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Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations

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**BOARD OF GOVERNORS
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DIVISION OF BANKING
SUPERVISION AND REGULATION

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

SR 08-9 / CA 08-12

October 16, 2008

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH
RESERVE BANK AND TO DOMESTIC AND FOREIGN
LARGE COMPLEX BANKING ORGANIZATIONS, REGIONAL
BANKING ORGANIZATIONS, AND U.S. OFFICES OF MULTI-
OFFICE FOREIGN BANKING ORGANIZATIONS
SUPERVISED BY THE FEDERAL RESERVE**

**SUBJECT: Consolidated Supervision of Bank Holding Companies
and the Combined U.S. Operations of Foreign
Banking Organizations**

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 primary objectives of this letter and the attached 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 attached guidance details 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; addresses unique aspects of supervising the combined U.S. operations of FBOs; and highlights 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.

While initiation of this effort to enhance and clarify the Federal Reserve's approach to consolidated supervision predated the recent period of considerable strain in financial markets, this enhanced approach 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.

Background

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 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 relationships 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.⁵ Under these provisions, the Federal Reserve, in conducting its consolidated supervisory responsibilities, relies to the fullest extent possible on (i) the reports that a BHC or subsidiary has provided to another federal or state supervisor or to an appropriate self-regulatory organization, (ii) information that is otherwise required to be reported publicly, and (iii) 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.

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 BHC⁶ and the combined U.S. operations rating assigned to an FBO with multiple U.S. operations.⁷ The Federal Reserve utilizes three principal processes to understand, supervise and assess BHCs and FBOs: continuous monitoring activities,⁸ discovery reviews,⁹ and testing.¹⁰

The Federal Reserve's supervisory objectives are the same for all BHCs and FBOs. However,

the type and amount of information and scope and extent of Federal Reserve supervisory and examination¹¹ work that is necessary to understand, supervise, and develop an assessment of an individual BHC or the U.S. operations of an individual FBO varies. Federal Reserve supervisory activities are tailored for each organization based on a variety of factors, including the organization's legal entity and regulatory structure;¹² 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.

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.

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.

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.

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.

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 framework¹³) 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 towards, 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 the conduct of 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 develops and maintains an understanding and assessment of consumer compliance risk at nonbank subsidiaries of a BHC or FBO primarily through continuous monitoring activities, 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 nonbank 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.¹⁴

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.

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)
- Single-office foreign banking organizations (single-office FBOs)

In 1999, the Federal Reserve formally established its supervision program for both domestic and foreign LCBOs (see SR letter 99-15). 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.

Supervisory Guidance

The attached guidance 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 guidance documents address:

- Consolidated supervision of LCBO BHCs (Attachment A.1);
- Consolidated supervision of regional BHCs (Attachment A.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.

Consolidated supervision of community BHCs will continue to follow the procedures contained in SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of \$5 Billion or Less," while supervision of single-office FBOs will continue to follow the procedures contained in SR letter 00-14.

Overview of Significant Federal Reserve Supervisory Activities

As discussed in the attached guidance documents, 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 (i) the effectiveness of risk management systems and controls over the primary risks inherent in the organization's activities, (ii) the organization's financial condition, and (iii) 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:

- Key corporate governance functions, including internal audit;
- Risk management and internal control functions for primary risks of the consolidated organization (or combined U.S. operations for FBOs), and supporting MIS;
- 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;
- 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;
- Where applicable, areas of emerging interest with potential financial market consequences;
- Consolidated financial strength (in the case of FBOs, the financial strength of combined U.S. operations);
- Risk management and financial condition of significant nonbank subsidiaries; and
- 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 attached guidance 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, and supplement ongoing continuous monitoring activities and periodic discovery reviews necessary to maintain an understanding and assessment for each of these key functions.

As discussed in greater detail in the attached guidance, control processes for several areas are 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.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 letter 00-13 in conducting any examination of, or requesting a specialized report from, a functionally regulated subsidiary of a BHC or FBO.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.

Application of Supervisory Guidance

As a general matter, the supervisory expectations and processes included in the attached guidance documents 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 attached documents 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 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 letter 04-18; SR letter 03-22/CA letter 03-15; SR letter 00-14; and SR letter 00-13.

The attached guidance does not modify or alter the Federal Reserve's supervisory programs for state member banks, Edge and agreement corporations, or the U.S. branches or agencies of foreign banks. The Federal Reserve will coordinate and integrate to the fullest extent possible its supervisory activities for a BHC or FBO with its supervisory activities for a state member bank, Edge or agreement corporation, or U.S. branch or agency of a foreign bank.¹⁷ Where the lead U.S. depository institution of a BHC or FBO is a state member bank or state chartered branch or agency, the Federal Reserve's supervisory programs for the BHC or FBO and the state chartered depository institution are fully integrated.

