with limited nonbank activities, the Federal Reserve typically will need to conduct less work to understand and assess the risk-management systems and financial condition of nonbank subsidiaries than the level of monitoring and examination work required for organizations with more-extensive or complex nonbank activities.

By their nature, understanding and assessing some areas—such as the risk management and financial condition of significant nonbank

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1. Nontraditional BHCs, as defined in SR-04-18, “Bank Holding Company Rating System,” (see section 4070.0) are bank holding companies where most or all of the organization’s significant nondepository subsidiaries are regulated by a functional regulator, and subsidiary depository institution(s) are small in relation to nondepository subsidiaries.

2. See section 1050.0.4, appendix, for definitions of terms commonly used in this section.

3. While by definition “examination” activities are applicable to the supervision of banks and other depository institutions, as well as U.S. banking offices of FBOs, and “inspection” activities are applicable to the supervision of BHCs and nonbank subsidiaries and affiliates, the term “examination” is generally used throughout this section to refer to both examination and inspection activities.
subsidiaries that are not functionally regulated—typically will require more independent Federal Reserve supervisory work. Other areas—such as primary firmwide risk-management and control functions—typically will require a greater degree of coordination with other relevant primary supervisors or functional regulators, who will likely have information or assessments upon which the Federal Reserve can draw.

The following sections provide further detail on how the Federal Reserve will develop, working in coordination with other relevant primary supervisors and functional regulators, an understanding and assessment of a regional BHC. In conducting the activities described throughout this document, the Federal Reserve will, to the fullest extent possible

- rely on the information and assessments of relevant primary supervisors and functional regulators, including the information and assessments reflected in the reports of examination of such supervisors and regulators;
- focus its supervisory activities on the bank holding company, as well as on those of its nonbank subsidiaries that could have a direct or indirect materially adverse effect on the safety and soundness of a depository institution subsidiary of the BHC due to the size, condition, or activities of the nonbank subsidiary, or the nature or size of its transactions with the depository institution; and
- use publicly reported information (including externally audited financial statements) as well as reports that a large complex BHC or a subsidiary prepares for other primary supervisors, functional regulators, or self-regulatory organizations.

1050.2.1.2 Functionally Regulated Subsidiaries

As discussed below, in certain situations, the Federal Reserve may find it necessary to conduct an examination of a functionally regulated nonbank subsidiary in order to fulfill the Federal Reserve’s responsibilities as supervisor of the consolidated organization. In any such case, the Federal Reserve will continue to adhere to the procedural and other requirements governing examinations of, or requests for a specialized report from, a functionally regulated subsidiary as discussed in SR-00-13 and sections 1040.0 and 3900.0. Under these provisions, for example, the Federal Reserve may conduct an examination of a functionally regulated subsidiary if, after reviewing relevant reports, it reasonably determines that the examination is necessary to adequately inform the Federal Reserve about the systems used to monitor and control financial and operational risks within the consolidated organization that may pose a direct or indirect threat to the safety and soundness of a depository institution subsidiary.4

1050.2.2 UNDERSTANDING THE ORGANIZATION

For each regional BHC, the Federal Reserve will develop an understanding of the legal, operating, and corporate governance structure of the organization and its primary strategies, business lines, and risk-management and internal control functions.5 This understanding will inform the development of a risk-assessment and supervisory plan for the BHC. The extent of information necessary to gain this understanding is tailored to the scope and complexity of the regional BHC’s operations, and typically may be obtained from the organization’s management, public reports,

4. The Federal Reserve also may examine a functionally regulated subsidiary of a regional BHC if, after reviewing relevant reports and other information, it has reasonable cause to believe that the subsidiary is engaged in an activity that poses a material risk to an affiliated depository institution, or that the subsidiary is not in compliance with any federal law that the Federal Reserve Board has specific jurisdiction to enforce against the subsidiary (and the Federal Reserve cannot determine compliance by examining the BHC or its affiliated depository institutions).

Similarly, before requiring a specialized report from a functionally regulated subsidiary, the Federal Reserve first will request that the subsidiary’s appropriate functional regulator obtain the report and make it available to the Federal Reserve. In the event that the report is not obtained or made available as requested, the Federal Reserve may, consistent with the Bank Holding Company Act, obtain the report directly from the functionally regulated subsidiary if the report is necessary to allow the Federal Reserve to adequately assess (1) a material risk to the BHC or any of its depository institution subsidiaries, (2) the systems used to monitor and control financial and operational risks within the consolidated organization that may pose a threat to the safety and soundness of a depository institution subsidiary, or (3) compliance with any federal law that the Federal Reserve Board has specific jurisdiction to enforce against the BHC or a subsidiary.

5. This understanding is formally documented during development of the institutional overview, which coincides with creation of the annual risk assessment. SR-97-24, “Risk-Focused Framework for Supervision of Large Complex Institutions,” (see section 2124.01) describes processes for developing an institutional overview, risk assessment, and supervisory plan. Each of these products is kept current to reflect significant changes in an organization’s risks or activities.
regulatory reports, surveillance screens, third-party sources (e.g., credit-rating agency and market analyst reports), and other relevant primary supervisors or functional regulators.

Key elements that should be identified and understood include the following:

- **Corporate strategy.** Primary business strategies; institutional risk tolerance; key changes in strategic direction or risk profile; significant new business activities; areas of growth and emerging areas with potential to become primary drivers of risk or revenue; and plans for expansion through mergers or acquisitions.

- **Significant activities.** Key revenue and risk drivers; primary business lines; product mix; budget and internal capital allocations (as applicable); market share for revenue and customers served; key external trends, including competitive pressures; and areas that are vulnerable to volatility in revenue, earnings, capital, or liquidity.

- **Structure.** Business line and legal entity structure; domestic and foreign regulatory responsibilities for legal entities and business lines; key interrelationships and dependencies between depository institution subsidiaries and nonbank affiliates; material business lines operated across multiple legal entities for accounting or risk-management purposes; and the activities and risk profile of Edge and agreement corporation subsidiaries.

- **Corporate governance, risk management, and internal controls for primary risks.** Board of directors (board) and executive-level committees; senior management and management committees; key risk-management and internal control functions and associated MIS relied upon by the board, senior management, and senior risk managers and committees; and consistency of public disclosures with how the board and senior management assess and manage risks.

To ensure the quality and consistency of consolidated supervision across the regional BHC portfolio, it is also necessary to understand how these key elements compare with industry trends and with evolving practices of well-managed organizations with similar characteristics.

1050.2.3 ASSESSING THE REGIONAL BHC ON A CONSOLIDATED BASIS

The Federal Reserve uses a systematic approach to develop an assessment of a BHC on a consolidated basis. This assessment is reflected in the RFI (Risk Management, Financial Condition, and Impact) rating assigned to a BHC.6

1050.2.3.1 Risk Management

1050.2.3.1.1 Key Corporate Governance Functions

Objectives: One of the primary areas of focus for consolidated supervision of regional BHCs is the adequacy of governance provided by the board and senior management. The culture, expectations, and incentives established by the highest levels of corporate leadership set the tone for the entire organization and are essential determinants of whether a banking organization is capable of maintaining fully effective risk-management and internal control processes.

The board and its committees should have an ongoing understanding of key inherent risks, associated trends, primary control functions, and senior management capabilities. Primary expectations for the board and its committees include:

1. selecting competent senior managers, ensuring that they have the proper incentives to operate the organization in a safe and sound manner, and regularly evaluating senior managers’ performance;
2. establishing, communicating, and monitoring (for example, by reviewing comprehensive MIS reports produced by senior management) institutional risk tolerances and a corporate culture that emphasizes the importance of compliance with the law and ethical business practices;
3. approving significant strategies and policies;
4. demonstrating leadership, expertise, and effectiveness;
5. ensuring the organization has an effective and independent internal audit function;
6. ensuring the organization has appropriate policies governing the segregation of duties and avoiding conflicts of interest; and
7. for publicly held organizations, ensuring that public disclosures
   - are consistent with how the board and

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6. The RFI rating system for BHCs is discussed in SR-04-18 and section 4070.0. RFI ratings are assigned at least annually for BHCs that are complex or that have $1 billion or more in consolidated assets, and are communicated via a comprehensive summary supervisory report that supports the BHC’s assigned ratings and encompasses the results of the entire supervisory cycle.

BHC Supervision Manual    July 2016
Page 3
senior management assess and manage the risks of the organization,
• balance quantitative and qualitative information with clear discussions about risk-management processes, and
• reflect evolving disclosure practices for peer organizations.

A regional BHC’s senior management and its committees should be able to clearly communicate risk tolerances and measures, control risks, hire and retain competent staff, and respond to changes in the organization’s risk profile and the external environment. Members of senior management are expected to have qualifications and experience commensurate with the size and complexity of the organization. Primary expectations for senior management include

1. establishing effective oversight and an appropriate risk culture;
2. appropriately delegating authority and overseeing the establishment and implementation of effective policies for the proper segregation of duties and for the avoidance or management of conflicts of interest;
3. establishing and implementing an effective risk-management framework capable of identifying and controlling both current and emerging risks, and effective independent control functions that ensure risk taking is consistent with the organization’s established risk appetite;
4. establishing and implementing incentives for personnel that are consistent with institutional risk tolerances, compliance with the law, and ethical business practices;
5. promoting a continuous dialogue between and across business areas and risk-management functions to help align the organization’s established risk appetite and risk controls;
6. ensuring that the board and its committees are provided with timely, accurate, and comprehensive MIS reports that are adaptive to changing circumstances regarding risks and controls; and
7. ensuring timely resolution of audit, compliance, and regulatory issues.

An effective internal audit function plays an essential role by providing an independent and objective evaluation of all key governance, risk-management, and internal control processes. As the complexity of financial products and supporting technology has grown, in combination with greater reliance on third-party service providers, the importance of internal audit’s role in identifying risks and testing internal controls has increased.

In addition, the extent to which supervisors can rely on or utilize the work of internal audit is an essential determinant of the risk-focused supervisory program that is tailored to the activities and risks of individual regional BHCs.

Supervisory Activities: For each regional BHC, the Federal Reserve will understand and assess the adequacy of oversight provided by the board and senior management, as well as the adequacy of internal audit and associated MIS. The Federal Reserve also will understand and assess other key corporate governance functions (e.g., corporate finance and treasury functions), whose effectiveness is essential to sustaining consolidated holding company operations, as well as the organization’s business resiliency and crisis management capabilities.7

• Board, senior management, and other key corporate governance functions. Continuous monitoring activities—which draw from all available sources on an as-needed basis, including internal control functions, the work of other relevant primary supervisors and functional regulators, regulatory reports, and related surveillance results—will be used to understand and assess the effectiveness of board and senior management resources and oversight.8

The results of continuous monitoring activities, as documented in supervisory products that reflect the Federal Reserve’s overview and risk assessment of the organization, may identify certain corporate governance functions that will require more intensive supervisory focus due to (1) significant changes in corporate strategy, activities, organizational structure, oversight mechanisms, or key personnel; (2) potential concerns regarding the adequacy of a specific governance function; or (3) the absence of sufficiently recent exami-

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7. As discussed further in section 1050.2.4.6, because of the special structure of nontraditional BHCs and the relatively small size of their depository institution subsidiaries, much of the information necessary to develop the assessments of the risk-management (as described in this section 1050.2.3.1) and financial condition elements (as described in section 1050.2.3.2) typically may be obtained or drawn from the work of the relevant functional regulator.

8. As noted in section 1050.2.1 above, the scale and frequency of monitoring activities will differ by organization. For many regional BHCs in sound condition, these activities are typically performed on a periodic or quarterly basis and supplemented as necessary.
nation activities for a key function by the Federal Reserve or another primary supervisor or functional regulator.

- **Internal audit.** Continuous monitoring activities will be used to understand and assess key elements of internal audit governance for the organization on a consolidated basis, including (1) the adequacy (and, where applicable, independence\(^9\)) of the audit committee; (2) the independence, professional competence, and the quality of the internal audit function; (3) the quality and scope of the audit methodology, audit plan, and risk-assessment process; and (4) the adequacy of audit programs and

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\(^9\) As outlined in section 2060.05, “The Sarbanes-Oxley Act of 2002,” section 301 of the Sarbanes-Oxley Act requires that each public company (including banks and bank holding companies that are public companies) have an audit committee composed entirely of independent directors. (See 15 U.S.C. 78j-1.)
workpaper standards. On at least an annual basis, the results of these supervisory activities will be reviewed to determine whether there have been significant changes in the internal audit infrastructure or whether there are potential concerns regarding the adequacy of key elements of internal audit. In addition to this periodic audit infrastructure review, testing activities for specific control functions or business lines should include an assessment of internal audit’s recent work in these areas to the extent possible as a means of validating internal audit’s findings.

- **Additional supervisory activities.** If continuous monitoring activities identify a key corporate governance function or element of internal audit requiring more intensive supervisory focus due to significant changes, potential concerns, or the absence of sufficiently recent examination activities, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) in developing discovery reviews or testing activities focusing on the area of concern. In situations where another primary supervisor or functional regulator leads the examination activities, the Federal Reserve may conduct portions of the examination, or otherwise participate as necessary (e.g., in determining the examination objectives and scope), to ensure that the review provides sufficient information on the specific area of concern to form a comprehensive and timely understanding and assessment.

  If the area of concern is not within the oversight of another primary supervisor or functional regulator, or if the supervisor or regulator does not conduct or coordinate the examination activities in a reasonable period of time, the Federal Reserve will lead the necessary examination activities in coordination with other relevant primary supervisors and functional regulators to the extent possible.

- **Additional required audit testing activities.** In all instances, the Federal Reserve will conduct testing activities as part of its audit infrastructure review (either by leading the activities and coordinating with other relevant primary supervisors or functional regulators, or participating in activities led by other relevant supervisors or regulators) on at least a three-year cycle to ensure that the internal audit program is appropriately designed and achieving its objectives.\(^{10}\)

In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.2.1.2.

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**1050.2.3.1.2 Risk-Management and Internal Control Functions for Primary Risks to the Consolidated Organization**

**Objectives:** Underlying the risk-focused approach to consolidated supervision of regional BHCs is the premise that it is each organization’s responsibility to develop an appropriate control structure for identifying, measuring, monitoring, and controlling key risks as measured against supervisory standards and expectations, applicable laws and regulations, and evolving practices of well-managed organizations.

The Federal Reserve will understand and assess risk-management and control functions for primary risks to the consolidated organization (primary firmwide risk-management and control functions), and associated MIS, for each regional BHC. This will include risk-management and control functions for primary credit, legal, and operational risks for the consolidated organization. The Federal Reserve also will understand and assess other risk-management and control functions that, based on the specific characteristics and activities of the individual BHC, relate to primary risks to the organization as a whole.

For example, for regional BHCs with particularly dynamic corporate strategies, the Federal Reserve will understand and assess the adequacy of the control mechanisms relevant to such strategies, including strategic planning, merger integration, new business approval, and processes for ensuring that risk management and controls keep pace with areas of growing inherent risk.

In all instances, the adequacy of each primary firmwide risk-management or control mechanism depends on the appropriateness of the following:

- A comprehensive understanding of the risk-focused approach to consolidated supervision of regional BHCs.
- An understanding of the organization’s legal, operating, and regulatory structure, is not able to develop—a comprehensive understanding and assessment of the internal audit infrastructure.

\(^{11}\) Federal Reserve processes for understanding and assessing legal and compliance risk management encompass consumer compliance risk inherent in the organization’s business activities.
control infrastructure and governance, including degree of oversight by the board and senior management;
2. development, maintenance, and communication of appropriate policies, procedures, and internal controls;
3. risk identification and measurement systems and processes, and associated MIS, that are adaptive to changing circumstances and capable of providing timely, accurate, and comprehensive information to senior management and the board;
4. monitoring and testing the effectiveness of controls;
5. processes for identifying, reporting, and escalating issues and emerging risks;
6. ability to implement corrective actions in a timely manner;
7. appropriate authority and independence of staff to carry out responsibilities; and
8. integration of risk-management and control objectives within management goals and the organization’s compensation structure.

Organizations in the regional BHC portfolio use a variety of control structures to monitor, manage, and control firmwide risks. A number of larger organizations have implemented firmwide risk-management functions to measure and assess the range of their exposures across business lines and legal entities and the way these exposures interrelate. However, many organizations within the portfolio effectively control risks using a decentralized approach that relies on individual control structures for the organization’s primary business lines or legal entities. In all instances, the Federal Reserve will assess whether the approach to a key control function used by a particular organization is effective in controlling primary risks to the consolidated organization.12

Supervisory Activities: The Federal Reserve will use continuous monitoring activities to understand and assess each primary firmwide risk-management and control function. This process begins with the overarching design and architecture of each primary firmwide risk-management or control function, and drills down, as appropriate, through analysis of risk management and controls for material portfolio areas and business lines (described in section 1050.2.3.1.3 below). Activities will verify the sufficiency of fundamental aspects of internal controls in relation to the holding company’s current risk profile and in comparison with supervisory expectations and evolving sound practices, and assess the capability of these primary functions (whether centralized or decentralized) to remain effective in the face of growth, changing strategic direction, significant market developments, and other internal or external factors.

The results of continuous monitoring activities, as documented in supervisory products that reflect the Federal Reserve’s overview and risk assessment of the organization, may identify certain primary firmwide risk-management or control functions that require more intensive supervisory focus due to (1) significant changes in inherent risk, control processes, or key personnel; (2) potential concerns regarding the adequacy of controls; or (3) the absence of sufficiently recent examination activities for a primary firmwide risk-management or control function by the Federal Reserve or another relevant primary supervisor or functional regulator.

In these instances, the Federal Reserve will work with other relevant primary supervisors or functional regulators (where applicable) to develop discovery reviews or testing activities focusing on the area of concern. In situations where another primary supervisor or functional regulator leads the examination activities, the Federal Reserve may conduct portions of the examination, or otherwise participate as necessary (e.g., in determining the examination objectives and scope), to ensure that the review provides sufficient information on the specific area of concern to form a comprehensive and timely understanding and assessment.

If the primary firmwide risk-management or control function is not within the oversight of another primary supervisor or functional regulator, or if the primary supervisor or functional regulator does not conduct or coordinate the implementation of the organization’s firmwide compliance risk-management program and that plays a key role in controlling compliance risks that transcend business lines, legal entities, and jurisdictions of operation.

12. As outlined in SR-08-8/CA-08-11, “Compliance Risk-Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles,” (see section 2124.07), while the Federal Reserve does not prescribe a particular organizational structure for primary firmwide risk-management and control functions, establishment of a firmwide function that is dedicated to managing and overseeing compliance risk, and that promotes a strong compliance culture, is particularly important for large banking organizations with complex compliance profiles, due to the unique challenges associated with compliance risk management for these organizations. In addition to the oversight provided by the board and various executive and management committees, a key component of firmwide compliance oversight for these organizations is a corporate compliance function that has day-to-day responsibility for overseeing and supporting the
examination activities in a reasonable period of time, the Federal Reserve will lead the necessary examination activities in coordination with other relevant supervisors and regulators to the extent possible. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.2.1.2.

1050.2.3.1.3 Risk Management of Material Portfolios and Business Lines

Objectives: For each regional BHC, there are selected portfolio risk areas (such as retail or wholesale credit risk) or individual business lines (such as residential mortgage or commercial real estate lending) that are primary drivers of risk or revenue, or that otherwise materially contribute to either understanding inherent risk within the consolidated organization or assessing controls for a broader corporate function (such as consolidated credit risk management).

During the development of supervisory products that reflect the Federal Reserve’s overview and risk assessment of the organization, the Federal Reserve will analyze external factors and internal trends in the BHC’s strategic initiatives—as evidenced by budget and (where applicable) internal capital allocations and other factors—to identify significant activities and areas vulnerable to volatility in revenue, earnings, capital, or liquidity that represent material risks or activities of the organization. This determination of material portfolios and business lines considers all associated risk elements, including legal and compliance risks. For example, when evaluating whether retail activities such as mortgage or automobile lending are material to a banking organization, the extent of inherent consumer compliance and reputational risks, as well as interest rate and credit risks, should be considered.

Supervisory Activities: Because an understanding of material risks and activities is needed to assess the primary firmwide risk-management and control functions (as discussed in preceding section 1050.2.3.1.2), the Federal Reserve will maintain an understanding of inherent risk and assess the adequacy of risk-management and internal controls for material portfolios and business lines. To form this understanding and assessment, the Federal Reserve will rely primarily on continuous monitoring activities, supplemented, as appropriate, by examination activities.

To the fullest extent possible, the Federal Reserve will draw its understanding and assessment of these risks and risk-management practices from the information and assessment of the primary supervisor or functional regulator where the BHC’s legal and operating structure provides the supervisor or regulator a sufficient view of these areas. In these instances, the Federal Reserve will undertake continuous monitoring and participate in activities led by primary supervisors and functional regulators, as necessary, to maintain an understanding and assessment of related firmwide risk-management and control functions.

A regional BHC’s activities may span legal entities that are subject to oversight by multiple supervisors or regulators or that are outside the oversight of other supervisors or regulators. If this is the case, or if the primary supervisor or functional regulator does not conduct or coordinate the necessary continuous monitoring or examination activities in a reasonable period of time, the Federal Reserve will initiate and lead these activities in coordination with other relevant primary supervisors and functional regulators to the extent possible. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its supervisory and testing activities in accordance with the provisions described above in section 1050.2.1.2.

1050.2.3.1.4 Risk Management of Nonmaterial Business Lines

Objectives: For nonmaterial business lines identified during the development of supervisory products that reflect the Federal Reserve’s overview and risk assessment of the organization, the Federal Reserve’s focus will be on identifying and understanding those business lines that are increasing in importance and have the potential to become material.

