



UNITED STATES

FINANCIAL SECTOR ASSESSMENT PROGRAM

April 2015

DETAILED ASSESSMENT OF OBSERVANCE ON THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance on the Basel Core Principles For Effective Banking Supervision on the United States was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in March 2015.

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DETAILED ASSESSMENT OF OBSERVANCE

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BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in the United States during October-November 2014, led by Aditya Narain, IMF, and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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GLOSSARY

ABS	Asset Backed Securities
AC	Additional Criteria or Additional Criterion
AICPA	American Institute of Certified Public Accountants
ALLL	Allowance for Loan and Lease Losses
AMA	Advanced Measurement Approach for Operational Risk
AML/CFT	Anti Money Laundering and Combating the Financing of Terrorism
ATRR	Allocated Transfer Risk Reserve
BCP	Basel Core Principles for Effective Banking Supervision
BHC	Bank Holding Company
BSA	Bank Secrecy Act
CAMELS	Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk)
CCAR	Comprehensive Capital Analysis and Review
CCR	Counterparty Credit Risk
CELM	Current Expected Loss Model
CFO	Chief Financial Officer
CFPB	Consumer Financial Protection Bureau
CFR	Code of Federal Regulations
CFTC	Commodity Futures Trading Commission
CIBC	Change In Bank Control Act
CLAR	Comprehensive Liquidity Analysis and Review
CLS	Continuous Linked Settlement
CMG	Crisis Management Group
COAG	Complete Cooperation Agreement
CP	Core Principle
CPC	Central Point of Contact
CRA	Community Reinvestment Act
CRE	Commercial Real Estate
CRM	Country Risk Management
CRO	Chief Risk Officer
C-SCAPE	Consolidated Supervision, Comparative Analysis, Planning and Execution
DAR	Detailed Assessment Report
DFA	Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act
EC	Essential Criteria or Essential Criterion
EDTF	Enhanced Disclosure Task Force
EIC	Examiner-in-Charge
FBA	Federal Banking Agencies
FBO	Foreign Banking Organization
FDIA	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FMU	Financial Market Utility
FRB	Federal Reserve Board
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FSSA	Financial System Stability Assessment
GAO	Government Accounting Office

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GDP	Gross Domestic Product
GSE	Government-Sponsored Enterprises
GSIB	Global Systemically Important Banks
HOLA	Home Owner's Loan Act
IAP	Institution-Affiliated Parties
IASB	International Accounting Standards Board
ICE	Intercontinental Exchange Clear Credit L.L.C
ICERC	Interagency Country Exposure Review Committee
ILSA	International Lending Supervision Act
IOSCO	International Organization of Securities Commissions
LBOs	Large Banking Organizations
LC	Largely Compliant
LCR	Liquidity Coverage Ratio
LIDI	Large Insured Depository Institution
LISCC	Large Institution Supervision Coordinating Committee
MNC	Materially Non-Compliant
MoU	Memorandum of Understanding
MRA	Matters Requiring Attention
MRBA	Matters Requiring Board Attention
MRIA	Matters Requiring Immediate Attention
NRC	National Risk Committee
OCC	Office of the Comptroller of the Currency
OIG	Office of the Inspector General
OLA	Orderly Liquidation Authority
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
PCAOB	Public Company Accounting Oversight Board
PEP	Politically Exposed Person
PPM	Policies and Procedures Manual
ROCA	Risk Management, Operational Controls, Compliance, And Asset Quality
ROE	Report of Examination
SCAP	Supervisory Capital Assessment Program
SEC	Securities and Exchange Commission
SLHC	Savings and Loans Holding Companies
SR	Supervision and Regulation Letters
SSFA	Simplified Supervisory Framework Approach
UBPR	Uniform Bank Performance Reports
UFIRS	Uniform Financial Institution Rating System, known as CAMELS
U.S.	United States of America
U.S.C.	United States Code
U.S. GAAP	United States Generally Accepted Accounting Principles

SUMMARY AND KEY FINDINGS

1. The U.S. federal banking agencies (FBAs¹) have improved considerably in effectiveness since the previous FSAP. In response to global and domestic reforms, particularly the Dodd-Frank Act (DFA), the FBAs have stepped up their supervisory intensity, especially of large banking organizations, putting emphasis on banks' capital planning, stress testing and corporate governance. To match, the FBAs have also enhanced their supervisory capacity, adding significantly to their staffing numbers and skills base.

