

Attachment C

Definitions of Key Terms for Consolidated Supervision

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.

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 foreign banking organizations (FBOs), and inspection activities are applicable to the supervision of bank holding companies (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.

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 (i) those that are designated as being part of the portfolio of *LCBOs*, and (ii) 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.

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 letter 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 (i) broader U.S. capital market activity, including underwriting, securitization, derivatives, and trading; (ii) retail financial services; and (iii) 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, and operational 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 Gramm-Leach-Bliley Act, 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.