Supervisory Activities: When a primary supervisor or functional regulator has a sufficient view of nonmaterial business lines, the Federal Reserve will, to the fullest extent possible, use information developed by that supervisor or regulator to monitor areas of increasing importance with the potential to become material. The Federal Reserve also will maintain an ability to access internal MIS for these businesses to facilitate a more in-depth analysis of a business line, if appropri-
Consolidated Supervision of Regional BHCs

1050.2.3.2 Financial Condition

Objectives: The Federal Reserve’s evaluation of a regional BHC’s consolidated financial condition focuses on the ability of the organization’s resources to support the level of risk associated with its activities. Assessments are developed for each “CAEL” subcomponent: Capital Adequacy (C), Asset Quality (A), Earnings (E), and Liquidity (L).13

In developing this evaluation, the Federal Reserve’s primary focus is on developing an understanding and assessment of:

1. the sufficiency of the BHC’s consolidated capital to support the level of risk associated with the organization’s activities and provide a sufficient cushion to absorb unanticipated losses;
2. the capability of liquidity levels and funds-management practices to allow reliable access to sufficient funds to meet present and future liquidity needs; and
3. other aspects of financial strength that need to be assessed on a consolidated basis across the organization’s various legal entities, or that relate to the financial soundness of the parent company and significant nonbank subsidiaries, as discussed in section 1050.2.3.3 below.

In assessing consolidated regulatory capital, the Federal Reserve looks to ensure that the BHC demonstrates the effectiveness of its framework for complying with relevant capital adequacy guidelines and meeting supervisory expectations, and focuses on analyzing key models and processes14 that influence this assessment. This assessment utilizes results from examinations led by the Federal Reserve or other primary supervisors or functional regulators, as well as information gained from the BHC’s internal control functions and from market-based assessments, where available.

When assessing the adequacy of a BHC’s liquidity levels and funds-management practices, areas of focus include15

1. the extent to which the treasury function is aligned with risk-management processes, and whether incentives are in place for business lines to compile and provide information on expected liquidity needs and contingency funding plans so that the treasury function is able to develop a firmwide perspective and incorporate business line information into assessments of actual and contingent liquidity risk;
2. whether funds-management practices provide sufficient funding flexibility to respond to unanticipated, evolving, and potentially correlated market conditions for the organization and/or across financial markets; and
3. the sufficiency of liquidity planning tools, such as stress testing, scenario analysis, and contingency planning efforts, including (1) whether liquidity buffers—comprised of unencumbered liquid assets as well as access to stable funding sources—adequately reflect the possibility and duration of severe liquidity shocks; (2) the reasonableness of assumptions about the stability of secured funding in circumstances in which the liquidity of markets for the underlying collateral becomes impaired; and (3) whether these efforts adequately reflect the potential for the organization to be called on in stressed environments to provide contingent liquidity support to off-balance-sheet entities or bring additional assets on the balance sheet (even if not legally or contractually obligated to do so).

Beyond capital adequacy and liquidity, the nature of independent Federal Reserve supervisory work required to evaluate a regional BHC’s consolidated financial condition depends largely on the extent to which other relevant primary

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13. See SR-04-18 and section 4070.0 for more information about the CAEL subcomponents.

14. “Key models and processes” are those where evaluation of the model/process will influence the Federal Reserve’s assessment of the activity or control area that is supported by the model/process.

15. Assessing liquidity levels and funding practices for a consolidated BHC also incorporates elements presented in section 1050.2.3.3.2 below on “Parent Company and Nonbank Funding and Liquidity.”
supervisors or functional regulators have information or assessments upon which the Federal Reserve can draw. For example, more independent Federal Reserve work typically will be required to assess consolidated asset quality or earnings for regional BHCs with significant nonbank activities that are not functionally regulated. However, where all material holding company assets are concentrated in a single depository institution subsidiary, a minimal level of incremental Federal Reserve efforts typically will be required to assess consolidated asset quality and earnings.

**Supervisory Activities**: The Federal Reserve will primarily utilize continuous monitoring activities to assess a regional BHC’s financial strength. Such activities will include periodic meetings with BHC management (such as the chief financial officer); review of regulatory reports, surveillance screens, and internal MIS; and analysis of market indicators (where available), including external debt ratings, subordinated debt spreads, and credit default swap spreads. Testing and discovery activities will be used as necessary to assist in the understanding and assessment of areas of concern.

Testing and discovery activities also will be used to understand and assess the sufficiency of the BHC’s consolidated capital and liquidity positions to support the level of risk associated with its activities, including (1) regulatory capital calculation methodologies and, where applicable, internal assessments of capital adequacy and (2) funds-management and liquidity planning tools and practices. The Federal Reserve will work with other relevant primary supervisors and functional regulators to participate in or, if necessary, to coordinate activities designed to analyze key capital and liquidity models or processes of a depository institution or functionally regulated subsidiary that are of such significance that they will influence the Federal Reserve’s assessment of these areas. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.2.1.2.

### 1050.2.3.3 Impact

#### 1050.2.3.3.1 Risk Management and Financial Condition of Significant Nonbank Subsidiaries

**Objectives**: Many regional BHCs engage in activities and manage control functions on a firmwide basis, spanning depository institution and nonbank legal entities. In some instances, these BHCs have intra-group exposures and servicing arrangements across affiliates, presenting increased potential risks for depository institution subsidiaries and a higher likelihood of aggregate risk concentrations across the organization’s legal entities. Common interactions between a regional BHC’s depository institution subsidiaries and their nonbank affiliates (including the parent company) include assets originating in, or being marketed by, a nonbank affiliate that are booked in the depository institution; a depository institution providing funding for nonbank affiliates; and risk-management or internal control functions being shared between depository and nonbank operations.

Due to these interrelationships, financial, legal, compliance, or reputational troubles in one part of a BHC can spread rapidly to other parts of the organization. Even absent these interactions, the parent or nonbank subsidiaries of an organization may present financial, legal, compliance, or reputational risk to the consolidated entity, and thus directly or indirectly to its depository institution subsidiaries. As the federal banking agency charged with supervising the organization on a consolidated basis, the Federal Reserve is responsible for understanding and assessing the risks that the parent bank holding company and its nonbank subsidiaries may pose to the BHC itself or its depository institution subsidiaries.

The primary objectives of Federal Reserve supervision of the nonbank subsidiaries of a bank holding company are to
1. identify significant nonbank activities and risks—where the parent company or nonbank subsidiaries engage in risk-taking activities or hold exposures that are material to the risk management or financial condition of the consolidated organization or a depository institution subsidiary—by developing an understanding of the size and nature of primary activities and key trends, and the extent to which business lines, risks, or control functions are shared with or may impact a depository institution affiliate;

2. evaluate the financial condition and the adequacy of risk-management practices of the parent and significant nonbank subsidiaries, including the ability of nonbank subsidiaries to repay advances provided by the parent, using benchmarks and analysis appropriate for those businesses;

3. evaluate the degree to which nonbank entity risks may present a threat to the safety and soundness of subsidiary depository institutions, including through transmission of legal, compliance, or reputational risks;

4. identify and assess any intercompany relationships, dependencies, or exposures—or aggregate firmwide concentrations—with the potential to threaten the condition of a depository institution affiliate; and

5. evaluate the effectiveness of the policies, procedures, and systems at nonbank subsidiaries to repay advances provided by the parent, using benchmarks and analysis appropriate for those businesses;

6. identify significant businesses operated across multiple legal entities for accounting, risk management, or other purposes, as well as activities that functionally operate as separate business units for legal or other reasons;

7. identify intercompany transactions subject to Regulation W—utilizing information submitted on quarterly regulatory reporting form FR Y-8 (‘‘The Bank Holding Company Report of Insured Depository Institutions’’ Section 23A Transactions with Affiliates’’), internal MIS, and other information sources—and determine (in conjunction with the primary supervisor) whether compliance issues are present; and

8. understand and assess the sufficiency, reliability, and timeliness of associated MIS relied upon by the board, senior management, and senior risk managers and committees to monitor key activities and risks.

Periodic testing may be used to supplement continuous monitoring and discovery reviews to (1) ensure that key risk-management and internal control practices conform to internal policies and/or are designed to ensure compliance with the law and (2) understand and assess operations presenting a moderate or greater likelihood of significant negative impact to a subsidiary depository institution or the consolidated organization. Areas of potential negative impact include financial or operational risks that pose a potential threat to the safety and soundness of a depository institution subsidiary, or to the holding company’s ability to serve as a source of financial and managerial strength to its depository institution affiliate.

Supervisory Activities: For all significant nonbank subsidiaries and activities of the parent BHC, the Federal Reserve will use continuous monitoring activities and discovery reviews to

1. maintain an understanding of the holding company’s business line and legal entity structure, including key interrelationships and dependencies between depository institution subsidiaries and nonbank affiliates, utilizing regulatory structure reports, internal MIS, and other information sources;

2. understand and assess the exposure to, and tolerance for, legal, compliance, and reputational risks, as well as the extent to which potential conflicts of interest are identified and avoided or managed;

3. understand the scope of intercompany transactions and aggregate concentrations, and assess the adequacy of risk-management processes, accounting policies, and operating procedures to measure and manage related risks;

4. identify and assess key interrelationships and dependencies between subsidiary depository institutions and nonbank affiliates, such as the extent to which a depository institution subsidiary is reliant on services provided by the parent company or other nonbank affiliates and the reasonableness of associated management fees;

5. identify those nonbank subsidiaries whose activities present material financial, legal, compliance, or reputational risk to the consolidated entity and/or a depository institution subsidiary;

6. identify significant businesses operated across multiple legal entities for accounting, risk management, or other purposes, as well as activities that functionally operate as separate business units for legal or other reasons;

7. identify intercompany transactions subject to Regulation W—utilizing information submitted on quarterly regulatory reporting form FR Y-8 (‘‘The Bank Holding Company Report of Insured Depository Institutions’’ Section 23A Transactions with Affiliates’’), internal MIS, and other information sources—and determine (in conjunction with the primary supervisor) whether compliance issues are present; and

8. understand and assess the sufficiency, reliability, and timeliness of associated MIS relied upon by the board, senior management, and senior risk managers and committees to monitor key activities and risks.

Periodic testing may be used to supplement continuous monitoring and discovery reviews to (1) ensure that key risk-management and internal control practices conform to internal policies and/or are designed to ensure compliance with the law and (2) understand and assess operations presenting a moderate or greater likelihood of significant negative impact to a subsidiary depository institution or the consolidated organization. Areas of potential negative impact include financial or operational risks that pose a potential threat to the safety and soundness of a depository institution subsidiary, or to the holding company’s ability to serve as a source of financial and managerial strength to its deposit-
4. the extent of "double leverage"\textsuperscript{19} and the organization’s capital management policies, including the distribution and transferability of capital across jurisdictions and legal entities; and

5. the parent company’s ability to provide financial and managerial support to its depository institution subsidiaries during periods of financial stress or adversity, including the sufficiency of related stress testing, scenario analysis, and contingency planning efforts.

The Federal Reserve also will remain apprised of the funding profile—including intraday liquidity management policies and practices, and compliance with the "Federal Reserve Policy on Payments System Risk"\textsuperscript{20}—and market access of material depository institution subsidiaries, as in most instances these entities represent the consolidated BHC’s primary and most active vehicles for external funding and liquidity management. The primary supervisor retains responsibility for assessing liquidity risk-management practices with respect to the depository institution subsidiary.

\textsuperscript{19} "Double leverage" refers to situations in which debt is issued by the parent company and the proceeds are invested in subsidiaries as equity.

\textsuperscript{20} This policy statement is available on the Board’s public website at www.federalreserve.gov/paymentsystems/psr.
liquidity: board and senior management oversight; policies, procedures, and limits; risk monitoring and management information systems; and related internal controls. In all cases involving a functionally regulated subsidiary, the Federal Reserve will conduct its activities in accordance with the provisions described above in section 1050.2.1.2.

1050.2.4 INTERAGENCY COORDINATION

1050.2.4.1 Coordination and Information Sharing Among Domestic Primary Bank Supervisors and Functional Regulators

Objectives: Effective consolidated supervision requires strong, cooperative relationships between the Federal Reserve and other relevant primary bank supervisors and functional regulators. To achieve this objective, the Federal Reserve has worked over the years to enhance interagency coordination through the development and use of information-sharing protocols and mechanisms. These protocols and mechanisms respect the individual statutory authorities and responsibilities of the respective supervisors and regulators, provide for appropriate information flows and coordination to limit unnecessary duplication or burden, comply with restrictions governing access to information, and ensure that the confidentiality of information is maintained.

As discussed in section 1050.2.3., in understanding and assessing the activities and risks of the organization as a whole, the Federal Reserve will rely to the fullest extent possible on the examination and other supervisory work conducted by the domestic primary bank supervisors and functional regulators of a BHC’s subsidiaries. In addition, the Federal Reserve will seek to coordinate its supervisory activities with relevant supervisors and regulators, and will work to align each agency’s assessment of key corporate governance functions, risk-management and internal control functions for primary risks, financial condition, and other areas of the consolidated BHC’s operations as applicable.

Supervisory Activities: The Federal Reserve will continue to work with the relevant primary supervisors and functional regulators of a regional BHC’s subsidiaries to ensure that the necessary information flows and coordination mechanisms exist to permit the effective supervision of the BHC on a consolidated basis. The Federal Reserve will continue to share information, including confidential supervisory information, obtained or developed through its consolidated supervisory activities with other relevant primary supervisors or functional regulators when appropriate and permitted by applicable laws and regulations.

The Federal Reserve also will continue to use a variety of formal and informal channels to facilitate interagency information sharing and coordination consistent with the principles outlined above, including

- supervisory protocols, agreements, and memoranda of understanding (MOUs) with primary supervisors and functional regulators that allow the coordination of supervisory activities and that permit the ongoing exchange of information, including confidential information on a confidential basis;
- bilateral exchanges of letters to facilitate information sharing on a situation-specific basis;
- periodic and as-needed contacts with primary supervisors and functional regulators to discuss and coordinate matters of common interest, including the planning and conduct of examinations and continuous monitoring activities;
- the use of information technology platforms, such as the Banking Organization National Desktop (BOND), to provide secure automated access to examination/inspection reports and other supervisory information prepared by the Federal Reserve and other relevant supervisors and regulators; and
- participation in a variety of interagency forums that facilitate the discussion of broad industry issues and supervisory strategies, including the Federal Financial Institutions Examination Council, the President’s Working Group on Financial Markets, and the Federal Reserve...

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21. Section 1050.2.4.2 discusses cooperation and information sharing among foreign supervisors.

22. Among the federal laws that may limit the sharing of information among supervisors are the Right to Financial Privacy Act (12 U.S.C. 3401 et seq) and the Trade Secrets Act (18 U.S.C. 1905). The Federal Reserve has established procedures to authorize the sharing of confidential supervisory information, and Federal Reserve staff must ensure that appropriate approvals are obtained prior to releasing such information. See Subpart C of the Board’s Rules Regarding the Availability of Information (12 C.F.R. 261.20 et seq.).

23. BOND is a Federal Reserve information technology platform providing secure interagency access to documents, supervisory and financial data, and other information utilized in the consolidated supervision of individual BHCs and FBOs, and in developing comparative analyses of organizations with similar business lines and risk characteristics.
sponsored cross-sector meetings of financial supervisors and regulators.

1050.2.4.1.1 Coordination of Examination Activities at a Supervised BHC Subsidiary

As discussed in section III, the Federal Reserve will seek to work cooperatively with the relevant primary supervisor or functional regulator to address information gaps or indications of weakness or risk identified in a supervised BHC subsidiary that are material to the Federal Reserve’s understanding or assessment of the consolidated organization’s risks, activities, or key corporate governance, risk-management, or control functions. Prior to conducting discovery reviews or testing activities at a depository institution (other than where the Federal Reserve is the primary federal supervisor) or functionally regulated subsidiary of a BHC, the Federal Reserve will

• review available information sources as part of its continuous monitoring activities, including examination reports and the BHC’s internal MIS, to determine whether such information addresses the Federal Reserve’s information needs or supervisory concerns; and
• if needed, seek to gain a better understanding of the primary supervisor’s or functional regulator’s basis for its supervisory activities and assessment of the subsidiary. This may include a request to review related examination work.

If, following these activities, the Federal Reserve’s information needs or supervisory concerns remain, the Federal Reserve will work cooperatively with the relevant primary supervisor or functional regulator in the manner discussed in section 1050.2.3.24

1050.2.4.2 Cooperation and Information Sharing With Host-Country Foreign Supervisors

Objectives: A number of regional BHCs have international banking and other operations that are licensed and supervised by foreign host-country authorities. As home-country supervisor for domestic BHCs, the Federal Reserve is responsible for the comprehensive, consolidated supervision of these organizations, while each host country is responsible for supervision of the legal entities (including foreign subsidiaries of U.S. BHCs) in its jurisdiction.

Information sharing among domestic and foreign supervisors, consistent with applicable laws, is essential to ensure that a regional BHC’s global activities are supervised on a consolidated basis. Cross-border information sharing is often facilitated by an MOU that establishes a framework for bilateral relationships and includes provisions for cooperation during the licensing process, in the supervision of ongoing activities, and in the handling of problem institutions. The Federal Reserve has established bilateral and multilateral information-sharing MOUs and other arrangements with numerous host-country foreign supervisors. The Federal Reserve also monitors changes in foreign bank regulatory and supervisory systems and seeks to understand how these systems affect supervised banking organizations. In addition to its longstanding cooperative relationships with home- and host-country foreign supervisors, the Federal Reserve expects to increasingly lead and participate in “colleges of supervisors” and other multilateral groups of supervisors that discuss issues related to specific, internationally active banking organizations.

The Federal Reserve also is a member of the Basel Committee on Banking Supervision, which is a forum for supervisors from member countries to discuss important supervisory issues, foster consistent supervision of organizations with similar business and risk profiles, promote the sharing of leading supervisory practices, and formulate guidance to enhance and refine banking supervision globally.

The Federal Reserve’s processes for understanding and assessing firmwide legal and compliance risk management, as described earlier, encompass both domestic and international operations. Most areas of supervisory focus for management of legal and compliance risks are applicable to both domestic and international entities, and include proper oversight of licensed operations, compliance with supervisory and regulatory requirements, and the sufficiency of associated MIS.

There are, however, areas of focus for the Federal Reserve that are unique to a holding company’s international operations. For exam-
ple, some host-country legal and regulatory structures and supervisory approaches are fundamentally different from those in the United States. As a result, the banking organization often must devote additional resources to maintain expertise in local regulatory requirements. In some instances, privacy concerns have led to limits on the information a BHC’s foreign office may share with its parent company, thereby limiting the parent company’s ability to exercise consolidated risk management on a global basis.

Additionally, while considerable progress has been made to strengthen supervisory cross-border cooperation and information sharing, the Federal Reserve and other U.S. supervisors have at times faced challenges in accessing information on a bank’s or BHC’s foreign operations or in carrying out examinations of cross-border or foreign activities. These circumstances are to be taken into account when developing a supervisory strategy for a regional BHC with cross-border or foreign operations.

Supervisory Activities: For regional BHCs with international operations, continuous monitoring will be used to understand and assess each BHC’s international strategy, trends, operations, and legal entity structure, as well as related governance, risk-management, and internal controls. For a regional BHC with significant international operations or risks, an assessment of cross-border and foreign operations will be incorporated into the evaluation of key corporate governance functions and primary firmwide risk-management and internal control functions, including legal and regulatory risk management.

Continuous monitoring activities will include review of materials prepared by host-country supervisors, including examination reports and assessments, and ongoing communication with relevant foreign and domestic supervisors regarding trends and assessments of cross-border and foreign operations.

When assessing the sufficiency of a regional BHC’s management of its international operations, consideration is given to the extent that foreign laws restrict the transmission of information to the BHC’s head office. Impediments to sharing information imposed by a host country may constrain the BHC’s ability to effectively oversee its international operations and globally manage its risks, and the materiality of such impediments should be a determinant of whether the organization should be conducting operations in that host country.

In addition, any limits placed on the Federal Reserve’s ability to access information on host-country operations, or to engage in onsite activities at the organization’s operations in the host country, should be considered when assessing whether the organization’s activities in that jurisdiction are appropriate.

1050.2.4.3 Indications of Weakness or Risk Related to Subsidiary Depository Institutions

Objectives: For areas beyond those specifically addressed in section 1050.2.3, there may be circumstances where the Federal Reserve has indications of material weakness or risk in a depository institution subsidiary of a BHC that is supervised by another primary supervisor, and it is not clear that the weakness or risk is adequately reflected in the assessment or supervisory activities of that supervisor. Because a primary objective of consolidated supervision is to protect the BHC’s depository institution subsidiaries, the Federal Reserve will follow up with the appropriate primary supervisor in these circumstances to help ensure that, to the extent that a material weakness or risk exists, it is addressed appropriately.

Supervisory Activities: The Federal Reserve will take the following steps if it has indications of material weakness or risk in a depository institution subsidiary (other than where the Federal Reserve is the primary federal supervisor) in an area beyond those specifically addressed in section 1050.2.3, and it is not clear that the weakness or risk is adequately reflected in the assessment or supervisory activities of the depository institution’s primary supervisor.

- The Federal Reserve will first review available information sources, discuss the areas of concern with the primary supervisor, and seek to review the supervisor’s related work.
- If concerns remain following these activities, the Federal Reserve will request that the primary supervisor conduct a discovery review or testing activity at the depository institution to address the area of concern.
- In the event the primary supervisor does not undertake activities to address the concern in a reasonable period of time, the Federal Reserve will design and lead an examination of the depository institution to address the matter in consultation with the primary supervisor. A
1050.2.4.4 Condition or Management of BHC Subsidiary is Less than Satisfactory

**Objectives:** As noted above, a primary responsibility of the Federal Reserve as consolidated BHC supervisor is to ensure that a holding company’s activities, policies, and practices do not undermine its ability to serve as a source of financial and managerial strength to its depository institution subsidiaries. In situations where the condition or management of a supervised or functionally regulated BHC subsidiary is determined to be less than satisfactory, the Federal Reserve’s focus as consolidated supervisor is on complementing the efforts of the primary supervisor or functional regulator. In doing so, the Federal Reserve will seek to ensure that the parent company provides appropriate support to the subsidiary and does not take actions that may further weaken the parent company’s depository institution subsidiaries or its ability to act as a source of strength for such subsidiaries.