Reserve Banks are asked to distribute this letter to domestic and foreign LCBOs, regional bank

holding companies, and U.S. offices of multi-office foreign banking organizations supervised by the Federal Reserve, as well as to supervisory and examination staff. Questions pertaining to the consolidated supervision of BHCs should be addressed to Coryann Stefansson, Associate Director, Large Institutions Group, at (202) 452-5287, Betsy Cross, Associate Director, Regional Banking Organizations, at (202) 452-2574, or Bill Charwat, Senior Project Manager, Large Institutions Group, at (202) 452-3006; questions pertaining to the supervision of the combined U.S. operations of FBOs should be addressed to Jack Jennings, Associate Director, International Supervision/Training & Assistance, at (202) 452-3053, or Richard Naylor, Assistant Director, International Supervision, (202) 728-5854; and questions pertaining to consumer compliance should be addressed to Suzanne Killian, Assistant Director, Division of Consumer & Community Affairs, at (202) 452-2090. In addition, questions may be sent via the Board's public website at <http://www.federalreserve.gov/feedback.cfm>.

signed by
Deborah P. Bailey
Deputy Director
Division of Banking
Supervision and Regulation

signed by
Glenn E. Loney
Deputy Director
Division of Consumer
and Community Affairs

Attachments:

- A.1 [Guidance for the Consolidated Supervision of Domestic Bank Holding Companies that are Large Complex Banking Organizations](#)
- A.2 [Guidance for the Consolidated Supervision of Regional Bank Holding Companies](#)
- B.1 [Guidance for the Supervision of the Combined U.S. Operations of Foreign Banking Organizations that are Large Complex Banking Organizations](#)
- B.2 [Guidance for the Supervision of the Combined U.S. Operations of Multi-office Foreign Banking Organizations](#)
- C. [Definitions of Key Terms for Consolidated Supervision](#)

Cross References:

- [SR letter 08-8/CA letter 08-11](#), "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles"
- [SR letter 04-18](#), "Bank Holding Company Rating System"
- [SR letter 03-22/CA letter 03-15](#), "Framework for Assessing Consumer Compliance Risk at Bank Holding Companies"

- [SR letter 03-9](#), "Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System"
- [SR letter 02-20](#), "The Sarbanes-Oxley Act of 2002"
- [SR letter 02-1](#), "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of \$5 Billion or Less"
- [SR letter 01-1](#), "Application of the Board's Capital Adequacy Guidelines to Bank Holding Companies owned by Foreign Banking Organizations"
- [SR letter 00-14](#), "Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations"
- [SR letter 00-13](#), "Framework for Financial Holding Company Supervision"
- [SR letter 99-18](#), "Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles"
- [SR letter 99-15](#), "Risk-Focused Supervision of Large Complex Banking Organizations"
- [SR letter 97-24](#), "Risk-Focused Framework for Supervision of Large Complex Institutions"
- [SR letter 97-4](#), "Interagency Guidance on Common Questions About the Application of the Revised CAMELS Rating System"
- [SR letter 96-38](#), "Uniform Financial Institutions Rating System"
- [SR letter 90-21](#), "Rating System For International Examinations"

Notes:

1. See Attachment C for definitions of "core clearing and settlement organizations," "critical financial markets," and "key financial markets."
2. The term "nonbank subsidiaries" as used in this document and its attachments does not include savings associations.
3. "National treatment" refers to a policy that 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.
4. The term "primary supervisor" as used in this document refers to 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. The term "functional regulator" as used in this document refers to 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. See SR letter 00-13, "Framework for Financial Holding Company Supervision." 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 letter 00-13.
6. The RFI rating system for BHCs is discussed in SR letter 04-18, "Bank Holding Company Rating System." 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 (as described in SR letter 99-15, "Risk-Focused Supervision of Large Complex Banking Organizations").
7. SR letter 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.
10. “Testing” is an examination/inspection activity to assess whether a control process is appropriately designed and achieving its objectives, or to validate a management assertion about an organization’s operations. 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.
11. 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 guidance to refer to both examination and inspection activities.
12. An organization’s “regulatory structure” refers to the various legal entities within the organization that are subject to oversight by different domestic and foreign supervisors or functional regulators.
13. For more information on the prompt-corrective-action framework for banks, see section 4133.1 of the Federal Reserve’s *Commercial Bank Examination Manual*, or see 12 CFR 208, Subpart D.
14. See SR letter 03-22/CA letter 03-15, “Framework for Assessing Consumer Compliance Risk at Bank Holding Companies.” As previously announced (see the July 17, 2007, interagency press release, “Federal and State Agencies Announce Pilot Project to Improve Supervision of Subprime Mortgage Lenders”), the Federal Reserve is participating in an interagency pilot program that provides for targeted consumer compliance reviews of selected nondepository lenders with significant subprime mortgage operations. The Federal Reserve expects to evaluate carefully the results of these reviews to determine whether they should be continued or whether it would be appropriate to make other enhancements to its supervisory objectives and activities related to consumer compliance.
15. For these activities, the three-year testing cycle focuses on adherence with expectations of the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System* (see SR letter 03-9), including the geographic diversity and resiliency of data centers and operations, and testing of recovery and resumption arrangements.
16. For these purposes, a “specialized report” means a report that the functionally regulated subsidiary is not required to prepare for another federal or state regulatory authority or an appropriate self-regulatory organization. Consistent with the GLBA, if the Federal Reserve seeks to obtain a specialized report from a functionally regulated subsidiary, the

Federal Reserve will first request that the subsidiary's appropriate regulatory authority or self-regulatory organization obtain the report and make it available to the Federal Reserve.

17. The attached documents provide additional guidance on how the Federal Reserve will seek to coordinate its supervisory activities for Edge and agreement corporations owned by a BHC or FBO with its supervisory activities for the BHC or the U.S. operations of the FBO.