Beyond the specific activities noted below, these circumstances also may require the Federal Reserve to enhance the activities addressed in section 1050.2.3 for understanding and assessing key corporate governance functions, or primarily firmwide risk-management and internal controls. In addition, the Federal Reserve will adjust its supervisory activities as necessary when the consolidated BHC is in weakened condition or when there are questions regarding the capabilities of the holding company’s management.

**Supervisory Activities:**

- **Depository institution subsidiary.** In instances when a depository institution subsidiary’s condition or management is rated less than satisfactory, or when the depository institution subsidiary otherwise faces financial stress or material risks, the Federal Reserve’s primary supervisory objectives as consolidated supervisor are to ensure that the parent company (1) provides appropriate support to the depository institution and (2) does not take action that could harm the depository institution. The Federal Reserve will work closely with the primary supervisor to understand whether the BHC or a nonbank affiliate has contributed to the depository institution’s weakened condition, to understand the impact of the depository institution on the BHC’s condition, and to determine if the holding company is providing appropriate support to the depository institution. The Federal Reserve will coordinate its activities with those of the primary supervisor to the extent appropriate.

- **Nonbank subsidiary.** When any nonbank subsidiary faces financial stress or material risks, the Federal Reserve will seek to ensure that its condition and activities do not jeopardize the safety and soundness of the BHC or its depository institution subsidiaries, as discussed above in sections 1050.2.3.3.1, “Risk Management and Financial Condition of Significant Nonbank Subsidiaries” and 1050.2.3.3.2, “Parent Company and Nonbank Funding and Liquidity.” The Federal Reserve also will take appropriate steps to ensure that any actions taken by the parent company to assist a nonbank subsidiary do not impair the BHC’s continuing ability to serve as a source of strength to its depository institution subsidiaries. The Federal Reserve will coordinate its activities with those of any relevant functional regulator to the extent appropriate.

1050.2.4.5 Edge and Agreement Corporations

**Objectives:** Some regional BHCs control an Edge or agreement corporation subsidiary. The Federal Reserve serves as the primary supervisor of each Edge and agreement corporation subsidiary in addition to its role as consolidated BHC supervisor. When the Edge or agreement corporation is held by a U.S. bank, the primary supervisor often relies on information provided by the Federal Reserve in developing its own understanding and assessment of the parent bank.

During each calendar year, the Federal Reserve performs an examination of each Edge and agreement corporation, assesses the Bank Secrecy Act/Anti-Money-Laundering (BSA/AML) compliance program, and assigns a CAMEO rating. In addition, the Federal Reserve periodically conducts assessments of Edge and agreement corporations.

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25. The Federal Reserve is solely responsible for approving, and supervising the activities of, U.S. Edge and agreement corporations. As discussed in SR-90-21, “Rating System For International Examinations,” one of the Federal Reserve’s supervisory responsibilities is the assignment of a CAMEO rating (Capital, Asset Quality, Management, Earnings, and Operations and Internal Controls) to each Edge and agreement corporation.
corporations to determine whether a consumer compliance examination is warranted, in which case a compliance examination is conducted and a consumer compliance rating is assigned.

The Federal Reserve will coordinate the conduct of its activities as Edge and agreement corporation supervisor with its activities as consolidated supervisor. To this end, the extent and scope of Federal Reserve supervisory work related to an Edge or agreement corporation will be tailored to the entity’s activities, risk profile, and other attributes. A number of specific elements will be considered when developing a supervisory approach, including:

1. structure and attributes, including whether the Edge or agreement corporation is a banking or investment organization;
2. the size, nature, and location of its primary activities, as well as key financial and other trends;
3. the business lines and risks, and associated trends, of the Edge or agreement corporation’s primary activities on a standalone basis, as well as their significance to the risk profile of the parent bank (if applicable) and BHC;
4. the extent to which risk-management and internal control functions are unique to the Edge or agreement corporation, or are shared with a parent bank, another affiliate, or the consolidated BHC;
5. any potential Regulation K limitations or other U.S. compliance issues, and the adequacy of processes to ensure ongoing compliance; and
6. the adequacy of processes for ensuring compliance with all applicable laws and regulations imposed by host-country supervisors for the Edge or agreement corporation’s international operations.

Supervisory Activities: The Federal Reserve will maintain an understanding and perform an annual examination for each Edge and agreement corporation. While the examination scope will be risk focused to reflect the organization’s scale, activities, and risk profile, in all cases the Federal Reserve will assess the adequacy of processes to ensure compliance with BSA/AML requirements and other applicable U.S. laws and regulations, and with applicable foreign laws and regulations.

In developing its supervisory strategy, the Federal Reserve will identify those elements that are unique to the Edge or agreement corporation and those that are shared with the parent bank or BHC, and will coordinate fulfillment of the Federal Reserve’s responsibilities as Edge and agreement corporation supervisor with execution of its consolidated supervision role. This strategy will reflect the extent to which reliance can be placed on (1) the Federal Reserve’s understanding and assessments of key corporate governance, risk-management, and control functions, as well as material portfolios and business lines, of the consolidated BHC; (2) assessments developed by the primary supervisor (when applicable) for business lines, risk management, control functions, or financial factors that are common to the Edge or agreement corporation and its parent bank; and (3) findings developed by host-country supervisors for activities under their jurisdiction.

In addition, where the primary supervisor of an Edge or agreement corporation’s parent bank relies on the Federal Reserve’s understanding and assessment in order to develop its CAMELS rating,26 the Federal Reserve will work to fulfill that supervisor’s information needs.

1050.2.4.6 Nontraditional Bank Holding Companies

Objectives: A small number of regional BHCs are considered to be nontraditional bank holding companies because most or all of their significant nondepository subsidiaries are regulated by a functional regulator, and subsidiary depository institutions are small in relation to the nondepository entities. As with all BHCs, the level of analysis conducted and resources needed to supervise and assess nontraditional BHCs should be commensurate with the level of risk posed by the organization’s depository institution subsidiaries to the federal safety net and the level of risk posed by the parent or its nonbank subsidiaries to the BHC’s subsidiary depository institutions.

Due to the unique structure of nontraditional BHCs, it is likely that a single functional regulator will have a complete view of, and ability to address, significant aspects of the organization’s

Reserve will rely to the fullest extent possible on the assessment of the IDI as reflected in the examination work performed by the IDI regulator(s).

The Federal Reserve tailors its supervision of holding companies based on the size of the organization, complexity, and the degree of systemic risk that the organization poses to the U.S. financial system and the economy, including the deposit insurance fund. Within this framework of tailored supervision, the Federal Reserve focuses on the goals of both macroprudential and microprudential supervision for systematically important institutions, and microprudential supervisory goals for BHCs and SLHCs with total consolidated assets of less than $50 billion.\(^\text{28}\)

The BHC Act and the HOLA authorize the Federal Reserve to conduct examinations of BHCs and SLHCs, and certain subsidiaries of such holding companies, to obtain information needed to assess the safety and soundness of supervised financial institutions.\(^\text{29}\) At the same time, the Dodd-Frank Act requires the Federal Reserve, to the fullest extent possible, to rely on the reports and supervisory information from other regulatory agencies to avoid duplication of examination activities, reporting requirements, and requests for information. Supervisory overlap at the level of the IDI can be avoided through reliance on the examination work performed by the IDI regulators, as each agency follows similar rules and supervisory guidance when assessing the financial and managerial condition of an insured depository institution.

Consistent with this mandate to rely on the work of the IDI regulators, the IDI regulators and the Federal Reserve have the mutual responsibility to foster the timely sharing of information, including their risk-focused supervisory

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\(^{27}\) Refer to sections 5(c)(1)–(2) of the Bank Holding Company Act of 1956 (BHC Act) and sections 10(b)(2) and (b)(4) of the Home Owners’ Loan Act (HOLA), as amended by section 604 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). 12 U.S.C. 1844(c)(1)–(2); 12 U.S.C. 1467a(b)(2), (b)(4).

\(^{28}\) While recognizing that a large number of smaller BHCs and SLHCs simultaneously experiencing financial distress could have a harmful effect on a local economy’s availability of credit or on certain sectors or regions of the U.S. economy, institutions that are not systemically important do not have the size or degree of interconnectedness to the financial system to individually pose macroprudential risk.

\(^{29}\) 12 U.S.C. 1844(c)(2); 12 U.S.C. 1467a(b)(4)(A). This information pertains to the nature of the operations and financial condition of the holding company and its subsidiaries; the financial, operational, and other risks within the holding company system that may pose a threat to the safety and soundness of the holding company or of any depository institution subsidiary of the holding company, or the stability of the financial system of the United States; the systems of the holding company for monitoring and controlling any such risks; and the holding company’s and subsidiaries’ compliance with federal law, other than in the case of an insured depository institution or functionally regulated subsidiary.
analysis and conclusions. Moreover, the sharing of information is necessary so that Federal Reserve staff have an adequate basis for relying on the IDI regulators’ work. While exercising the Federal Reserve’s responsibility to assess and assign appropriate supervisory ratings to the consolidated holding company, the microprudential supervision framework for smaller BHCs and SLHCs provides the Federal Reserve with the flexibility to rely on the assessment of an IDI’s condition by another regulator.

The following guidance explains the Federal Reserve’s expectations for its examiners’ reliance on the work of the regulators of insured depository institution subsidiaries (IDI regulators) in the supervision of regional bank holding companies (BHCs) and savings and loan holding companies (SLHCs) with total consolidated assets of between $10 billion and $50 billion.

1050.2.5.1 Relying on the Work of IDI Regulators for RBOs

The Federal Reserve supervises RBOs using a program of continuous oversight which is characterized by a series of targeted examinations during the annual supervisory cycle, a roll-up examination at the end of the cycle, and continuous monitoring between examination events during the cycle.

1. Taking into account a holding company’s complexity, risk profile, and condition, the Federal Reserve will rely to the fullest extent possible on the work of the IDI regulators to supplement its own supervisory work regarding the consolidated holding company and its nonbank subsidiaries.

2. Federal Reserve staff will promote the sharing of information with the IDI regulators throughout the supervisory cycle, which will foster collaborative interagency relationships. Federal Reserve staff and the IDI regulators generally may participate on each other’s inspections and examinations to support and complement each other’s work as necessary. Through ongoing dialogue and exchange of supervisory documents and information, Federal Reserve staff are expected to:

- understand the IDI regulators’ risk assessment and supervisory plan for each IDI, to include this information into the Federal Reserve’s evaluation of consolidated holding company risk, and to support development of the Federal Reserve’s supervisory framework for the holding company;
- understand the IDI regulators’ examination work, including the scope, basis for, and support of conclusions reached, and the goal of any supervisory action;
- communicate to the IDI regulators the Federal Reserve’s supervisory goals and approach with respect to the holding company and any subsidiaries not subject to the supervision of IDI regulators; and
- use all information made available from the IDI regulators to reach conclusions regarding the consolidated holding company’s overall condition and to assign appropriate Federal Reserve supervisory ratings.

3. Federal Reserve staff should verify that the Federal Reserve’s supervisory ratings of the consolidated holding company are adequately supported by information that is timely and complete, including the information received from the IDI regulators.

4. Federal Reserve staff will scale their supervisory approach, including the review of and reliance on the IDI regulators’ work, according to the complexity, risk, and condition of the consolidated organization, and to the timeliness of information available from the IDI regulators. For noncomplex holding companies with satisfactory supervisory ratings, Federal Reserve consolidated ratings should rely heavily on the IDI regulators’ work for IDI subsidiaries exhibiting the following characteristics:

- CAMELS Composite 1 or 2;
- low or moderate risk profiles;
- stable financial condition;

30. For the purpose of this guidance, “IDI regulator” is defined as the prudential bank regulator(s) other than the Federal Reserve, which includes the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the state banking supervisory authorities.

31. “[A]ll bank holding companies...with total consolidated assets of less than $50 billion” includes by definition any U.S. bank holding company with total consolidated assets of less than $50 billion that is owned or controlled by a foreign banking organization.

32. The Federal Reserve distinguishes between complex and noncomplex holding companies by evaluating a number of factors, including: the size and structure of the company; the extent of intercompany transactions between IDI subsidiaries and the holding company or its non-depository subsidiaries; the risk, scale, and complexity of activities of any non-depository subsidiaries; and the degree of leverage at the holding company, including the extent of debt outstanding to the public. Companies are also designated “complex” if material risk management processes for the holding company and its affiliates are consolidated at the parent company.
• satisfactory management practices and an associated satisfactory management component rating; and
• IDI regulator examination reports issued within the past year.

In these situations, the Federal Reserve expects to limit its supervisory work to verify that the holding company can serve as a source of strength to, and the non-bank subsidiaries do not pose a threat to, the safety and soundness of the IDI(s). Thus, Federal Reserve staff will likely need to perform only limited analysis outside of the required annual on-site holding company inspection of the parent and nonbank subsidiaries. In addition, this analysis will be supplemented by the Federal Reserve’s continuous monitoring process.

In other situations, the Federal Reserve will scale its supervisory approach, including performing more detailed monitoring of a consolidated holding company’s internal management information systems, internal audit, and loan review reports, depending on the company’s complexity, risk, condition of the consolidated organization, and timeliness of information available from the IDI regulator. For example, a holding company with the following characteristics is a candidate for closer Federal Reserve supervision to ensure the conclusions reached by the IDI regulators remain a valid basis for assigning the supervisory ratings to the consolidated holding company:
• the IDI examination reports are not current;\(^\text{33}\)
• the composite rating for the holding company or any of its IDI subsidiaries is less than satisfactory; or
• the holding company has deteriorating financial or risk trends that are not reflected in the most current IDI regulators’ examination reports.

5. If Federal Reserve staff do not have an adequate basis for relying on the IDI regulators’ supervisory findings, the Federal Reserve will work to resolve information gaps with the IDI regulators.\(^\text{34}\)

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33. For the purpose of this guidance, RBO IDI examination reports that are not current are defined as reports older than one year, measured from the mailing date of a IDI regulator’s report to the start date of the Federal Reserve supervisory evaluation.

34. In rare and limited circumstances, where unresolved information gaps exist or reliance upon information obtained from the IDI regulators does not sufficiently support the Federal Reserve’s supervision of a consolidated holding company, the Federal Reserve would consider invoking its expanded examination authority under section 5(c)(2) of the BHC Act and section 10(b)(4) of the HOLA, as amended by section 604 of the Dodd-Frank Act, to examine IDIs for which the Federal Reserve is not the primary regulator. 12 U.S.C. 1844(c)(2); 12 U.S.C. 1467a(b)(4).
1060.0.1 OVERVIEW AND APPLICABILITY

Each large financial institution (LFI) is expected to ensure that the consolidated organization (or the combined U.S. operations in the case of foreign banking organizations), including its critical operations and banking offices, remain safe and sound and in compliance with laws and regulations, including those related to consumer protection. On November 21, 2018, the Board adopted a specific rating system for LFIs in order to align with the Federal Reserve’s supervisory programs and practices for these firms. The LFI rating system provides a supervisory evaluation of whether a covered firm possesses sufficient financial and operational strength and resilience to maintain safe-and-sound operations through a range of conditions, including stressful ones.

The LFI rating system applies to:

- bank holding companies with total consolidated assets of $100 billion or more;
- all non-insurance, non-commercial savings and loan holding companies with total consolidated assets of $100 billion or more; and
- U.S. intermediate holding companies of foreign banking organizations with combined U.S. assets of $50 billion or more established pursuant to the Federal Reserve’s Regulation YY.

The Federal Reserve will assign initial LFI ratings to firms in the LISCC portfolio in early 2019. For all other firms subject to the LFI rating system, the Federal Reserve will assign initial LFI ratings in early 2020.

Federal Reserve supervision staff will continue to use the RFI rating system in assessing bank holding companies with less than $100 billion in consolidated assets. For noncomplex holding companies with less than $3 billion in assets, Reserve Bank supervisory staff will assign only a composite RFI rating and risk-management rating to the firm following an inspection.

The LFI rating system is designed to:

- Fully align with the Federal Reserve’s current supervisory programs and practices, which are based upon the LFI supervision framework’s core objectives of reducing the probability of LFIs failing or experiencing material distress and reducing the risk to U.S. financial stability;
- Enhance the clarity and consistency of supervisory assessments and communications of supervisory findings and implications; and
- Provide transparency related to the supervisory consequences of a given rating.

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1. See SR letter 12-17/CA letter 12-14, “Consolidated Supervisory Framework for Large Financial Institutions.” Hereinafter, when “safe and sound” or “safety and soundness” is used in this framework, related expectations apply to the consolidated organization and the firm’s critical operations and banking offices. “Critical operations” are a firm’s operations, including associated services, functions and support, the failure or discontinuance of which, in the view of the firm or the Federal Reserve, would pose a threat to the financial stability of the United States. “Banking offices” are defined as U.S. depository institution subsidiaries, as well as the U.S. branches and agencies of foreign banking organizations.


3. “Financial strength and resilience” is defined as maintaining effective capital and liquidity governance and planning processes, and sufficiency of related positions, to provide for the continuity of the consolidated organization (including its critical operations and banking offices) through a range of conditions.

4. “Operational strength and resilience” is defined as maintaining effective governance and controls to provide for the continuity of the consolidated organization (including its critical operations and banking offices) and to promote compliance with laws and regulations, including those related to consumer protection, through a range of conditions.

5. Total consolidated assets will be calculated based on the average of the firm’s total consolidated assets in the four most recent quarters as reported on the firm’s quarterly financial reports filed with the Federal Reserve. A firm will continue to be rated under the LFI rating system until it has less than $95 billion in total consolidated assets, based on the average total consolidated assets as reported on the firm’s four most recent quarterly financial reports filed with the Federal Reserve. The Federal Reserve may determine to apply the RFI rating system or another applicable rating system in certain limited circumstances.

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BHC Supervision Manual February 2019
Page 1
The LFI rating system is comprised of three components:

- **Capital Planning and Positions:** an evaluation of (1) the effectiveness of a firm’s governance and planning processes used to determine the amount of capital necessary to cover risks and exposures, and to support activities through a range of conditions and events; and (2) the sufficiency of a firm’s capital positions to comply with applicable regulatory requirements and to support the firm’s ability to continue to serve as a financial intermediary through a range of conditions.

- **Liquidity Risk Management and Positions:** an evaluation of (1) the effectiveness of a firm’s governance and risk-management processes used to determine the amount of liquidity necessary to cover risks and exposures, and to support activities through a range of conditions; and (2) the sufficiency of a firm’s liquidity positions to comply with applicable regulatory requirements and to support the firm’s ongoing obligations through a range of conditions.

- **Governance and Controls:** an evaluation of the effectiveness of a firm’s (1) board of directors, (2) management of business lines and independent risk management and controls, and (3) recovery planning (only for domestic firms that are subject to the Board’s Large Institution Supervision Coordinating Committee (LISCC) Framework). This rating assesses a firm’s effectiveness in aligning strategic business objectives with the firm’s risk appetite and risk-management capabilities; maintaining effective and independent risk-management and control functions, including internal audit; promoting compliance with laws and regulations, including those related to consumer protection; and otherwise planning for the ongoing resiliency of the firm.9

### 1060.0.2 ASSIGNMENT OF THE LFI COMPONENT RATINGS

Each LFI component rating is assigned along a four-level scale:

- **Broadly Meets Expectations:** A firm’s practices and capabilities broadly meet supervisory expectations, and the firm possesses sufficient financial and operational strength and resilience to maintain safe-and-sound operations through a range of conditions. The firm may be subject to identified supervisory issues requiring corrective action. These issues are unlikely to present a threat to the firm’s ability to maintain safe-and-sound operations through a range of conditions.

- **Conditionally Meets Expectations:** Certain, material financial or operational weaknesses in a firm’s practices or capabilities may place the firm’s prospects for remaining safe and sound through a range of conditions at risk if not resolved in a timely manner during the normal course of business.

The Federal Reserve does not intend for a firm to be assigned a “Conditionally Meets Expectations” rating for a prolonged period, and will work with the firm to develop an appropriate timeframe to fully resolve the issues leading to the rating assignment and merit upgrade to a “Broadly Meets Expectations” rating.

A firm is assigned a “Conditionally Meets Expectations” rating-as opposed to a “Deficient” rating-when it has the ability to resolve these issues through measures that do not require a material change to the firm’s business model or financial profile, or its governance, risk management or internal control structures or practices. Failure to resolve the issues in a timely manner would most likely result in the firm’s downgrade to a “Deficient” rating, since the inability to resolve the issues would indicate that the firm does not...
possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

It is recognized that completion and validation of remediation activities for select supervisory issues—such as those involving information technology modifications—may require an extended time horizon. In all instances, appropriate and effective risk-mitigation techniques must be utilized in the interim to maintain safe-and-sound operations under a range of conditions until remediation activities are completed, validated, and fully operational.

- **Deficient-1**: Financial or operational deficiencies in a firm’s practices or capabilities put the firm’s prospects for remaining safe and sound through a range of conditions at significant risk. The firm is unable to remediate these deficiencies in the normal course of business, and remediation would typically require the firm to make a material change to its business model or financial profile, or its practices or capabilities. A firm’s failure to resolve the issues in a timely manner that gave rise to a “Conditionally Meets Expectations” rating would most likely result in its downgrade to a “Deficient” rating.

  A firm with a “Deficient-1” rating is required to take timely corrective action to correct financial or operational deficiencies and to restore and maintain its safety and soundness and compliance with laws and regulations, including those related to consumer protection. There is a strong presumption that a firm with a “Deficient-1” rating will be subject to an informal or formal enforcement action, and this rating assignment could be a barrier for a firm seeking Federal Reserve approval to engage in new or expansionary activities.

- **Deficient-2**: Financial or operational deficiencies in a firm’s practices or capabilities present a threat to the firm’s safety and soundness, or have already put the firm in an unsafe and unsound condition.

  A firm with a “Deficient-2” rating is required to immediately implement comprehensive corrective measures, and demonstrate the sufficiency of contingency planning in the event of further deterioration. There is a strong presumption that a firm with a “Deficient-2” rating will be subject to a formal enforcement action, and the Federal Reserve would be unlikely to approve any proposal from a firm with this rating to engage in new or expansionary activities.

The Federal Reserve will take into account a number of individual elements of a firm’s practices, capabilities, and performance when making each component rating assignment. The weighting of an individual element in assigning a component rating will depend on its impact on the firm’s safety, soundness, and resilience as provided for in the LFI rating system definitions. For example, for purposes of the Governance and Controls rating, a limited number of significant deficiencies or even just one significant deficiency noted for management of a single material business line could be viewed as sufficiently important to warrant a “Deficient-1” for the Governance and Controls component rating, even if the firm meets supervisory expectations under the Governance and Controls component in all other respects.

Under the LFI rating system, a firm must be rated “Broadly Meets Expectations” or “Conditionally Meets Expectations” for each of the three component ratings (Capital, Liquidity, Governance and Controls) to be considered “well managed” in accordance with various statutes and regulations.\(^\text{10}\) A “well managed” firm has sufficient financial and operational strength and resilience to maintain safe-and-sound operations through a range of conditions, including stressful ones.

### 1060.0.3 LFI RATING COMPONENTS

The LFI rating system is comprised of three component ratings: (1) capital planning and positions, (2) liquidity risk management and positions, and (3) governance and controls.\(^\text{11}\)

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\(^{10}\) 12 USC 1841 et. seq. and 12 USC 1461 et seq. See, e.g., 12 CFR 225.4(b)(6), 225.14, 225.22(a), 225.23, 225.85, and 225.86; 12 CFR 211.9(b), 211.10(a)(14), and 211.34; and 12 CFR 223.41.

\(^{11}\) There may be instances where deficiencies or supervisory issues may be relevant to the Federal Reserve’s assessment of more than one component area. As such, the LFI rating will reflect these deficiencies or issues within multiple rating components when necessary to provide a comprehensive supervisory assessment.
1060.0.3.1 Capital Planning and Positions Component Rating

The Capital Planning and Positions component rating evaluates (1) the effectiveness of a firm’s governance and planning processes used to determine the amount of capital necessary to cover risks and exposures, and to support activities through a range of conditions; and (2) the sufficiency of a firm’s capital positions to comply with applicable regulatory requirements and to support the firm’s ability to continue to serve as a financial intermediary through a range of conditions.

In developing this rating, the Federal Reserve evaluates:

- **Capital Planning:** The extent to which a firm maintains sound capital planning practices through effective governance and oversight; effective risk management and controls; maintenance of updated capital policies and contingency plans for addressing potential shortfalls; and incorporation of appropriately stressful conditions into capital planning and projections of capital positions; and

- **Capital Positions:** The extent to which a firm’s capital is sufficient to comply with regulatory requirements, and to support its ability to meet its obligations to depositors, creditors, and other counterparties and continue to serve as a financial intermediary through a range of conditions.

### 1060.0.3.1.1 Definitions for the Capital Planning and Positions Component Rating

**Broadly Meets Expectations**

A firm’s capital planning and positions broadly meet supervisory expectations and support maintenance of safe-and-sound operations. Specifically:

- The firm is capable of producing sound assessments of capital adequacy through a range of conditions; and
- The firm’s current and projected capital positions comply with regulatory requirements, and support its ability to absorb current and potential losses, to meet obligations, and to continue to serve as a financial intermediary through a range of conditions.

A firm rated “Broadly Meets Expectations” may be subject to identified supervisory issues requiring corrective action. However, these issues are unlikely to present a threat to the firm’s ability to maintain safe-and-sound operations through a range of potentially stressful conditions.

A firm that does not meet the capital planning and position expectations associated with a “Broadly Meets Expectations” rating will be rated “Conditionally Meets Expectations,” “Deficient-1,” or “Deficient-2,” and subject to potential consequences as outlined below.

**Conditionally Meets Expectations**

Certain material financial or operational weaknesses in a firm’s capital planning or positions may place the firm’s prospects for remaining safe and sound through a range of conditions at risk if not resolved in a timely manner during the normal course of business.

Specifically, if left unresolved, these weaknesses:

- May threaten the firm’s ability to produce sound assessments of capital adequacy through a range of conditions; and/or
- May result in the firm’s projected capital positions being insufficient to absorb potential losses, comply with regulatory requirements, and support the firm’s ability to meet current and prospective obligations and to continue to serve as a financial intermediary through a range of conditions.

The Federal Reserve does not intend for a firm to be rated “Conditionally Meets Expectations” for a prolonged period. The firm has the ability to resolve these issues through measures that do not require a material change to the firm’s business model or financial profile, or its governance, risk management, or internal control structures or practices. The Federal Reserve will work with the firm to develop an appropriate timeframe during which the firm would be required to resolve each supervisory issue leading to the “Conditionally Meets Expectations” rating.

The Federal Reserve will closely monitor the firm’s remediation and mitigation activities; in most instances, the firm will either:

1. Resolve the issues in a timely manner and, if no new material supervisory issues arise,
be upgraded to a “Broadly Meets Expectations” rating because the firm’s capital planning practices and related positions would broadly meet supervisory expectations; or

2. Fail to resolve the issues in a timely manner and be downgraded to a “Deficient-1” rating, because the inability to resolve the issues would indicate that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

It is possible that a firm may be close to completing resolution of the supervisory issues leading to the “Conditionally Meets Expectations” rating, but new issues are identified that, taken alone, would be consistent with a “Conditionally Meets Expectations” rating. In this event, the firm may continue to be rated “Conditionally Meets Expectations,” provided the new issues do not reflect a pattern of deeper or prolonged capital planning or position weaknesses consistent with a “Deficient” rating.

A “Conditionally Meets Expectations” rating may be assigned to a firm that meets the above definition regardless of its prior rating. A firm previously rated “Deficient-1” may be upgraded to “Conditionally Meets Expectations” if the firm’s remediation and mitigation activities are sufficiently advanced so that the firm’s prospects for remaining safe and sound are no longer at significant risk, even if the firm has outstanding supervisory issues or is subject to an active enforcement action.

Deficient-1

Financial or operational deficiencies in a firm’s capital planning or positions put the firm’s prospects for remaining safe and sound through a range of conditions at significant risk. The firm is unable to remediate these deficiencies in the normal course of business, and remediation would typically require a material change to the firm’s business model or financial profile, or its capital planning practices.

Specifically, although the firm’s current condition is not considered to be materially threatened:

- Deficiencies in the firm’s capital planning processes are not effectively mitigated. These deficiencies limit the firm’s ability to effectively assess capital adequacy through a range of conditions; and/or

- The firm’s projected capital positions may be insufficient to absorb potential losses and to support its ability to meet current and prospective obligations and serve as a financial intermediary through a range of conditions.

Supervisory issues that place the firm’s safety and soundness at significant risk, and where resolution is likely to require steps that clearly go beyond the normal course of business—such as issues requiring a material change to the firm’s business model or financial profile, or its governance, risk management or internal control structures or practices—would generally warrant assignment of a “Deficient-1” rating.

A “Deficient-1” rating may be assigned to a firm regardless of its prior rating. A firm previously rated “Broadly Meets Expectations” may be downgraded to “Deficient-1” when supervisory issues are identified that place the firm’s prospects for maintaining safe-and-sound operations through a range of potentially stressful conditions at significant risk. A firm previously rated “Conditionally Meets Expectations” may be downgraded to “Deficient-1” when the firm’s inability to resolve supervisory issues in a timely manner indicates that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

To address these financial or operational deficiencies, the firm is required to take timely corrective action to restore and maintain its capital planning and positions consistent with supervisory expectations. There is a strong presumption that a firm rated “Deficient-1” will be subject to an informal or formal enforcement action by the Federal Reserve.

A firm rated “Deficient-1” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. A “Deficient-1” rating could be a barrier for a firm seeking Federal Reserve approval of a proposal to engage in new or expansionary activities, unless the firm can demonstrate that (1) it is making meaningful, sustained progress in resolving identified deficiencies and issues; (2) the proposed new or expansionary activities would not present a risk of exacerbating current deficiencies or issues or lead to new concerns; and (3) the proposed activities would not distract the firm from remedying current deficiencies or issues.
Deficient-2

Financial or operational deficiencies in a firm’s capital planning or positions present a threat to the firm’s safety and soundness, or have already put the firm in an unsafe and unsound condition.

Specifically, as a result of these deficiencies:

- The firm’s capital planning processes are insufficient to effectively assess the firm’s capital adequacy through a range of conditions; and/or
- The firm’s current or projected capital positions are insufficient to absorb current or potential losses, and to support the firm’s ability to meet current and prospective obligations and serve as a financial intermediary through a range of conditions.

To address these deficiencies, the firm is required to immediately (1) implement comprehensive corrective measures sufficient to restore and maintain appropriate capital planning capabilities and adequate capital positions; and (2) demonstrate the sufficiency, credibility and readiness of contingency planning in the event of further deterioration of the firm’s financial or operational strength or resiliency. There is a strong presumption that a firm rated “Deficient-2” will be subject to a formal enforcement action by the Federal Reserve.

A firm rated “Deficient-2” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. The Federal Reserve would be unlikely to approve any proposal from a firm rated “Deficient-2” to engage in new or expansionary activities.

1060.0.3.2 Liquidity Risk Management and Positions Component Rating

The Liquidity Risk Management and Positions component rating evaluates (1) the effectiveness of a firm’s governance and risk-management processes used to determine the amount of liquidity necessary to cover risks and exposures, and to support activities through a range of conditions; and (2) the sufficiency of a firm’s liquidity positions to comply with applicable regulatory requirements and to support the firm’s ongoing obligations through a range of conditions.

In developing this rating, the Federal Reserve evaluates:

- **Liquidity Risk Management**: The extent to which a firm maintains sound liquidity-risk management practices through effective governance and oversight; effective risk management and controls; maintenance of updated liquidity policies and contingency plans for addressing potential shortfalls; and incorporation of appropriately stressful conditions into liquidity planning and projections of liquidity positions; and
- **Liquidity Positions**: The extent to which a firm’s liquidity is sufficient to comply with regulatory requirements, and to support its ability to meet current and prospective obligations to depositors, creditors and other counterparties through a range of conditions.

1060.0.3.2.1 Definitions for the Liquidity Risk Management and Positions Component Rating

**Broadly Meets Expectations**

A firm’s liquidity risk management and positions broadly meet supervisory expectations and support maintenance of safe-and-sound operations. Specifically:

- The firm is capable of producing sound assessments of liquidity adequacy through a range of conditions; and
- The firm’s current and projected liquidity positions comply with regulatory requirements, and support its ability to meet current and prospective obligations and to continue to serve as a financial intermediary through a range of conditions.

A firm rated “Broadly Meets Expectations” may be subject to identified supervisory issues requiring corrective action. However, these issues are unlikely to present a threat to the firm’s ability to maintain safe-and-sound operations through a range of potentially stressful conditions.

A firm that does not meet the liquidity risk management and position expectations associated with a “Broadly Meets Expectations” rating will be rated “Conditionally Meets Expectations,” “Deficient-1,” or “Deficient-2,” and subject to potential consequences as outlined below.
Certain material financial or operational weaknesses in a firm’s liquidity risk management or positions may place the firm’s prospects for remaining safe and sound through a range of conditions at risk if not resolved in a timely manner during the normal course of business.

Specifically, if left unresolved, these weaknesses:

- May threaten the firm’s ability to produce sound assessments of liquidity adequacy through a range of conditions; and/or
- May result in the firm’s projected liquidity positions being insufficient to comply with regulatory requirements, and support its ability to meet current and prospective obligations and to continue to serve as a financial intermediary through a range of conditions.

The Federal Reserve does not intend for a firm to be rated “Conditionally Meets Expectations” for a prolonged period. The firm has the ability to resolve these issues through measures that do not require a material change to the firm’s business model or financial profile, or its governance, risk management or internal control structures or practices. The Federal Reserve will work with the firm to develop an appropriate timeframe during which the firm would be required to resolve each supervisory issue leading to the “Conditionally Meets Expectations” rating.

The Federal Reserve will closely monitor the firm’s remediation and mitigation activities; in most instances, the firm will either:

1. Resolve the issues in a timely manner and, if no new material supervisory issues arise, and be upgraded to a “Broadly Meets Expectations” rating because the firm’s liquidity risk-management practices and related positions would broadly meet supervisory expectations; or
2. Fail to resolve the issues in a timely manner and be downgraded to a “Deficient-1” rating, because the firm’s inability to resolve those issues would indicate that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

It is possible that a firm may be close to completing resolution of the supervisory issues leading to the “Conditionally Meets Expectations” rating, but new issues are identified that, taken alone, would be consistent with a “Conditionally Meets Expectations” rating. In this event, the firm may continue to be rated “Conditionally Meets Expectations,” provided the new issues do not reflect a pattern of deeper or prolonged liquidity-risk management and positions weaknesses consistent with a “Deficient” rating.

A “Conditionally Meets Expectations” rating may be assigned to a firm that meets the above definition regardless of its prior rating. A firm previously rated “Deficient-1” may be upgraded to “Conditionally Meets Expectations” if the firm’s remediation and mitigation activities are sufficiently advanced so that the firm’s prospects for remaining safe and sound are no longer at significant risk, even if the firm has outstanding supervisory issues or is subject to an active enforcement action.

### Deficient-1

Financial or operational deficiencies in a firm’s liquidity risk management or positions put the firm’s prospects for remaining safe and sound through a range of conditions at significant risk. The firm is unable to remediate these deficiencies in the normal course of business, and remediation would typically require a material change to the firm’s business model or financial profile, or its liquidity risk-management practices.

Specifically, although the firm’s current condition is not considered to be materially threatened:

- Deficiencies in the firm’s liquidity risk-management processes are not effectively mitigated. These deficiencies limit the firm’s ability to effectively assess liquidity adequacy through a range of conditions; and/or
- The firm’s projected liquidity positions may be insufficient to support its ability to meet prospective obligations and serve as a financial intermediary through a range of conditions.

Supervisory issues that place the firm’s safety and soundness at significant risk, and where resolution is likely to require steps that clearly go beyond the normal course of business—such as issues requiring a material change to the firm’s business model or financial profile, or its governance, risk management or internal control structures or practices—would generally warrant assignment of a “Deficient-1” rating.
A “Deficient-1” rating may be assigned to a firm regardless of its prior rating. A firm previously rated “Broadly Meets Expectations” may be downgraded to “Deficient-1” when supervisory issues are identified that place the firm’s prospects for maintaining safe-and-sound operations through a range of potentially stressful conditions at significant risk. A firm previously rated “Conditionally Meets Expectations” may be downgraded to “Deficient-1” when the firm’s inability to resolve supervisory issues in a timely manner indicates that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

To address these financial or operational deficiencies, the firm is required to take timely corrective action to restore and maintain its liquidity risk management and positions consistent with supervisory expectations. There is a strong presumption that a firm rated “Deficient-1” will be subject to an informal or formal enforcement action by the Federal Reserve.

A firm rated “Deficient-1” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. A “Deficient-1” rating could be a barrier for a firm seeking Federal Reserve approval of a proposal to engage in new or expansionary activities, unless the firm can demonstrate that (1) it is making meaningful, sustained progress in resolving identified deficiencies and issues; (2) the proposed new or expansionary activities would not present a risk of exacerbating current deficiencies or issues or lead to new concerns; and (3) the proposed activities would not distract the firm from remediating current deficiencies or issues.

**Deficient-2**

Financial or operational deficiencies in a firm’s liquidity risk management or positions present a threat to the firm’s safety and soundness, or have already put the firm in an unsafe and unsound condition.

Specifically, as a result of these deficiencies:

- The firm’s liquidity risk-management processes are insufficient to effectively assess the firm’s liquidity adequacy through a range of conditions; and/or
- The firm’s current or projected liquidity positions are insufficient to support the firm’s ability to meet current and prospective obligations and serve as a financial intermediary through a range of conditions.

To address these deficiencies, the firm is required to immediately (1) implement comprehensive corrective measures sufficient to restore and maintain appropriate liquidity risk management capabilities and adequate liquidity positions; and (2) demonstrate the sufficiency, credibility, and readiness of contingency planning in the event of further deterioration of the firm’s financial or operational strength or resiliency. There is a strong presumption that a firm rated “Deficient-2” will be subject to a formal enforcement action by the Federal Reserve.

A firm rated “Deficient-2” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. The Federal Reserve would be unlikely to approve any proposal from a firm rated “Deficient-2” to engage in new or expansionary activities.

1060.0.3.3 Governance and Controls Component Rating

The Governance and Controls component rating evaluates the effectiveness of a firm’s (1) board of directors, (2) management of business lines and independent risk management and controls, and (3) recovery planning (for domestic LISCC firms only). This rating assesses a firm’s effectiveness in aligning strategic business objectives with the firm’s risk appetite and risk management capabilities; maintaining effective and independent risk management and control functions, including internal audit; promoting compliance with laws and regulations, including those related to consumer protection; and otherwise providing for the ongoing resiliency of the firm.

In developing this rating, the Federal Reserve evaluates:

- **Effectiveness of the Board of Directors:** The extent to which the board exhibits attributes that are consistent with those of effective boards in carrying out its core roles and responsibilities, including: (1) setting a clear, aligned, and consistent direction regarding the firm’s strategy and risk appetite; (2) directing senior management regarding the board’s information; (3) overseeing and holding senior management accountable; (4) supporting the independence and stature of independent risk
management and internal audit; and (5) maintaining a capable board composition and governance structure.

- **Management of Business Lines and Independent Risk Management and Controls**
  The extent to which:
  - Senior management effectively and prudently manages the day-to-day operations of the firm and provides for ongoing resilience; implements the firm’s strategy and risk appetite; maintains an effective risk-management framework and system of internal controls; and promotes prudent risk-taking behaviors and business practices, including compliance with laws and regulations, including those related to consumer protection.
  - Business line management executes business line activities consistent with the firm’s strategy and risk appetite; identifies and manages risks; and ensures an effective system of internal controls for its operations.
  - Independent risk management effectively evaluates whether the firm’s risk appetite appropriately captures material risks and is consistent with the firm’s risk management capacity; establishes and monitors risk limits that are consistent with the firm’s risk appetite; identifies and measures the firm’s risks; and aggregates, assesses and reports on the firm’s risk profile and positions. Additionally, the firm demonstrates that its internal controls are appropriate and tested for effectiveness. Finally, internal audit effectively and independently assesses the firm’s risk-management framework and internal control systems, and reports findings to senior management and the firm’s audit committee.
- **Recovery Planning (domestic LISCC firms only):** The extent to which recovery planning processes effectively identify options that provide a reasonable chance of a firm being able to remedy financial weakness and restore market confidence without extraordinary official sector support.

1060.0.3.3.1 Definitions for the Governance and Controls Component Rating

**Broadly Meets Expectations**

A firm’s governance and controls broadly meet supervisory expectations and support maintenance of safe-and-sound operations.

Specifically, the firm’s practices and capabilities are sufficient to align strategic business objectives with its risk appetite and risk-management capabilities, maintain effective and independent risk management and control functions, including internal audit; promote compliance with laws and regulations (including those related to consumer protection); and otherwise provide for the firm’s ongoing financial and operational resiliency through a range of conditions.

A firm rated “Broadly Meets Expectations” may be subject to identified supervisory issues requiring corrective action. However, these issues are unlikely to present a threat to the firm’s ability to maintain safe-and-sound operations through a range of potentially stressful conditions.

A firm that does not meet supervisory expectations associated with a “Broadly Meets Expectations” rating will be rated “Conditionally Meets Expectations,” “Deficient-1,” or “Deficient-2,” and subject to potential consequences, as outlined below.

**Conditionally Meets Expectations**

Certain material financial or operational weaknesses in a firm’s governance and controls practices may place the firm’s prospects for remaining safe and sound through a range of conditions at risk if not resolved in a timely manner during the normal course of business.

Specifically, if left unresolved, these weaknesses may threaten the firm’s ability to align strategic business objectives with the firm’s risk appetite and risk-management capabilities; maintain effective and independent risk management and control functions, including internal audit; promote compliance with laws and regulations (including those related to consumer protection); or otherwise provide for the firm’s ongoing resiliency through a range of conditions.

The Federal Reserve does not intend for a firm to be rated “Conditionally Meets Expectations” for a prolonged period. The firm has the ability to resolve these issues through measures that do not require a material change to the firm’s business model or financial profile, or its governance, risk management or internal controls.

12. References to risk-management capabilities includes risk management of business lines and independent risk management and control functions, including internal audit.
control structures or practices. The Federal Reserve will work with the firm to develop an appropriate timeframe during which the firm would be required to resolve each supervisory issue leading to the “Conditionally Meets Expectations” rating.

The Federal Reserve will closely monitor the firm’s remediation and mitigation activities; in most instances, the firm will either:

1. Resolve the issues in a timely manner and, if no new material supervisory issues arise, be upgraded to a “Broadly Meets Expectations” rating because the firm’s governance and controls would broadly meet supervisory expectations; or
2. Fail to resolve the issues in a timely manner and be downgraded to a “Deficient-1” rating, because the firm’s inability to resolve those issues would indicate that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

It is possible that a firm may be close to completing resolution of the supervisory issues leading to the “Conditionally Meets Expectations” rating, but new issues are identified that, taken alone, would be consistent with a “Conditionally Meets Expectations” rating. In this event, the firm may continue to be rated “Conditionally Meets Expectations,” provided the new issues do not reflect a pattern of deeper or prolonged governance and controls weaknesses consistent with a “Deficient” rating.

A “Conditionally Meets Expectations” rating may be assigned to a firm that meets the above definition regardless of its prior rating. A firm previously rated “Deficient” may be upgraded to “Conditionally Meets Expectations” if the firm’s remediation and mitigation activities are sufficiently advanced so that the firm’s prospects for remaining safe and sound are no longer at significant risk, even if the firm has outstanding supervisory issues or is subject to an active enforcement action.

**Deficient-1**

Financial or operational deficiencies in a firm’s governance and controls put the firm’s prospects for remaining safe and sound through a range of conditions at significant risk. The firm is unable to remediate these deficiencies in the normal course of business, and remediation would typically require a material change to the firm’s business model or financial profile, or its governance, risk management or internal control structures or practices.

Specifically, although the firm’s current condition is not considered to be materially threatened, these deficiencies limit the firm’s ability to align strategic business objectives with its risk appetite and risk-management capabilities; maintain effective and independent risk management and control functions, including internal audit; promote compliance with laws and regulations (including those related to consumer protection); or otherwise provide for the firm’s ongoing resiliency through a range of conditions.

A “Deficient-1” rating may be assigned to a firm regardless of its prior rating. A firm previously rated “Broadly Meets Expectations” may be downgraded to “Deficient-1” when supervisory issues are identified that place the firm’s prospects for maintaining safe-and-sound operations through a range of potentially stressful conditions at significant risk. A firm previously rated “Conditionally Meets Expectations” may be downgraded to “Deficient-1” when the firm’s inability to resolve supervisory issues in a timely manner indicates that the firm does not possess sufficient financial or operational capabilities to maintain its safety and soundness through a range of conditions.

To address these financial or operational deficiencies, the firm is required to take timely corrective action to restore and maintain its governance and controls consistent with supervisory expectations. There is a strong presumption that a firm rated “Deficient-1” will be subject to an informal or formal enforcement action by the Federal Reserve.

A firm rated “Deficient-1” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. A “Deficient-1” rating could be a barrier for a firm seeking Federal Reserve approval of a proposal to engage in new or expansionary activities, unless the firm can demonstrate that (1) it is making meaningful, sustained progress in resolving identified deficiencies and issues; (2) the proposed new or expansionary activities would not present a risk of exacerbating current deficiencies or issues or lead to new concerns; and (3) the proposed activities would not distract the firm from remediating current deficiencies or issues.
Deficient-2

Financial or operational deficiencies in governance or controls present a threat to the firm’s safety and soundness, or have already put the firm in an unsafe and unsound condition. Specifically, as a result of these deficiencies, the firm is unable to align strategic business objectives with its risk appetite and risk-management capabilities; maintain effective and independent risk management and control functions, including internal audit; promote compliance with laws and regulations (including those related to consumer protection); or otherwise provide for the firm’s ongoing resiliency. To address these deficiencies, the firm is required to immediately (1) implement comprehensive corrective measures sufficient to restore and maintain appropriate governance and control capabilities; and (2) demonstrate the sufficiency, credibility, and readiness of contingency planning in the event of further deterioration of the firm’s financial or operational strength or resiliency. There is a strong presumption that a firm rated “Deficient-2” will be subject to a formal enforcement action by the Federal Reserve.

A firm rated “Deficient-2” for any rating component would not be considered “well managed,” which would subject the firm to various consequences. The Federal Reserve would be unlikely to approve any proposal from a firm rated “Deficient-2” to engage in new or expansionary activities.

1060.0.4 COMMUNICATION OF RATINGS

In accordance with the Federal Reserve’s regulations governing confidential supervisory information, ratings assigned under the LFI rating system will be communicated by the Federal Reserve to the firm, but individual ratings are not disclosed publicly. The Federal Reserve will assign LFI ratings and communicate ratings to large firms on an annual basis and more frequently as warranted. Under the LFI rating system, the Federal Reserve will continue to rely to the fullest extent possible on the information and assessments developed by other relevant supervisors and functional regulators.
1062.0.1 RFI RATING SYSTEM

INTRODUCTION

Since 2004, the Federal Reserve has used the “RFI/C(D)” rating system (referred to as the “RFI rating system”) to communicate its supervisory assessment of bank holding companies (BHCs) regardless of their asset size, complexity, or systemic importance. In 2018, the Board adopted the RFI rating system for non-insurance and non-commercial savings and loan holding companies (SLHCs) with less than $100 billion in total consolidated assets. At the same time, the Board also adopted a rating system for BHCs and non-insurance and non-commercial savings and loan holding companies with total consolidated assets of $100 billion or more (referred to as the “LFI rating system”). As a result, the Federal Reserve has two frameworks for rating holding companies.

1062.0.2 RFI RATING SYSTEM

APPLICABILITY

The RFI rating system generally applies to BHCs and non-insurance and non-commercial savings and loan holding companies with less than $100 billion in total consolidated assets. Examination staff assign and communicate ratings to BHCs and non-insurance and non-commercial savings and loan holding companies with total consolidated assets between $10 billion and $100 billion on at least an annual basis, and more frequently as warranted. However, U.S. intermediate holding companies of foreign banking organizations (FBOs) established under the Board’s Regulation YY that have $50 billion or more in total consolidated assets are subject to the LFI rating system.

1. 69 Fed. Reg. 70,444 (December 6, 2004).
2. SLHCs that are excluded from the definition of “covered holding company” in section 217.2 of the Board’s Regulation Q receive indicative supervisory ratings. Section 271.2 excludes the following SLHCs: (1) SLHCs that derive 50 percent or more of their total consolidated assets or total revenues from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act of 1956, as amended (12 USC 1843(k)) (commercial SLHCs), and (2) SLHCs that are insurance companies or hold 25 percent or more of their total consolidated assets in subsidiaries that are insurance companies (insurance SLHCs).


The Dodd-Frank Wall Street Reform and Consumer Protection Act transferred to the Federal Reserve the supervisory functions of the Office of Thrift Supervision related to SLHCs and their nondepository subsidiaries beginning on July 21, 2011. At that time, the Federal Reserve decided to issue “indicative RFI ratings” to SLHCs until such time that a rating system was formally adopted for these companies.

In November 2018, the Federal Reserve adopted a final rule to apply the RFI rating system on a fully implemented basis to SLHCs with less than $100 billion in total consolidated assets, excluding SLHCs engaged in significant insurance or commercial activities. Therefore, starting on February 1, 2019, the Federal Reserve will assign an RFI rating to non-insurance and non-commercial SLHCs with less than $100 billion in total consolidated assets. Non-insurance and non-commercial SLHCs face similar risks and engage largely in the same activities as BHCs. As such, it is appropriate for the RFI rating system to apply to non-insurance and non-commercial SLHCs to ensure that they are subject to standards and supervisory programs that are consistent with those that apply to BHCs. Inspection frequency and scope guidance for non-insurance and non-commercial SLHCs with $10 billion or less in total consolidated assets are described in SR letter 13-21, “Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less.” Further, in November 2018, the Federal Reserve adopted the LFI rating system for non-insurance or non-commercial SLHCs with total consolidated assets of $100 billion or more.

The Federal Reserve will continue to assign an indicative RFI rating to SLHCs engaged in significant insurance or commercial activities, regardless of asset size. The Federal Reserve is in the process of reviewing whether a modified version of the RFI rating system, LFI rating system, or some other supervisory rating system is appropriate for these firms on a permanent basis.


1062.0.4 RFI RATING SYSTEM

The RFI rating system provides an assessment of certain risk management and financial condition factors that are common to holding companies, as well as an assessment of the potential impact of the parent holding company and its nondepository subsidiaries (collectively, nondepository entities) on the holding company’s subsidiary depository institutions. Under this system, the Federal Reserve endeavors to ensure that applicable BHCs, including financial holding companies, and non-insurance and noncommercial SLHCs are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on the holding companies that exhibit financial and operational weaknesses or adverse trends. The RFI rating system serves as a useful vehicle for identifying problem or deteriorating holding companies, as well as for categorizing holding companies with deficiencies in particular areas. Further, the RFI rating system assists the Federal Reserve in following safety-and-soundness trends and in assessing the aggregate strength and soundness of the financial industry.

Each holding company subject to the RFI rating system is assigned a composite rating (C) based on an overall evaluation and rating of its managerial and financial condition and an assessment of future potential risk to its subsidiary depository institution(s). The main components of the rating system represent: Risk Management (R); Financial Condition (F); and Impact (I) of the nondepository entities on the subsidiary depository institutions. While the Federal Reserve expects holding companies to act as a source of strength to their subsidiary depository institutions, the Impact rating focuses on downside risk—that is, on the likelihood of significant negative impact by the nondepository entities on the subsidiary depository institution(s). A fourth rating, Depository Institution(s) (D), will generally mirror the primary regulator’s assessment of the subsidiary depository institution(s). Thus, the primary component and composite ratings are displayed:

**RFI/C (D)**

In order to provide a consistent framework for assessing risk management, the R component is supported by four subcomponents that reflect the effectiveness of the organization’s risk management and controls. The subcomponents are Board and Senior Management Oversight; Policies, Procedures, and Limits; Risk Monitoring and Management Information Systems (MIS); and Internal Controls. The F component is also supported by four subcomponents reflecting an assessment of the quality of the consolidated organization’s Capital, Asset Quality, Earnings, and Liquidity.

Composite, component, and subcomponent ratings are assigned based on a 1 to 5 numeric scale. A 1 numeric rating indicates the highest rating, strongest performance and practices, and least degree of supervisory concern, whereas a 5 numeric rating indicates the lowest rating, weakest performance, and the highest degree of supervisory concern.

The sections that follow contain detailed descriptions of the composite, component, and subcomponent ratings; implementation guidance by holding company type; and definitions of the ratings.

1062.0.5 DESCRIPTION OF THE RFI RATING SYSTEM ELEMENTS

1062.0.5.1 The Composite (C) Rating

C is the overall composite assessment of the holding company as reflected by consolidated risk management, consolidated financial strength, and the potential impact of the nondepository entities on the subsidiary depository institutions. The composite rating encompasses both a forward-looking and static assessment of the consolidated organization, as well as an assessment of the relationship between the depository and nondepository entities. The C rating is not derived as a simple numeric average of the R, F, and I components; rather, it reflects examiner judgment with respect to the relative importance

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5. The information in this manual section largely conveys the information in the original 2004 RFI rating system document conveyed in 69 Fed. Reg. 70,444 (December 6, 2004). However, the information was revised to clarify the applicability of the rating system and to provide current references to regulations and guidance. The elements of the RFI rating system and the ratings’ definitions are unchanged. See SR letter 19-4, “Supervisory Rating System for Holding Companies with Total Consolidated Assets Less Than $100 billion.”

6. A simplified version of the rating system that includes only the R and C components will be applied to noncomplex holding companies with assets at or below $3 billion. See SR-13-21 for more information.

7. In 2004, this risk-management rating replaced the risk-management rating required for bank holding companies by SR letter 95-51, “Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies.”
of each component to the safe-and-sound operation of the holding company.

1062.0.5.2 The Risk Management (R) Component

R represents an evaluation of the ability of the holding company’s board of directors and senior management, as appropriate for their respective positions, to identify, measure, monitor, and control risk. The R rating underscores the importance of the control environment, taking into consideration the complexity of the organization and the risk inherent in its activities.

The R rating is supported by four subcomponents that are each assigned a separate rating. The four subcomponents are as follows: (1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. The subcomponents are evaluated in the context of the risks undertaken by and inherent in an organization and the overall level of complexity of the holding company’s operations. They provide the Federal Reserve System with a consistent framework for evaluating risk management and the control environment. Moreover, the subcomponents provide a clear structure and basis for discussion of the R rating with holding company management, reflect the principles in supervisory guidance that are familiar to examiners, and parallel the existing risk assessment process.

1062.0.5.2.1 Risk Management Subcomponents

Board and Senior Management Oversight

This subcomponent evaluates the adequacy and effectiveness of board and senior management’s understanding and management of risk inherent in the holding company’s activities, as well as the general capabilities of management. It also includes consideration of management’s ability to identify, understand, and control the risks undertaken by the institution, to hire competent staff, and to respond to changes in the institution’s risk profile or innovations in the banking sector.

Policies, Procedures, and Limits

This subcomponent evaluates the adequacy of a holding company’s policies, procedures, and limits given the risks inherent in the activities of the consolidated organization and its stated goals and objectives. This analysis will include consideration of the adequacy of the institution’s accounting and risk disclosure policies and procedures.

Risk Monitoring and Management Information Systems

This subcomponent assesses the adequacy of a holding company’s risk measurement and monitoring, and the adequacy of its management reports and information systems. This analysis will include a review of the assumptions, data, and procedures used to measure risk and the consistency of these tools with the level of complexity of the organization’s activities.

Internal Controls

This subcomponent evaluates the adequacy of a holding company’s internal controls and internal audit procedures, including the accuracy of financial reporting and disclosure and the strength and influence, within the organization, of the internal audit team. This analysis will also include a review of the independence of control areas from management and the consistency of the scope coverage of the internal audit team with the complexity of the organization.

1062.0.5.3 The Financial Condition (F) Component

F represents an evaluation of the consolidated organization’s financial strength. The F rating focuses on the ability of the holding company’s resources to support the level of risk associated with its activities. The F rating is supported by four subcomponents: capital (C), asset quality (A), earnings (E), and liquidity (L). The CAEL subcomponents can be evaluated along individual business lines, product lines, or on a
legal entity basis, depending on what is most appropriate given the structure of the organization. The assessment of the CAEL components should utilize benchmarks and metrics appropriate to the business activity being evaluated.

Examination staff should continue to review relevant market indicators, such as external debt ratings, credit spreads, debt and equity prices, and qualitative rating agency assessments as a source of information complementary to examination findings.

1062.0.5.3.1 Financial Condition Subcomponents (CAEL)

Capital Adequacy
C reflects the adequacy of an organization’s consolidated capital position, from a regulatory capital perspective and an economic capital perspective, as appropriate to the holding company. The evaluation of capital adequacy should consider the risk inherent in an organization’s activities and the ability of capital to absorb unanticipated losses, to provide a base for growth, and to support the level and composition of the parent company and subsidiaries’ debt.

Asset Quality
A reflects the quality of an organization’s consolidated assets. The evaluation should include, as appropriate, both on-balance sheet and off-balance sheet exposures, and the level of criticized and nonperforming assets. Forward-looking indicators of asset quality, such as the adequacy of underwriting standards, the level of concentration risk, the adequacy of credit administration policies and procedures, and the adequacy of management information systems for credit risk may also inform the Federal Reserve’s view of asset quality.

Earnings
E reflects the quality of consolidated earnings. The evaluation considers the level, trend, and sources of earnings, as well as the ability of earnings to augment capital as necessary, to provide ongoing support for a holding company’s activities.

Liquidity
L reflects the consolidated organization’s ability to attract and maintain the sources of funds necessary to support its operations and meet its obligations. The funding conditions for each of the material legal entities in the holding company structure should be evaluated to determine if any weaknesses exist that could affect the funding profile of the consolidated organization.

1062.0.5.4 The Impact (I) Component

Like the other components and subcomponents, the I component is rated on a five-point numerical scale. However, the descriptive definitions of the numerical ratings for I are different than those of the other components and subcomponents. The I ratings are defined as follows:

1—low likelihood of significant negative impact;
2—limited likelihood of significant negative impact;
3—moderate likelihood of significant negative impact;
4—considerable likelihood of significant negative impact; and
5—high likelihood of significant negative impact.

The I component is an assessment of the potential impact of the nondepository entities on the subsidiary depository institution(s). The I assessment will evaluate both the risk-management practices and financial condition of the nondepository entities—an analysis that will borrow heavily from the analysis conducted for the R and F components. Nondepository entities will be evaluated using benchmarks and analysis appropriate for those businesses. In addition, for functionally regulated nondepository subsidiaries, examination staff will continue to rely, to the extent possible, on the work of those functional regulators to assess the risk management practices and financial condition of those entities. In rating the I component, examination

10. The regulatory minimum capital ratios for covered holding companies subject to the Board’s Regulation Q (12 CFR part 217) are (1) a common equity tier 1 capital ratio of 4.5 percent; (2) a tier 1 capital ratio of 6 percent; (3) a total capital ratio of 8 percent; (4) a leverage ratio of 4 percent, and (5) for advanced approaches Board-regulated institutions, a supplementary leverage ratio of 3 percent.
staff is required to evaluate the degree to which current or potential issues within the nondepository entities present a threat to the safety and soundness of the subsidiary depository institution(s).

The I component focuses on the aggregate impact of the nondepository entities on the subsidiary depository institution(s). In this regard, the I rating does not include individual subcomponent ratings for the parent company and nondepository subsidiaries. An I rating is always assigned for each holding company; however, nonmaterial nondepository subsidiaries may be excluded from the I analysis at examiner discretion.\footnote{In general, nondepository subsidiaries should be included in the I analysis whenever their assets exceed 5\% of the holding company’s consolidated capital or $10 million, whichever is lower.}

Any risk-management and financial issues at the nondepository entities that potentially impact the safety and soundness of the subsidiary depository institution(s) should be identified in the written comments under the I rating. This approach is consistent with the Federal Reserve’s objective not to extend bank-like supervision to nondepository entities.

The analysis of the parent company for the purpose of assigning an I rating should emphasize weaknesses that could directly impact the risk-management or financial condition of the subsidiary depository institution(s). Similarly, the analysis of the nondepository subsidiaries for the purpose of assigning an I rating should emphasize weaknesses that could negatively impact the parent company’s relationship with its subsidiary depository institution(s) and weaknesses that could have a direct impact on the risk-management practices or financial condition of the subsidiary depository institution(s). The analysis under the I component should consider existing as well as potential issues and risks that may impact the subsidiary depository institution(s) now or in the future. Particular attention should be paid to the following risk-management and financial factors in assigning the I rating:

1062.0.5.4.1 Risk-Management Factors

- **Strategic Considerations:** The potential risks posed to the subsidiary depository institution(s) by the nondepository entities’ strategic plans for growth in existing activities and expansion into new products and services;
- **Operational Considerations:** The spillover impact on the subsidiary depository institution(s) from actual losses, a poor control environment, or an operational loss history in the nondepository entities;
- **Legal and Reputational Considerations:** The spillover effect on the subsidiary depository institution(s) of complaints and litigation that name one or more of the nondepository entities as defendants, or violations of laws or regulations, especially pertaining to intercompany transactions where the subsidiary depository institution(s) is involved; and
- **Concentration Considerations:** The potential risks posed to the subsidiary depository institution(s) by concentrations within the nondepository entities in business lines, geographic areas, industries, customers, or other factors.

1062.0.5.4.2 Financial Factors

- **Capital Distribution:** The distribution and transferability of capital across the legal entities;
- **Intra-Group Exposures:** The extent to which intra-group exposures, including servicing agreements, have the potential to undermine the condition of subsidiary depository institution(s); and
- **Parent Company Cash Flow and Leverage:** The extent to which the parent company is dependent on dividend payments, from both the nondepository subsidiaries and the subsidiary depository institution(s), to service debt and cover fixed charges. Also, the effect that these upstreamed cash flows have had, or can be expected to have, on the financial condition of the holding company’s nondepository subsidiaries and subsidiary depository institution(s).

1062.0.5.5 The Depository Institution(s) (D) Component

The (D) component will generally reflect the composite CAMELS rating assigned by the subsidiary depository institution’s primary supervisor. In a multi-depository institution holding company, the (D) rating will reflect a weighted average of the CAMELS composite ratings of the individual subsidiary depository institutions, weighted by both asset size and the relative importance of each depository institution within the holding company structure. In this regard, the CAMELS composite rating for a subsidiary...
depository institution that dominates the corporate culture may figure more prominently in the assignment of the (D) rating than would be dictated by asset size, particularly when problems exist within that depository institution.

The (D) component conveys important supervisory information, reflecting the primary supervisor’s assessment of the legal entity. The (D) component stands outside of the composite rating although significant risk-management and financial condition considerations at the depository institution level are incorporated in the consolidated R and F ratings, which are then factored into the C rating.

In the process of analyzing the financial condition and risk-management programs of the consolidated organization, a major difference of opinion regarding the safety and soundness of the subsidiary depository institution(s) emerges between the Federal Reserve and the depository institution’s primary regulator, then the (D) rating should reflect the Federal Reserve’s evaluation.

To highlight the presence of one or more problem depository institution(s) in a multi-depository institution holding company whose depository institution component, based on weighted averages, might not otherwise reveal their presence (i.e., depository institution ratings of 1, 2, or 3), a problem modifier, “P” would be attached to the depository institution rating (e.g., 1P, 2P, or 3P). Thus, 2P would indicate that, while on balance the depository subsidiaries are rated satisfactory, there exists a problem depository institution (composite 4 or 5) among the subsidiary depository institutions. The problem identifier is unnecessary when the depository institution component is rated 4 or 5.

1062.0.6 IMPLEMENTATION OF THE RFI RATING SYSTEM BY HOLDING COMPANY TYPE

Since 2004, the Federal Reserve has used the RFI rating system to communicate its supervisory assessment of BHCs regardless of their asset size, complexity, or systemic importance. In 2018, the Board adopted the RFI rating system for non-insurance and non-commercial SLHCs with less than $100 billion in total consolidated assets. The scope and frequency of inspections of holding companies under the RFI rating system will vary based upon whether a holding company has been determined to be “complex” or “noncomplex.” In addition, the resources dedicated to the inspection of each holding company will continue to be determined by the risk posed by the subsidiary depository institution(s) to the federal safety net and the risk posed by the holding company to the subsidiary depository institution(s).13

1062.0.6.1 Noncomplex Holding Companies with Assets of $3 Billion or Less (Shell Holding Companies) Rating: R and C

Examination staff will assign only an R and C rating for all noncomplex holding companies with assets under $3 billion.14 The R rating is the M rating from the subsidiary depository institution’s CAMELS rating. The C rating is the subsidiary depository institution’s composite CAMELS rating.

1062.0.6.2 Noncomplex Holding Companies with Assets Greater than $3 Billion

1062.0.6.2.1 One-Depository Institution Holding Company Rating: RFI/C(D)

For all noncomplex, one-depository institution holding companies with assets of greater than $3 billion, examination staff will assign all component and subcomponent ratings; however, examination staff should rely heavily on information and analysis contained in the primary regulator’s report of examination for the subsidiary depository institution to assign the R and F ratings. If examination staff have reviewed the primary regulator’s examination report and are

12. The determination of whether a holding company is “complex” versus “noncomplex” is made at least annually on a case-by-case basis taking into account and weighing a number of considerations, such as: the size and structure of the holding company; the extent of intercompany transactions between depository institution subsidiaries and the holding company or nondepository subsidiaries of the holding company; the nature and scale of any nondepository activities, including whether the activities are subject to review by another regulator and the extent to which the holding company is conducting Gramm-Leach-Bliley authorized activities (e.g., insurance, securities, merchant banking); whether risk-management processes for the holding company are consolidated; and whether the holding company has material debt outstanding to the public. Size is a less important determinant of complexity than many of the factors noted above.

13. The federal safety net includes the federal deposit insurance fund, the payments system, and the Federal Reserve’s discount window.

comfortable with the analysis and conclusions contained in that report, then the holding company ratings should be supported with concise language that indicates that the conclusions are based on the analysis of the primary regulator. No additional analysis will be required.

Please note, however, in cases where the analysis and conclusions of the primary regulator are insufficient to assign the ratings, the primary regulator should be contacted to ascertain whether additional analysis and support may be available. Further, if discussions with the primary regulator do not provide sufficient information to assign the ratings, discussions with holding company management may be warranted to obtain adequate information to assign the ratings. In most cases, additional information or support obtained through these steps will be sufficient to permit the assignment of the R and F ratings. To the extent that additional analysis is deemed necessary, the level of analysis and resources spent on this assessment should be in line with the level of risk the subsidiary depository institution poses to the federal safety net. In addition, any activities that involve information gathering with respect to the subsidiary depository institution should be coordinated with and, if possible, conducted by, the primary regulator of that institution.

Examination staff are required to make an independent assessment in order to assign the I rating, which provides an evaluation of the impact of the holding company on the subsidiary depository institution. Analysis for the I rating in non-complex one-depository institution holding companies should place particular emphasis on issues related to parent company cash flow and compliance with sections 23A and 23B of the Federal Reserve Act.

1062.0.6.2.2 Multi-Depository Institution Holding Company Rating: RFI/C(D)

For all noncomplex holding companies with assets of greater than $3 billion and more than one subsidiary depository institution, examination staff will assign all component and subcomponent ratings of the RFI rating system. Examiners should rely, to the extent possible, on the work conducted by the primary regulators of the subsidiary depository institutions to assign the R and F ratings. However, any risk management or other important functions conducted by the nondepository entities of the holding company, or conducted across legal entity lines, should be subject to review by Federal Reserve examination staff. These reviews should be conducted in coordination with the primary regulator(s). The assessment for the I rating requires an independent assessment by Federal Reserve examination staff.

1062.0.6.3 Complex Holding Companies Rating: RFI/C(D)

For complex holding companies, examination staff will assign all component and subcomponent ratings of the RFI rating system. The ratings analysis should be based on the primary and functional regulators’ assessment of the subsidiary entities, as well as on the examiners’ assessment of the consolidated organization as determined through off-site review and the holding company inspection process, as appropriate. The resources needed for the inspection and the level of support needed for developing a full rating will depend on the complexity of the organization, including structure and activities, and should be commensurate with the level of risk posed by the subsidiary depository institution(s) to the federal safety net and the level of risk posed by the holding company to the subsidiary depository institution(s).

1062.0.6.4 Nontraditional Holding Companies Rating: RFI/C(D)

Examination staff are required to assign the full-rating system for nontraditional holding companies. Nontraditional holding companies include holding companies in which most or all nondepository entities are regulated by a functional regulator and in which the subsidiary depository institution(s) are small in relation to the nondepository entities. The rating system is not intended to introduce significant additional work in the rating process for these organizations. As discussed above, the level of analysis conducted and resources needed to inspect the holding company and to assign the consolidated R and F ratings should be commensurate with the level of risk posed by the subsidiary depository insti-

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15. SLHCs that derive 50 percent or more of their total consolidated assets or total revenues from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act of 1956, as amended (12 USC 1843(k)) (commercial SLHCs), and SLHCs that are insurance companies or hold 25 percent or more of their total consolidated assets in subsidiaries that are insurance companies (insurance SLHCs) will receive an “indicative” RFI rating regardless of size.
tution(s) to the federal safety net and the level of risk posed by the holding company to the subsidiary depository institution(s). The report of examination by, and other information obtained from, the functional and primary bank regulators should provide the basis for the consolidated R and F ratings. On-site work, to the extent it involves areas that are the primary responsibility of the functional or primary depository institution(s) regulator, should be coordinated with and, if possible, conducted by, those regulators. Examination staff should concentrate their independent analysis for the R and F ratings around activities and risk management conducted by the parent company and nonfunctionally regulated nondepository subsidiaries, as well as around activities and risk management functions that are related to the subsidiary depository institution(s), for example, audit functions for the depository institution(s) and compliance with sections 23A and 23B.

Examination staff are required to make an independent assessment of the impact of the nondepository entities on the subsidiary depository institution(s) in order to assign the I rating.

1062.0.7 RATING DEFINITIONS FOR THE RFI/C(D) RATING SYSTEM

All component and subcomponent ratings are rated on a five-point numeric scale. With the exception of the I component, ratings will be assigned in ascending order of supervisory concern as follows:

1—Strong; 2—Satisfactory; 3—Fair; 4—Marginal; and 5—Unsatisfactory.

A description of the I component ratings can be found below in subsection 1062.0.7.4, “Impact Component.”

The component ratings are not derived as a simple numeric average of the subcomponent ratings; rather, weight afforded to each subcomponent in the overall component rating will depend on the severity of the condition of that subcomponent and the relative importance of that subcomponent to the consolidated organization. Similarly, some components may be given more weight than others in determining the composite rating, depending on the situation of the holding company. Assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the holding company, although generally the composite rating bears a close relationship to the component ratings assigned.

1062.0.7.1 Composite Rating

Rating 1 (Strong). Holding companies in this group are sound in almost every respect; any negative findings are basically of a minor nature and can be handled in a routine manner. Risk management practices and financial condition provide resistance to external economic and financial disturbances. Cash flow is more than adequate to service debt and other fixed obligations, and the nondepository entities pose little risk to the subsidiary depository institution(s).

Rating 2 (Satisfactory). Holding companies in this group are fundamentally sound but may have modest weaknesses in risk-management practices or financial condition. The weaknesses could develop into conditions of greater concern but are believed correctable in the normal course of business. As such, the supervisory response is limited. Cash flow is adequate to service obligations, and the nondepository entities are unlikely to have a significant negative impact on the subsidiary depository institution(s).

Rating 3 (Fair). Holding companies in this group exhibit a combination of weaknesses in risk-management practices and financial condition that range from fair to moderately severe. These companies are less resistant to the onset of adverse business conditions and would likely deteriorate if concerted action is not effective in correcting the areas of weakness. Consequently, these companies are vulnerable and require more than normal supervisory attention and financial surveillance. However, the risk management and financial capacity of the company, including the potential negative impact of the nondepository entities on the subsidiary depository institution(s), pose only a remote threat to its continued viability.

Rating 4 (Marginal). Holding companies in this group have an immoderate volume of risk management and financial weaknesses, which may pose a heightened risk of significant negative impact on the subsidiary depository institution(s). The holding company’s cash flow needs may be being met only by upstreaming imprudent dividends and/or fees from its subsidiaries. Unless prompt action is taken to correct these conditions, the organization’s future viability could be impaired. These companies require close supervisory attention and substantially increased financial surveillance.

Rating 5 (Unsatisfactory). The critical volume and character of the risk management and financial weaknesses of holding companies in
this category, and concerns about the nondepository entities negatively impacting the subsidiary depository institution(s), could lead to insolvency without urgent aid from shareholders or other sources. The imminent inability to prevent liquidity and/or capital depletion places the holding company’s continued viability in serious doubt. These companies require immediate corrective action and constant supervisory attention.

**1062.0.7.2 Risk-Management Component**

*Rating 1 (Strong).* A rating of 1 indicates that management effectively identifies and controls all major types of risk posed by the holding company’s activities. Management is fully prepared to address risks emanating from new products and changing market conditions. The board and management are forward-looking and active participants in managing risk. Management ensures that appropriate policies and limits exist and are understood, reviewed, and approved by the board. Policies and limits are supported by risk-monitoring procedures, reports, and management information systems that provide management and the board with the information and analysis that is necessary to make timely and appropriate decisions in response to changing conditions. Risk-management practices and the organization’s infrastructure are flexible and highly responsive to changing industry practices and current regulatory guidance. Staff has sufficient experience, expertise and depth to manage the risks assumed by the institution.

Internal controls and audit procedures are sufficiently comprehensive and appropriate to the size and activities of the institution. There are few noted exceptions to the institution’s established policies and procedures, and none are material. Management effectively and accurately monitors the condition of the institution consistent with the standards of safety and soundness, and in accordance with internal and supervisory policies and practices. Risk-management processes are fully effective in identifying, monitoring, and controlling the risks to the institution.

*Rating 2 (Satisfactory).* A rating of 2 indicates that the institution’s management of risk is largely effective, but lacking in some modest degree. Management demonstrates a responsiveness and ability to cope successfully with existing and foreseeable risks that may arise in carrying out the institution’s business plan. While the institution may have some minor risk-management weaknesses, these problems have been recognized and are in the process of being resolved. Overall, board and senior management oversight, policies and limits, risk monitoring procedures, reports, and management information systems are considered satisfactory and effective in maintaining a safe and sound institution. Risks are controlled in a manner that does not require more than normal supervisory attention.

The holding company’s risk-management practices and infrastructure are satisfactory and generally are adjusted appropriately in response to changing industry practices and current regulatory guidance. Staff experience, expertise and depth are generally appropriate to manage the risks assumed by the institution.

Internal controls may display modest weaknesses or deficiencies, but they are correctable in the normal course of business. The examiner may have recommendations for improvement, but the weaknesses noted should not have a significant effect on the safety and soundness of the institution.

*Rating 3 (Fair).* A rating of 3 signifies that risk-management practices are lacking in some important ways and, therefore, are a cause for more than normal supervisory attention. One or more of the four elements of sound risk management (active board and senior management oversight; adequate policies, procedures, and limits; adequate risk-management monitoring and management information systems; comprehensive internal controls) is considered less than acceptable, and has precluded the institution from fully addressing one or more significant risks to its operations. Certain risk-management practices are in need of improvement to ensure that management and the board are able to identify, monitor, and control all significant risks to the institution. Also, the risk-management structure may need to be improved in areas of significant business activity, or staff expertise may not be commensurate with the scope and complexity of business activities. In addition, management’s response to changing industry practices and regulatory guidance may need to improve.

The internal control system may be lacking in some important aspects, particularly as indicated by continued control exceptions or by a failure to adhere to written policies and procedures. The risk-management weaknesses could have adverse effects on the safety and soundness of the institution.

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ness of the institution if corrective action is not taken by management.

Rating 4 (Marginal). A rating of 4 represents deficient risk-management practices that fail to identify, monitor, and control significant risk exposures in many material respects. Generally, such a situation reflects a lack of adequate guidance and supervision by management and the board. One or more of the four elements of sound risk management is deficient and requires immediate and concerted corrective action by the board and management.

The institution may have serious identified weaknesses, such as an inadequate separation of duties, that require substantial improvement in internal control or accounting procedures, or improved adherence to supervisory standards or requirements. The risk-management deficiencies warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

Rating 5 (Unsatisfactory). A rating of 5 indicates a critical absence of effective risk-management practices with respect to the identification, monitoring, or control over significant risk exposures. One or more of the four elements of sound risk management is considered wholly deficient, and management and the board have not demonstrated the capability to address these deficiencies.

Internal controls are critically weak and, as such, could seriously jeopardize the continued viability of the institution. If not already evident, there is an immediate concern as to the reliability of accounting records and regulatory reports and the potential for losses if corrective measures are not taken immediately. Deficiencies in the institution’s risk-management procedures and internal controls require immediate and close supervisory attention.

1062.0.7.2.1 Risk Management Subcomponents

Board and Senior Management Oversight

Rating 1 (Strong). An assessment of “Strong” signifies that the board and senior management are forward-looking, fully understand the types of risk inherent in the holding company’s activities, and actively participate in managing those risks. The board has approved overall business strategies and significant policies, and ensures that senior management is fully capable of managing the activities that the holding company conducts. Consistent with the standards of safety and soundness, oversight of risk-management practices is strong and the organization’s overall business strategy is effective.

Senior management ensures that risk-management practices are rapidly adjusted in accordance with enhancements to industry practices and regulatory guidance, and exposure limits are adjusted as necessary to reflect the institution’s changing risk profile. Policies, limits, and tracking reports are appropriate, understood, and regularly reviewed.

Management provides effective supervision of the day-to-day activities of all officers and employees, including the supervision of the senior officers and the heads of business lines. It hires staff that possess experience and expertise consistent with the scope and complexity of the organization’s business activities. There is a sufficient depth of staff to ensure sound operations. Management ensures compliance with laws and regulations and that employees have the integrity, ethical values, and competence consistent with a prudent management philosophy and operating style.

Management responds appropriately to changes in the marketplace. It identifies all risks associated with new activities or products before they are launched, and ensures that the appropriate infrastructure and internal controls are established.

Rating 2 (Satisfactory). An assessment of “Satisfactory” indicates that board and senior management have an adequate understanding of the organization’s risk profile and provide largely effective oversight of risk-management practices. In this regard, the board has approved all major business strategies and significant policies, and ensures that senior management is capable of managing the activities that the holding company conducts. Oversight of risk-management practices is satisfactory and the organization’s overall business strategy is generally sound.

Senior management generally adjusts risk-management practices appropriately in accordance with enhancements to industry practices and regulatory guidance, and adjusts exposure limits as necessary to reflect the institution’s changing risk profile, although these practices may be lacking in some modest degree. Policies, limits, and tracking reports are generally appropriate, understood, and regularly reviewed, and the new product approval process adequately identifies the associated risks and nec-
Senior management’s day-to-day supervision of management and staff at all levels is generally effective. The level of staffing, and its experience, expertise, and depth, is sufficient to operate the business lines in a safe and sound manner. Minor weaknesses may exist in the staffing, infrastructure, and risk-management processes for individual business lines or products, but these weaknesses have been identified by management, are correctable in the normal course of business, and are in the process of being addressed. Weaknesses noted should not have a significant effect on the safety and soundness of the institution.

Rating 3 (Fair). An assessment of “Fair” signifies that board and senior management oversight is lacking in some important way and, therefore, is a cause for more than normal supervisory attention. The weaknesses may involve a broad range of activities or be material to a major business line or activity. Weaknesses in one or more aspect of board and senior management oversight have precluded the institution from fully addressing one or more significant risks to the institution. The deficiencies may include a lack of knowledge with respect to the organization’s risk profile, insufficient oversight of risk-management practices, ineffective policies or limits, inadequate or under-utilized management reporting, an inability to respond to industry enhancements and changes in regulatory guidance, or failure to execute appropriate business strategies. Staffing may not be adequate or staff may not possess the experience and expertise needed for the scope and complexity of the organization’s business activities. The day-to-day supervision of officer and staff activities, including the management of senior officers or heads of business lines, may be considerably lacking. These conditions warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

Rating 5 (Unsatisfactory). An assessment of “Unsatisfactory” indicates a critical absence of effective board and senior management oversight practices. Problems may include a severe lack of knowledge with respect to the organization’s risk profile, insufficient oversight of risk-management practices, wholly ineffective policies or limits, critically inadequate or under-utilized management reporting, a complete inability to respond to industry enhancements and changes in regulatory guidance, or failure to execute appropriate business strategies. Staffing may be inadequate, inexpert, and/or inadequately supervised. The deficiencies require immediate and close supervisory attention, as management and the board have not demonstrated the capability to address them. Weaknesses could seriously jeopardize the continued viability of the institution.

Policies, Procedures, and Limits

Rating 1 (Strong). An assessment of “Strong” indicates that the policies, procedures, and limits provide for effective identification, measurement, monitoring, and control of the risks posed by all significant activities, including lending, investing, trading, trust, and fiduciary activities. Policies, procedures, and limits are consistent with the institution’s goals and objectives and its overall financial strength. The policies clearly delineate accountability and lines of authority across the institution’s activities. The policies also provide for the review of new activities to ensure that the infrastructure necessary to identify, monitor, and control the associated risks is
in place before the activities are initiated.

**Rating 2 (Satisfactory).** An assessment of “Satisfactory” indicates that the policies, procedures, and limits cover all major business areas, are thorough and substantially up-to-date, and provide a clear delineation of accountability and lines of authority across the institution’s activities. Policies, procedures, and limits are generally consistent with the institution’s goals and objectives and its overall financial strength. Also, the policies provide for adequate due diligence before engaging in new activities or products. Any deficiencies or gaps that have been identified are minor in nature and in the process of being addressed. Weaknesses should not have a significant effect on the safety and soundness of the institution.

**Rating 3 (Fair).** An assessment of “Fair” signifies that deficiencies exist in policies, procedures, and limits that require more than normal supervisory attention. The deficiencies may involve a broad range of activities or be material to a major business line or activity. The deficiencies may include policies, procedures, or limits (or the lack thereof) that do not adequately identify, measure, monitor, or control the risks posed by significant activities; are not consistent with the experience of staff, the organization’s strategic goals and objectives, or the financial strength of the institution; or do not clearly delineate accountability or lines of authority. Also, the policies may not provide for adequate due diligence before engaging in new activities or products. Weaknesses noted could have adverse effects on the safety and soundness of the institution unless corrective action is taken by management.

**Rating 4 (Marginal).** An assessment of “Marginal” indicates deficient policies, procedures, and limits that do not address a number of significant risks to the institution. Multiple practices are in need of immediate improvement, which may include policies, procedures, or limits (or the lack thereof) that ineffectively identify, measure, monitor, or control the risks posed by significant activities; are not commensurate with the experience of staff, the institution’s strategic goals and objectives, or the financial strength of the institution; or do not delineate accountability or lines of authority. Moreover, policies may be considerably lacking with regards to providing for effective due diligence before engaging in new activities or products. These conditions warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

**Rating 5 (Unsatisfactory).** An assessment of “Unsatisfactory” indicates a critical absence of effective policies, procedures, and limits. Policies, procedures, or limits (or the lack thereof) are largely or entirely ineffective with regard to identifying, measuring, monitoring, or controlling the risks posed by significant activities; are completely inconsistent with the experience of staff, the organization’s strategic goals and objectives, or the financial strength of the institution; or do not delineate accountability or lines of authority. Also, policies may be completely lacking with regard to providing for effective due diligence before engaging in new activities or products. Critical weaknesses could seriously jeopardize the continued viability of the institution and require immediate and close supervisory attention.

### Risk Monitoring and MIS

**Rating 1 (Strong).** An assessment of “Strong” indicates that risk-monitoring practices and MIS reports address all material risks. The key assumptions, data sources, and procedures used in measuring and monitoring risk are appropriate, thoroughly documented, and frequently tested for reliability. Reports and other forms of communication are consistent with activities, are structured to monitor exposures and compliance with established limits, goals, or objectives, and compare actual versus expected performance when appropriate. Management and board reports are accurate and timely and contain sufficient information to identify adverse trends and to thoroughly evaluate the level of risk faced by the institution.

**Rating 2 (Satisfactory).** An assessment of “Satisfactory” indicates that risk-monitoring practices and MIS reports cover major risks and business areas, although they may be lacking in some modest degree. In general, the reports contain valid assumptions that are periodically tested for accuracy and reliability and are adequately documented and distributed to the appropriate decisionmakers. Reports and other forms of communication generally are consistent with activities; are structured to monitor exposures and compliance with established limits, goals, or objectives; and compare actual versus expected performance when appropriate. Management and board reports are generally accurate and timely, and broadly identify adverse trends and the level of risk faced by the institution. Any weaknesses or deficiencies that
have been identified are in the process of being addressed.

**Rating 3 (Fair).** An assessment of “Fair” signifies that weaknesses exist in the institution’s risk-monitoring practices or MIS reports that require more than normal supervisory attention. The weaknesses may involve a broad range of activities or be material to a major business line or activity. They may contribute to ineffective risk identification or monitoring through inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. In addition, MIS reports may not be distributed to the appropriate decisionmakers, adequately monitor significant risks, or properly identify adverse trends and the level of risk faced by the institution. Weaknesses noted could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

**Rating 4 (Marginal).** An assessment of “Marginal” represents deficient risk-monitoring practices or MIS reports that, unless properly addressed, could seriously affect the safety and soundness of the institution. A number of significant risks to the institution are not adequately monitored or reported. Ineffective risk identification may result from notably inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. In addition, MIS reports may not be distributed to the appropriate decisionmakers, may inadequately monitor significant risks, or fail to identify adverse trends and the level of risk faced by the institution. The risk monitoring and MIS deficiencies warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

**Rating 5 (Unsatisfactory).** An assessment of “Unsatisfactory” represents deficient risk-monitoring practices or MIS reports that, unless properly addressed, could seriously affect the safety and soundness of the institution. A number of significant risks to the institution are not adequately monitored or reported. Ineffective risk identification may result from notably inappropriate assumptions, incorrect data, poor documentation, or the lack of timely testing. Moreover, MIS reports may not be distributed to the appropriate decisionmakers, fail to monitor significant risks, or fail to identify adverse trends and the level of risk faced by the institution. These critical weaknesses require immediate and close supervisory attention, as they could seriously jeopardize the continued viability of the institution.

***Internal Controls***

**Rating 1 (Strong).** An assessment of “Strong” indicates that the system of internal controls is robust for the type and level of risks posed by the nature and scope of the organization’s activities. The organizational structure establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits, and wherever applicable, exceptions are noted and promptly investigated. Reporting lines provide clear independence of the control areas from the business lines and separation of duties throughout the organization. Robust procedures exist for ensuring compliance with applicable laws and regulations, including consumer laws and regulations. Financial, operational, and regulatory reports are reliable, accurate, and timely. Internal audit or other control review practices provide for independence and objectivity. Internal controls and information systems are thoroughly tested and reviewed; the coverage, procedures, findings, and responses to audits and review tests are well documented; identified material weaknesses are given thorough and timely high-level attention; and management’s actions to address material weaknesses are objectively reviewed and verified. The board or its audit committee regularly reviews the effectiveness of internal audits and other control review activities.

**Rating 2 (Satisfactory).** An assessment of “Satisfactory” indicates that the system of internal controls adequately covers major risks and business areas, with some modest weaknesses. In general, the control functions are independent from the business lines, and there is appropriate separation of duties. The control system supports accuracy in record-keeping practices and reporting systems, is adequately documented, and verifies compliance with laws and regulations, including consumer laws and regulations. Internal controls and information systems are adequately tested and reviewed, and the coverage, procedures, findings, and responses to audits and review tests are documented. Identified material weaknesses are given appropriate attention and management’s actions to address material weaknesses are objectively reviewed and verified. The board or its audit committee reviews the effectiveness of internal audits and other control review activities. Any weaknesses or deficiencies that have been identified are modest in nature and in the process of being addressed.

**Rating 3 (Fair).** An assessment of “Fair” signifies that weaknesses exist in the system of internal controls that require more than normal supervisory attention. The weaknesses may involve a broad range of activities or be material to a major business line or activity. The weak-
nesses may include insufficient oversight of internal controls and audit by the board or its audit committee; unclear or conflicting lines of authority and responsibility; a lack of independence between control areas and business activities; or ineffective separation of duties. The internal control system may produce inadequate or untimely risk coverage and verification, including monitoring compliance with both safety and soundness and consumer laws and regulations; inaccurate records or financial, operational, or regulatory reporting; a lack of documentation for work performed; or a lack of timeliness in management review and correction of identified weaknesses. Weaknesses noted could have adverse effects on the safety and soundness of the institution if corrective action is not taken by management.

**Rating 4 (Marginal).** An assessment of “Marginal” represents a deficient internal control system that does not adequately address a number of significant risks to the institution. The deficiencies may include neglect of internal controls and audit by the board or its audit committee; conflicting lines of authority and responsibility; a lack of independence between control areas and business activities; or no separation of duties in critical areas. The internal control system may produce inadequate, untimely, or nonexistent risk coverage and verification in certain areas, including monitoring compliance with both safety and soundness and consumer laws and regulations; inaccurate records or financial, operational, or regulatory reporting; a lack of documentation for work performed; or infrequent management review and correction of identified weaknesses. The internal control deficiencies warrant a high degree of supervisory attention because, unless properly addressed, they could seriously affect the safety and soundness of the institution.

**Rating 5 (Unsatisfactory).** An assessment of “Unsatisfactory” indicates a critical absence of an internal control system. There may be no oversight by the board or its audit committee; conflicting lines of authority and responsibility; no distinction between control areas and business activities; or no separation of duties. The internal control system may produce totally inadequate or untimely risk coverage and verification, including monitoring compliance with both safety and soundness and consumer laws and regulations; completely inaccurate records or regulatory reporting; a severe lack of documentation for work performed; or no management review and correction of identified weaknesses. Such deficiencies require immediate and close supervisory attention, as they could seriously jeopardize the continued viability of the institution.

### 1062.0.7.3 Financial Condition Component

**Rating 1 (Strong).** A rating of 1 indicates that the consolidated holding company is fundamentally financially sound, but may have modest weaknesses correctable in the normal course of business. The capital adequacy, asset quality, earnings, and liquidity of the consolidated holding company are adequate to protect the company from reasonably foreseeable external economic and financial disturbances. The company generates more than sufficient cash flow to service its debt and fixed obligations with no harm to subsidiaries of the organization.

**Rating 2 (Satisfactory).** A rating of 2 indicates that the consolidated holding company is generally fundamentally financially sound, but may have combinations of weaknesses ranging from fair to moderately severe. The company has less than adequate financial strength stemming from one or more of the following: modest capital deficiencies, substandard asset quality, weak earnings, or liquidity problems. As a result, the holding company and its subsidiaries are less resistant to adverse business conditions. The financial condition of the holding company will likely deteriorate if concerted action is not taken to correct areas of weakness. The company’s cash flow is sufficient to meet immediate obligations, but may not remain adequate if action is not taken to correct weaknesses. Consequently, the holding company is vulnerable and requires more than normal supervision. Overall financial strength and capacity are still such as to pose only a remote threat to the viability of the company.
Rating 4 (Marginal). A rating of 4 indicates that the consolidated holding company has either inadequate capital, an immoderate volume of problem assets, very weak earnings, serious liquidity issues, or a combination of factors that are less than satisfactory. An additional weakness may be that the holding company’s cash flow needs are met only by upstreaming imprudent dividends and/or fees from subsidiaries. Unless prompt action is taken to correct these conditions, they could impair future viability. Holding companies in this category require close supervisory attention and increased financial surveillance.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the volume and character of financial weaknesses of the holding company are so critical as to require urgent aid from shareholders or other sources to prevent insolvency. The imminent inability of such a company to service its fixed obligations and/or prevent capital depletion due to severe operating losses places its viability in serious doubt. Such companies require immediate corrective action and constant supervisory attention.

1062.0.7.3.1 The Financial Condition Subcomponents

The financial condition subcomponents can be evaluated along business lines, product lines, or legal entity lines—depending on which type of review is most appropriate for the holding company structure.

Capital Adequacy

Rating 1 (Strong). A rating of 1 indicates that the consolidated holding company maintains more than adequate capital to support the volume and risk characteristics of all parent and subsidiary business lines and products; provide a sufficient cushion to absorb unanticipated losses arising from the parent and subsidiary activities; and support the level and composition of parent and subsidiary borrowing. In addition, a company assigned a rating of 2 has sufficient capital to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries.

Rating 2 (Satisfactory). A rating of 2 indicates that the consolidated holding company maintains a sufficient capital position to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries. The capital position of the consolidated holding company could quickly become inadequate in the event of asset deterioration or other negative factors and therefore requires more than normal supervisory attention.

Rating 3 (Fair). A rating of 3 indicates that the consolidated holding company may not maintain sufficient capital to ensure support for the volume and risk characteristics of all parent and subsidiary business lines and products; the unanticipated losses arising from the parent and subsidiary activities; or the level and composition of parent and subsidiary borrowing. In addition, a company assigned a rating of 3 may not maintain a sufficient capital position to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries. The capital position of the consolidated holding company might evolve into weaknesses or conditions that could threaten the viability of the institution. The capital position of the consolidated holding company requires immediate supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the consolidated holding company is significantly below the amount needed to ensure support for the volume and risk characteristics of all parent and subsidiary business lines and products; the unanticipated losses arising from the parent and subsidiary activities; and the level and composition of parent and subsidiary borrowing. In addition, a company assigned a rating of 4 does not maintain a sufficient capital position to provide a base for the growth of risk assets and the entry into capital markets as the need arises for the parent company and subsidiaries. If left unchecked, the consolidated capital position of the company might evolve into weaknesses or conditions that could threaten the viability of the institution. The capital position of the consolidated holding company requires immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the level of capital of the consolidated holding company is critically deficient and in need of immediate corrective action. The consolidated capital position threatens the viability of the institution and requires constant supervisory attention.
Asset Quality

Rating 1 (Strong). A rating of 1 indicates that the holding company maintains strong asset quality across all parts of the organization, with a very low level of criticized and nonperforming assets. Credit risk across the organization is commensurate with management’s abilities and modest in relation to credit risk-management practices.

Rating 2 (Satisfactory). A rating of 2 indicates that the holding company maintains satisfactory asset quality across all parts of the organization, with a manageable level of criticized and nonperforming assets. Any identified weaknesses in asset quality are correctable in the normal course of business. Credit risk across the organization is commensurate with management’s abilities and generally modest in relation to credit risk-management practices.

Rating 3 (Fair). A rating of 3 indicates that the asset quality across all or a material part of the consolidated holding company is less than satisfactory. The holding company may be facing a decrease in the overall quality of assets currently maintained on and off balance sheet. The holding company may also be experiencing an increase in credit-risk exposure that has not been met with an appropriate improvement in risk-management practices. Holding companies assigned a rating of 3 require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the holding company’s asset quality is deficient. The level of problem assets and/or unmitigated credit risk subjects the holding company to potential losses that, if left unchecked, may threaten its viability. Holding companies assigned a rating of 4 require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the holding company’s asset quality is critically deficient and presents an imminent threat to the institution’s viability. Holding companies assigned a rating of 5 require immediate remedial action and constant supervisory attention.

Earnings

Rating 1 (Strong). A rating of 1 indicates that the quantity and quality of the holding company’s consolidated earnings over time are more than sufficient to make full provision for the absorption of losses and/or accretion of capital when due consideration is given to asset quality and holding company growth. Generally, holding companies with a 1 rating have earnings well above peer-group averages.

Rating 2 (Satisfactory). A rating of 2 indicates that the quantity and quality of the holding company’s consolidated earnings over time are generally adequate to make provision for the absorption of losses and/or accretion of capital in relation to company growth. The consolidated earnings of companies rated 3 may be further clouded by static or inconsistent earnings trends, chronically insufficient earnings, or less than satisfactory asset quality. Holding companies with a 3 rating generally have earnings below peer-group averages. Such holding companies require more than normal supervisory attention.

Rating 3 (Fair). A rating of 3 indicates that the holding company’s consolidated earnings are not fully adequate to make provisions for the absorption of losses and the accretion of capital in relation to company growth. The consolidated earnings of companies rated 3 may be further clouded by static or inconsistent earnings trends, chronically insufficient earnings, or less than satisfactory asset quality. Holding companies with a 3 rating generally have earnings below peer-group averages. Such holding companies require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the holding company’s consolidated earnings, while generally positive, are clearly not sufficient to make full provision for losses and the necessary accretion of capital. Holding companies with earnings rated 4 may be characterized by erratic fluctuations in net income, poor earnings (and the likelihood of the development of a further downward trend), intermittent losses, chronically depressed earnings, or a substantial drop from the previous year. The earnings of such companies are generally substantially below peer-group averages. Such holding companies require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the holding company is experiencing losses or a level of earnings that is worse than that described for the 4 rating. Such losses, if not reversed, represent a distinct threat to the holding company’s solvency through erosion of capital. Such holding companies require immediate and constant supervisory attention.

Liquidity

Rating 1 (Strong). A rating of 1 indicates that the holding company maintains strong liquidity levels and well-developed funds-management practices. The parent company and subsidiaries
have reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.

Rating 2 (Satisfactory). A rating of 2 indicates that the holding company maintains satisfactory liquidity levels and funds-management practices. The parent company and subsidiaries have access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses in funds-management practices may be evident, but those weaknesses are correctable in the normal course of business.

Rating 3 (Fair). A rating of 3 indicates that the holding company’s liquidity levels or funds-management practices are in need of improvement. Holding companies rated 3 may lack ready access to funds on reasonable terms or may evidence significant weaknesses in funds-management practices at the parent company or subsidiary levels. However, these deficiencies are considered correctable in the normal course of business. Such holding companies require more than normal supervisory attention.

Rating 4 (Marginal). A rating of 4 indicates that the holding company’s liquidity levels or funds-management practices are deficient. Institutions rated 4 may not have or be able to obtain a sufficient volume of funds on reasonable terms to meet liquidity needs at the parent company or subsidiary levels and require immediate supervisory attention.

Rating 5 (Unsatisfactory). A rating of 5 indicates that the holding company’s liquidity levels or funds-management practices are critically deficient and may threaten the continued viability of the institution. Institutions rated 5 require constant supervisory attention and immediate external financial assistance to meet maturing obligations or other liquidity needs.

1062.0.7.4 Impact Component

The I component rating reflects the aggregate potential impact of the nondepository entities on the subsidiary depository institution(s). It is rated on a five-point numerical scale. Ratings will be assigned in ascending order of supervisory concern as follows:

1—low likelihood of significant negative impact;
2—limited likelihood of significant negative impact;
3—moderate likelihood of significant negative impact;
4—considerable likelihood of significant negative impact; and
5—high likelihood of significant negative impact.

Rating 1 (Low Likelihood of Significant Negative Impact). A rating of 1 indicates that the nondepository entities of the holding company are highly unlikely to have a significant negative impact on the subsidiary depository institution(s) due to the sound financial condition of the nondepository entities, strong risk-management practices within the nondepository entities, or the corporate structure of the holding company. The holding company maintains adequate capital allocation across the organization commensurate with associated risks. Intragroup exposures, including servicing agreements, are unlikely to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow is sufficient and not dependent on excessive dividend payments from subsidiaries. The potential risks posed to the subsidiary depository institution(s) by strategic plans, the control environment, risk concentrations, or legal or reputational issues within or facing the nondepository entities are minor in nature and can be addressed in the normal course of business.

Rating 2 (Limited Likelihood of Significant Negative Impact). A rating of 2 indicates a limited likelihood that the nondepository entities of the holding company will have a significant negative impact on the subsidiary depository institution(s) due to the adequate financial condition of the nondepository entities, the satisfactory risk-management practices within the parent nondepository entities, or the corporate structure of the holding company. The holding company maintains adequate capital allocation across the organization commensurate with associated risks. Intragroup exposures, including servicing agreements, are unlikely to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow is satisfactory and generally does not require excessive dividend payments from subsidiaries. The potential risks posed to the subsidiary depository institution(s) by strategic plans, the control environment, risk concentrations, or legal or reputational issues within the nondepository entities are modest and can be addressed in the normal course of business.

Rating 3 (Moderate Likelihood of Significant Negative Impact). A rating of 3 indicates a moderate likelihood that the aggregate impact of
the nondepository entities of the holding company on the subsidiary depository institution(s) will have a significant negative impact on the subsidiary depository institution(s) due to weaknesses in the financial condition and/or risk management practices of the nondepository entities. The holding company may have only marginally sufficient allocation of capital across the organization to support risks. Intra-group exposures, including servicing agreements, may have the potential to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow may at times require excessive dividend payments from subsidiaries. Strategic growth plans, weaknesses in the control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose significant risks to the subsidiary depository institution(s). A holding company assigned a 3 impact rating requires more than normal supervisory attention, as there could be adverse effects on the safety and soundness of the subsidiary depository institution(s) if corrective action is not taken by management.

**Rating 4 (Considerable Likelihood of Significant Negative Impact).** A rating of 4 indicates that there is a considerable likelihood that the nondepository entities of the holding company will have a significant negative impact on the subsidiary depository institution(s) due to weaknesses in the financial condition and/or risk management practices of the nondepository entities. A 4-rated holding company may have insufficient capital within the nondepository entities to support their risks and activities. Intra-group exposures, including servicing agreements, may also have the immediate potential to undermine the financial condition of the subsidiary depository institution(s). Parent company cash flow may be dependent on excessive dividend payments from subsidiaries. Strategic growth plans, weaknesses in the control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose critical risks to the subsidiary depository institution(s). A holding company assigned a 4 impact rating requires immediate and close supervisory attention, as the nondepository entities seriously jeopardize the continued viability of the subsidiary depository institution(s).

**Rating 5 (High Likelihood of Significant Negative Impact).** A rating of 5 indicates a high likelihood that the aggregate impact of the nondepository entities of the holding company on the subsidiary depository institution(s) is or will become significantly negative due to substantial weaknesses in the financial condition and/or risk-management practices of the nondepository entities. Strategic growth plans, a deficient control environment, risk concentrations or legal or reputational issues within the nondepository entities may pose critical risks to the subsidiary depository institution(s). The parent company also may be unable to meet its obligations without excessive support from the subsidiary depository institution(s). The holding company requires immediate and close supervisory attention, as the nondepository entities seriously jeopardize the continued viability of the subsidiary depository institution(s).

1062.0.7.5 (D) Depository Institutions Component

The (D) component identifies the overall condition of the subsidiary depository institution(s) of the holding company. For holding companies with only one subsidiary depository institution, the (D) component rating generally will mirror the CAMELS composite rating for that depository institution. To arrive at a (D) component rating for holding companies with multiple subsidiary depository institutions, the CAMELS composite ratings for each of the depository institutions should be weighted, giving consideration to asset size and the relative importance of each depository institution within the overall structure of the organization. In general, it is expected that the resulting (D) component rating will reflect the lead depository institution’s CAMELS composite rating.

If in the process of analyzing the financial condition and risk-management programs of the consolidated organization, a major difference of opinion regarding the safety and soundness of the subsidiary depository institution(s) emerges between the Federal Reserve and the depository institution’s primary regulator, then the (D) rating should reflect the Federal Reserve’s evaluation.
Holding Company Ratings Applicability and Inspection Frequency

The purpose of this section is to provide an overview of the inspection scope and frequency expectations for bank holding companies (BHCs) and savings and loan holding companies (SLHCs) supervised by the Federal Reserve. The Federal Reserve utilizes two rating systems to assess these and other holding companies.

BHCs and non-insurance, non-commercial SLHCs with total consolidated assets of $100 billion or more generally are subject to the large financial institution (LFI) rating system. (See section 1060.0 of this manual.) U.S. intermediate holding companies of foreign banking organizations with combined U.S. assets of $50 billion or more established pursuant to the Federal Reserve’s Regulation YY are also subject to the LFI rating system.

BHCs and non-insurance and non-commercial SLHCs with less than $100 billion in total consolidated assets generally are subject to the RFI rating system. (See section 1062.0 of this manual.) However, noncomplex holding companies with less than $3 billion in total consolidated assets only receive the risk-management rating and composite rating from the RFI rating system.

BHCs exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956, as amended, as a result of any of the following exemptions, will not be subject to any required periodic inspection:

1. section 4(a)(2)—permanent grandfather rights
2. section 4(c)(i)—labor, agricultural, or horticultural organization
3. section 4(c)(ii)—85 percent family-owned
4. section 4(c)(12)—irrevocable declaration to cease to be a BHC
5. section 4(d)—hardship exemption

However, the Reserve Bank should continue to monitor the financial condition of such holding companies and should conduct inspections whenever there is any indication of a potential problem in a subsidiary bank.
1063.0.1 RATING SYSTEMS FOR HOLDING COMPANIES

<table>
<thead>
<tr>
<th>Type of holding company</th>
<th>Total consolidated asset size</th>
<th>LFI rating</th>
<th>RFI rating</th>
<th>Modified RFI rating¹</th>
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</thead>
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<td>Bank holding company</td>
<td>$100 billion or more</td>
<td>LFI rating</td>
<td>RFI rating</td>
<td>Modified RFI rating¹</td>
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<td>Between $10 billion and $100 billion</td>
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<td>Non-insurance and non-commercial savings and loan holding company</td>
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<td>RFI rating</td>
<td>Modified RFI rating¹</td>
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</tbody>
</table>

1. The Modified RFI rating includes a composite rating and risk-management rating to the holding company. See SR letter 13-21, “Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less.”

2. Savings and loan holding companies (SLHCs) are considered to be “insurance savings and loan holding companies” if they are either insurance companies or hold 25 percent or more of their total consolidated assets in subsidiaries that are insurance companies.

3. SLHCs are considered to be “commercial savings and loan holding companies” if they derive 50 percent or more of their total consolidated assets or total revenues from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act of 1956, as amended (12 USC 1843(k)).

4. U.S. intermediate holding companies of foreign banking organizations established under the Board’s Regulation YY that have $50 billion or more in total consolidated assets would be subject to the LFI rating system.

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*SR Supervision Manual* February 2020

Page 2
<table>
<thead>
<tr>
<th>Type of holding company</th>
<th>Total consolidated asset size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank holding company</td>
<td>$100 billion or more</td>
</tr>
<tr>
<td>Non-insurance and non-commercial savings and loan holding company</td>
<td>Between $10 billion and $100 billion</td>
</tr>
<tr>
<td>Insurance savings and loan holding company</td>
<td>Between $3 billion and $10 billion (complex)</td>
</tr>
<tr>
<td>Commercial savings and loan holding company</td>
<td>Less than $3 billion (non-complex)</td>
</tr>
<tr>
<td>Intermediate holding company</td>
<td>U.S. intermediate holding companies of foreign banking organizations established under the Board’s Regulation YY that have $50 billion or more in total consolidated assets are assigned an LFI rating on at least an annual basis, and more frequently as warranted.</td>
</tr>
</tbody>
</table>

Ratings (or indicative ratings) assigned and communicated to firms on at least an annual basis, and more frequently as warranted. See the below table and [SR letter 13-21](#), “Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less,” and its attachment for more information in inspection frequency and scope.

1. Bank holding companies exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956, as amended, are not subject to any required periodic inspection.
2. Savings and loan holding companies (SLHCs) are considered to be “insurance savings and loan holding companies” if they are either insurance companies or hold 25 percent or more of their total consolidated assets in subsidiaries that are insurance companies.
3. SLHCs are considered to be “commercial savings and loan holding companies” if they derive 50 percent or more of their total consolidated assets or total revenues from activities that are not financial in nature under section 4(k) of the Bank Holding Company Act of 1956, as amended (12 USC 1843(k)).
## 1063.0.3 Small Holding Company Inspection Scope and Frequency

<table>
<thead>
<tr>
<th>Asset size</th>
<th>Complex $3–$10 billion</th>
<th>Noncomplex $3–$10 billion</th>
<th>Complex Less than $3 billion</th>
<th>Noncomplex Less than $3 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of rating</strong></td>
<td>Complete RFI rating</td>
<td>Complete RFI rating</td>
<td>Complete RFI rating</td>
<td>Risk-management rating and composite rating only</td>
</tr>
<tr>
<td><strong>Scope and frequency</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rating of 1 or 2</td>
<td>Full scope on-site inspection is required annually. Additional targeted follow-up may be needed in response to off-site surveillance program results.</td>
<td>Off-site targeted inspection is required every two years. Additional targeted follow-up may be needed in response to off-site surveillance program results.</td>
<td>Off-site review should be conducted upon receipt of the lead DI exam report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a complete RFI rating, the Reserve Bank should conduct an on-site review of the company. Any on-site review should be targeted at those areas where additional information or analysis is needed to assign a complete supervisory rating.</td>
<td>If all subsidiary DIs have a management component rating and a composite supervisory rating of “1” or “2” and no material holding company issues are otherwise indicated, the Reserve Bank should assign only a composite rating and risk-management rating to the holding company based on the ratings of the lead DI.</td>
</tr>
<tr>
<td>Rating of 3, 4, or 5</td>
<td>Full scope on-site inspection is required annually. If the primary supervisor has conducted an interim examination or changed the rating at the lead depository institution (DI), the Reserve Bank should conduct an additional targeted inspection and update the rating if necessary. The targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead DI. Additional targeted follow-up may be needed in response to off-site surveillance program results.</td>
<td>Full-scope off-site inspection is required annually. If the primary supervisor has conducted an interim examination or changed the rating at the lead DI, the Reserve Bank staff should conduct an additional targeted inspection and update the rating if necessary. This targeted inspection may be conducted off-site and should start within 60 days of receiving the examination report for the lead DI. Additional targeted follow-up may be needed in response to off-site surveillance program results.</td>
<td>On-site review is required upon receipt of the lead DI exam report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a complete RFI rating, the Reserve Bank should conduct an on-site review of the company.</td>
<td>If one or more subsidiary DIs have a management component rating or a composite supervisory rating of “3,” “4,” or “5” or a material holding company issue is otherwise indicated, an off-site review is required upon receipt of the lead DI exam report or an updated rating from the primary supervisor using surveillance results and relevant supervisory and financial information. If the information obtained off-site is not sufficient for the Reserve Bank to determine the overall condition of the company and to assign a risk-management rating and a composite rating, contact the holding company to obtain more information.</td>
</tr>
</tbody>
</table>

### Reports

- **Rating of 1, 2, or 3**
  - A letter-format report template has been developed for supervision staff completing reports for holding companies that receive a complete RFI rating and have a composite rating of 1, 2, or 3.

- **Rating of 4 or 5**
  - Letter-format report of inspection may be prepared as indicated in SR-13-10, “Format for Safety-and-Soundness Reports of Examination and Inspection for Community State Member Banks and Holding Companies Rated Composite ‘4’ or ‘5.’”

1. Full-scope inspection covers all areas of interest to the Federal Reserve in depth; targeted inspections will focus intensely on one or two activities.
2. Complexity factors include the size and structure of the company; the extent of intercompany transactions between insured depository institution subsidiaries and the holding company or uninsured subsidiaries of the holding company; the risk, scale and complexity of activities of any nondepository subsidiaries; and the degree of leverage at the holding company, including the extent of its debt outstanding to the public. Other factors are also noted in the text of SR-13-21.
Nondisclosure of Supervisory Ratings and Confidential Supervisory Information

Section 1065.0

1065.0.1 LIMITED DISCLOSURE OF CONFIDENTIAL COMPOSITE AND COMPONENT RATINGS IN INSPECTIONS AND EXAMINATIONS

The Federal Reserve provides senior management and directors of supervised financial institutions the numeric and alphabetic component ratings assigned under various supervisory rating systems. See SR-96-26, “Provision of Individual Components of Supervisory Rating Systems to Management and Boards of Directors.”

This disclosure includes the ratings assigned to management under the holding company rating systems.

Depending upon the size and complexity of the organization, the disclosure of the rating and its components is made to the holding company in writing through formal examination or inspection reports, reports summarizing the results of targeted reviews, a roll-up of those reviews into a comprehensive report, any other supervisory communication, or some combination thereof. In conjunction with disclosing the ratings and their components to a holding company, examiners or supervisory officials should clearly explain what the ratings mean to the board of directors and management. During the exit meeting, the examiner should discuss key overall inspection findings, including preliminary composite and component numeric ratings.

In disclosing the assigned ratings, the examiner-in-charge should remind the board of directors and management that the ratings are part of the findings of the inspection or supervisory activity and are privileged and confidential under applicable law. When examiners change a firm’s ratings, examiners need to inform the firm’s board of directors and management about the rating change. Examiners should not disclose ratings to the holding company’s directors and management until preliminary approval has been received from the appropriate senior Reserve Bank supervisory officials.

1065.0.2 CONFIDENTIALITY OF THE SUPERVISORY RATING AND OTHER NONPUBLIC SUPERVISORY INFORMATION

The holding company inspection report and other supervisory communications constitute or contain the Board’s confidential supervisory information (CSI), which is nonpublic information belonging to the Board. The Board’s Rules Regarding Availability of Information specifically provide that, except in very limited circumstances, supervised financial institutions may not disclose CSI outside of the financial institution, including inspection or examination findings, nor make any representations concerning an examination or inspection report or the report’s findings, without the prior written permission of the Board. Any person who discloses or uses CSI except as expressly permitted by the appropriate federal banking agency or as provided by the agency’s regulations may be subject to the criminal penalties provided in 18 USC 641.

The legal prohibition on the release of CSI applies to all financial institutions examined by the agencies, including bank and savings and loan holding companies, Edge corporations, and the U.S. branches or agencies of foreign banking organizations that receive confidential supervisory ratings, including the LFI rating, ROCA rating, and CAMEO rating. As

1. The supervisory ratings are disclosed for the following rating systems:
   • CAMELS (state member banks)
   • RFI/C(D) and Large Financial Institution (LFI) rating system (bank holding companies, and savings and loan holding companies)
   • CAMEO (Edge and agreement corporations and overseas subsidiaries of U.S. banks)
   • ROCA (U.S. branches and agencies of foreign banking organizations)
   • Uniform Interagency Trust Rating System (UITRS)
   • The interagency Uniform Rating System for Information Technology (URSIT)


3. The inspection report should also include appropriate language stating that the findings of the inspection are privileged and confidential under applicable law.

4. See, e.g., 12 CFR 261.2(c)(1), 261.20(t), and 261.22(c).

5. 12 CFR part 261, subpart C. The regulation authorizes supervised financial institutions to disclose CSI to their directors, officers, and employees and to the directors, officers, and employees of their parent holding companies. 12 CFR 261.20(b)(1). In addition, institutions may also disclose CSI to their outside counsel and auditors on the premises of the institution. 12 CFR 261.20(b)(2).

6. RFI/C(D), LFI, ROCA, and CAMEO ratings are assigned by the Federal Reserve Board as a result of an examination or inspection. For noncomplex holding companies with assets of $3 billion or less, only risk-management and composite ratings are assigned. ROCA ratings are assigned to the U.S. branches, agencies, and commercial lending companies of foreign banking organizations. The ROCA rating components are risk management, operational controls, compliance,
with the CAMELS rating, examiners communicate these ratings to the regulated institutions in reports or other supervisory communications, which are the property of the Board.

Financial institutions that receive requests for confidential supervisory ratings should refer all requesters to the following publicly available information in lieu of disclosing any CSI, including the CAMELS rating:

- for banks and savings associations, an institution’s quarterly reports of condition (Call Reports) (see 12 USC 1817)
- for holding companies or foreign banks with U.S. operations, an institution’s quarterly and annual FR Y or H-(b)11 reports (see 12 USC 1844, 3106, 3108, 601–604a, and 611–631)
- for national banks, the annual disclosure statement (see 12 CFR 18.3)
- for banks, an institution’s Uniform Bank Performance Report (UBPR), which is available to all interested parties at www.ffiec.gov and is designed for summary and in-depth analysis of banks;
- an institution’s publicly available filings, if any, filed with the appropriate federal banking agency (15 USC 78(I)(i)) or with the U.S. Securities and Exchange Commission
- any reports or ratings on the institution compiled by private companies that track the performance of financial institutions
- any reports or ratings issued by private rating services on public debt issued by an institution
- any publicly available cease-and-desist order or enforcement proceeding against an institution
- any reports or sources of information on institution performance or internal matters created by the institution that do not contain information prohibited from release by law or regulation

and asset quality. CAMEO ratings are assigned to Edge corporations and the overseas branches and subsidiaries of U.S. banks. The CAMEO ratings components are capital, asset quality, management, earnings, and operations and internal controls.


8. Significantly, Board staff has taken the position that identification of information requested by, or provided to, supervisory staff—including the fact that an inspection has taken or will take place—is related to an inspection and falls within the definition of CSI. Accordingly, it is contrary to Federal Reserve regulation and policy for agreements between a banking organization and its counterparties (for example, mutual funds, hedge funds, and other trading counterparties) or other third parties to contain confidentiality provisions that

1. restrict the banking organization from providing information to Federal Reserve supervisory staff;
2. require or permit, without the prior approval of the Federal Reserve, the banking organization to disclose to a counterparty that any information will be or was provided to Federal Reserve supervisory staff; or
3. require or permit, without the prior approval of the Federal Reserve, the banking organization to inform a counterparty of a current or upcoming Federal Reserve inspection or any nonpublic Federal Reserve supervisory initiative or action.

Banking organizations that have entered into agreements containing such confidentiality provisions are subject to legal risk. (See SR-07-19, “Confidentiality Provisions in Third-Party Agreements,” and SR-97-17, “Access to Books and Records of Financial Institutions During Examinations and Inspections.”)
1070.1.1 INTRODUCTION

This section on the communication of supervisory findings is based on the guidance in SR-13-13/CA-13-10, “Supervisory Considerations for the Communication of Supervisory Findings,” which applies to all Federal Reserve-supervised banking organizations. In a supervisory finding, examiners should convey, if evident, both the root cause of the finding and the potential effect of the finding on the organization. Examiners should also consider the guidance in SR-18-5/CA-18-7, “Interagency Statement Clarifying the Role of Supervisory Guidance,” for more information on communication of supervisory findings, including the appropriate identification of unsafe or unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation.

1070.1.2 COMMUNICATION OF SUPERVISORY FINDINGS

Communication of supervisory findings to the organization’s board of directors is an important part of the supervision of a banking organization. While the board itself may not directly undertake the work to remediate supervisory findings as senior management is responsible for the organization’s day-to-day operations, it is nevertheless important that the board be made aware of significant supervisory issues and ultimately be accountable for the safety and soundness and assurance of compliance with applicable laws and regulations of the organization.

Depending upon the size and complexity of the organization, supervisory findings are communicated in writing through formal examination or inspection reports, reports summarizing the results of targeted reviews, a roll-up of those reviews into a comprehensive report, any other supervisory communication, or some combination thereof. These written communications (referred to collectively as “reports” in this section) are generally directed to the board of directors, or an executive-level committee of the board as appropriate. In turn, the board of directors (or executive-level committee of the board) typically will direct the organization’s management to take corrective action and will provide management with appropriate oversight, including approvals of proposed management actions as necessary.

To be effective, the communication of supervisory findings must be (1) written in clear and concise language, (2) prioritized based upon degree of importance, and (3) focused on any significant matters that require attention. Reserve Banks must formally communicate matters requiring immediate attention (MRIAs) and matters requiring attention (MRAs) resulting from any supervisory activity to the organization in these written reports. In order to promote an understanding of these terms, examiners should include definitions of MRIAs and MRAs in all supervisory documents communicating supervisory findings. When included in a safety-and-soundness examination or inspection report, MRIAs and MRAs should be listed in the “Matters Requiring Attention” section. In the case of findings from consumer compliance examinations, MRIAs and MRAs should be reflected in the “Executive Summary and Examination Ratings” section of the consumer affairs report of examination. Only outstanding MRIAs and MRAs are required to be discussed in the report; however, examiners have discretion to discuss closed MRIAs and MRAs in the report if such discussion would be meaningful.

For large banking organizations, an annual roll-up report summarizes the significant findings, based on outstanding MRIAs or MRAs, included in the reports of targeted reviews or other supervisory activities conducted during the supervisory cycle. These findings may be grouped by major supervisory issues, rating components, risks, or themes. This information should enable the banking organization’s board of directors and any executive-level committee of the board to understand the substance and status of outstanding MRIAs or MRAs and focus their attention on the most critical and time-sensitive issues.

Communications to banking organizations concerning safety-and-soundness or consumer compliance MRIAs or MRAs must specify a time-frame for corrective action. The board of directors (or its executive-level committee) should be provided with a detailed plan for corrective action, a timeline, and any necessary approvals.

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1. An executive-level committee of the board (such as, the audit committee or risk committee) typically meets regularly, keeps minutes of those meetings, and is accountable to and routinely reports to the board of directors.

2. In a safety-and-soundness report, these definitions could be included on the “Scope” page, in an appendix, or as a footnote on the “Matters Requiring Attention” section. In a consumer compliance report, these definitions could be included on the “Executive Summary and Examination Ratings” section.
frame within which the banking organization must complete the corrective actions. In certain circumstances, examiners may require the banking organization to submit an action plan that identifies remedial actions to be completed within specified timeframes. Action plans with intermediate- and long-term timeframes that span more than one supervisory or examination cycle with regard to safety-and-soundness matters, or a 12-month period with regard to consumer compliance issues, should include interim progress targets. Both safety-and-soundness and consumer protection or compliance considerations will remain a priority in determining whether the organization’s timeframes to correct the matter are reasonable.

1070.1.2.1 Matters Requiring Immediate Attention

MRIAs arising from an examination, inspection, or any other supervisory activity are matters of significant importance and urgency that the Federal Reserve requires banking organizations to address immediately and include (1) matters that have the potential to pose significant risk to the safety and soundness of the banking organization; (2) matters that represent significant non-compliance with applicable laws or regulations; (3) repeat criticisms that have escalated in importance due to insufficient attention or inaction by the banking organization; and (4) in the case of consumer compliance examinations, matters that have the potential to cause significant consumer harm. An MRIA will remain an open issue until resolution and examiners confirm the banking organization’s corrective actions.

Required language. Federal Reserve examiners are expected to use the following standardized language to communicate MRIAs to the board of directors (or executive-level committee of the board):

“The board of directors (or executive-level committee of the board), or banking organization is required to immediately...”

Timeframe. The expected timeframe for a banking organization to address MRIAs is generally short, and may be “immediate,” in the case of heightened safety-and-soundness or consumer compliance risk. For MRIAs that are necessary to preserve or restore the viability of a banking organization, the timeframe should take into account any potential losses to the Federal Deposit Insurance Corporation’s Deposit Insurance Fund, including the possibility that a delay in action will increase the potential for loss or the cost of resolution.

Organization response. Following its review of MRIAs discussed in the report, the banking organization’s board of directors is required to respond to the Reserve Bank in writing regarding corrective action taken or planned along with a commitment to corresponding timeframes.

Supervisory follow-up. The Reserve Bank must follow up on MRIAs to assess progress and verify satisfactory completion. The timeframe for follow-up should correspond with the timeframe specified for the action being required, and should be appropriate for the severity of the matter requiring the corrective action. The means of follow-up may vary depending upon the nature and severity of the matter requiring the action. Follow-up may take the form of a subsequent examination, a targeted review, or any other supervisory activity deemed suitable for evaluating the issue at hand.

In some cases, when follow-up indicates the organization’s corrective action has not been satisfactory, the initiation of additional formal or informal investigation or enforcement action may be necessary. In such cases, examiners should consult with enforcement staff.3 In all instances, examiners are expected to exercise judgment as to the supervisory activities best suited for evaluating a particular issue. Once follow-up is completed, examiners are expected to clearly and fully document the rationale for their decision to close any issue. Examiners are also expected to communicate in writing the results of their work and findings to the banking organization.

1070.1.2.2 Matters Requiring Attention

MRAs constitute matters that are important and that the Federal Reserve is expecting a banking organization to address over a reasonable period of time but when the timing need not be “immediate.” While issues giving rise to MRAs must be addressed to ensure the banking organization

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3. Such consultation should be made in accordance with existing guidance to Reserve Bank supervisory staff on the processing of enforcement actions, which provides that recommendations concerning formal enforcement actions should be submitted to the Board’s Legal Division.
operates in a safe and sound and compliant manner, the threat to safety and soundness is less immediate than with issues giving rise to MRIAs. Likewise, consumer compliance concerns that require less immediate resolution should be communicated as an MRA. An MRA typically will remain an open issue until resolution and confirmation by examiners that the banking organization has taken corrective action. If a banking organization does not adequately address an MRA in a timely manner, examiners may elevate an MRA to an MRIA. Similarly, a change in circumstances, environment, or strategy can also lead to an MRA becoming an MRIA. The key distinction between MRIAs and MRAs is the nature and severity of matters requiring corrective action as well as the immediacy with which the banking organization must begin and complete corrective actions.

Required language. Federal Reserve examiners are expected to use the following standardized language to communicate MRAs to the board of directors (or executive-level committee of the board):

“The board of directors (or executive-level committee of the board), or banking organization is required to...”

Timeframe. Communications to banking organizations about MRAs must specify a timeframe within which the corrective action is expected to be completed. The timeframe, at least initially, may require estimation because the banking organization may first need to complete preliminary planning to establish the timeframe for initiating and completing the corrective action. The timeframes for MRAs are likely to become more precise over time as planning evolves and circumstances make the completion of the MRAs more urgent. Timeframes that span more than one examination cycle for safety-and-soundness issues or that exceed 12 months for consumer compliance issues should include appropriate interim progress reports.

Organization response. Following its review of the report, the banking organization’s board of directors is required to provide a written response to the Reserve Bank regarding its plan, progress, and resolution of the MRA.

Supervisory follow-up. The Reserve Bank must follow-up on MRAs to assess progress and verify satisfactory completion. The timeframe for follow-up should correspond with the timeframe during which actions are to be completed. For intermediate- or long-term corrective actions for MRAs, Reserve Bank follow-up may consist of assessing the organization’s progress to address the MRAs, whether satisfactory or unsatisfactory, and noting whether the initial estimated timeframe continues to be reasonable or warrants adjustment.

The means of supervisory follow-up may vary based upon the nature and severity of the matter for which corrective action is expected. Follow-up may take the form of a subsequent examination, targeted review, continuous monitoring, reliance on validation work conducted by internal audit function, reliance on the results of examinations conducted by other supervisors, or any other supervisory activity deemed suitable for evaluating the issue at hand.4

In some cases, when follow-up indicates the organization’s corrective action has not been satisfactory, the initiation of additional formal or informal investigation or enforcement action may be necessary. In all instances, examiners are expected to exercise judgment regarding the supervisory activities best suited for evaluating a particular issue. Once follow-up is complete, examiners are expected to clearly and fully document the rationale for their decision to close any issue. Examiners also are expected to communicate in writing the results of their work and findings to the organization.

1070.1.2.3 Supervisory Considerations

The volume of MRIAs and MRAs should be one of the many considerations in assigning a supervisory rating to a banking organization. The presence of a large number of MRIAs or MRAs may indicate that additional formal or informal investigation may be necessary or that the initiation of a formal or informal enforcement action may be warranted.

Irrespective of the number of MRIAs or MRAs, in some cases, additional formal or informal investigation may be necessary or the initiation of a formal or informal enforcement

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4. Examiners may choose to rely on the work of internal audit when internal audit’s overall function and related processes are effective, as discussed in SR-13-1/CA-13-1, “Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing.” (See this manual’s section entitled “Internal Control and Audit Function, Oversight, and Outsourcing.”) When relying on internal audit to follow up on MRAs, examiners are expected to review the relevant workpapers and, when necessary, meet with internal audit staff who documented the resolution of the issue.
action may be warranted based on the severity of the issues, the repeat nature of issues, lack of responsiveness of management, violations of law, insider abuse, fraud, or other material deficiency. In any of these cases, examiners should consult with the Board’s enforcement staff.

1070.1.3 FACTORS IN ESCALATING ISSUES INTO ENFORCEMENT ACTIONS

The volume of open MRIAs and MRAs and the materiality of the issues therein to the safety and soundness of the banking organization are important overarching considerations in determining whether examiners need to consult with the Board’s enforcement staff in escalating issues into enforcement actions.\(^5\) In addition to the guidance presented in SR-13-13/CA-13-10, examiners should consider the following key factors in determining whether to recommend additional formal or informal investigation or enforcement action:

- the organization’s supervisory ratings and financial condition;\(^6\)
- whether the issues involve unsafe or unsound practices, violations of laws, noncompliance with regulations, insider abuse, fraud, or other material deficiencies;\(^7\)
- the severity or repetitive or intentional nature of the issues;
- management’s willingness and ability to correct the issues;
- management’s history of instituting timely remedial or corrective actions;
- whether management already initiated corrective action or established procedures to prevent future deficiencies;
- whether criminal or other regulatory authorities are taking a formal enforcement or prosecutorial action against the same institution;
- the organization’s history of violations of laws, noncompliance with regulations and unsafe and unsound unsatisfactory practices; and
- any other circumstances that warrant use of an enforcement action.

This manual’s section, “Formal Corrective Actions,” provides more information on formal supervisory actions, which regulators issue to correct practices that the regulators believe to be unlawful, unsafe, or unsound. See also the Commercial Bank Examination Manual’s section entitled, “Formal and Informal Supervisory Actions,” for more information.

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\(^5\) Issues are considered closed if the banking organization implements and examiners verify and validate the effectiveness of the corrective action, or if the organization’s practices are no longer a concern because of a change in the organization’s circumstances.


\(^7\) See 12 USC 1818(b)(1).