2. These improvements are reflected in the high degree of compliance with the Basel Core Principles for Effective Banking Supervision (BCP) in this current assessment.

Shortcomings have been observed, particularly in the treatment of concentration risk and large exposures, but they do not raise concerns overall about the authorities' ability to undertake effective supervision. These shortcomings should, however, be addressed if the United States is to achieve the standards of supervisory effectiveness expected of one of the most systemically important financial systems in the world.

3. The Dodd-Frank reforms have resulted in some rationalization of supervisory responsibilities but they did not address, fundamentally, the fragmented nature of the U.S. financial regulatory structure. This was an opportunity lost. The problems inherent in multiple regulators with distinct but overlapping mandates remain, with the new challenge of delineating responsibilities with a stand-alone consumer protection agency. The FBAs are committed to making the revised arrangements work and cooperation has clearly improved. Nonetheless, there is substantial duplication of supervisory effort, particularly in respect of entities in major banking groups, and the ongoing risk of inconsistent messages from the agencies. Against this background, the assessors saw scope to sharpen supervisory mandates and opportunities for a more targeted allocation and commitment of resources to the supervision of smaller banking institutions.

4. The U.S. prudential regulatory regime is a complex structure of federal statutes, regulations and reporting requirements, and policy statements and supervisory guidance.

Since the crisis, the DFA and other initiatives have introduced various "tiers" of prudential requirements for banks and bank holding companies, which underpin the heightened supervisory focus on large banking organizations but have added to the complexity of the regime. Many requirements of the BCP are in practice, however, determined by the supervisor under a principles-based approach. Such an approach provides flexibility for supervisors to tailor their actions to each individual situation and be more nuanced in their response. Under the Office of the Comptroller of the Currency (OCC)'s new "Heightened Standards", for example, the supervisor has a range of informal and formal corrective responses that can be pursued before formal enforcement actions—which, in the U.S., are published—are taken. Of course in benign circumstances, when the financial situation of a bank is still satisfactory, a principles-based approach may encourage a delayed

¹ For the purposes of this assessment, the FBAs are the OCC, the Federal Reserve and the FDIC.

supervisory response. However, the assessors observed that banks were responsive to informal guidance and “best practice” recommendations from the FBAs and that supervisory oversight based on that guidance has stepped up in intensity. In the upturn of the cycle, it is important that good supervisory practice established under crisis conditions be maintained.

5. In many cases, this principles-based approach is reflected in a lack of specificity in the regime, for example, the absence of guidelines or supervisory “triggers” for various risks. A greater degree of specificity would be consistent with the principles-based approach and would have three potential benefits: (i) the agencies would have an opportunity to make a preventative statement on risks that signals to banks where greater intensity of supervision can be expected; (ii) greater specificity would be a useful way to articulate the supervisors’ risk appetite and hence shorten the time gap between the build-up of risks and a supervisory response; and (iii) greater specificity would provide a useful (internal) reference point for offsite and continuous monitoring and an indicator of when a bank’s risk profile might need to be escalated up the supervisory management chain. There are a number of ways this greater level of specificity can be achieved within a principles-based approach, starting with agency statements to banks of areas that merit greater supervisory intensity and moving to more formal (internal) triggers for supervisory action.

6. Since the crisis, there has also been a marked improvement in the risk management practices of banking organizations, an area identified to have material shortcomings in the previous FSAP. Consistent with global initiatives to “raise the bar” in risk management, the improvements are apparent in the greater engagement and skill levels of many boards, the strengthening of the risk management function itself, and in the aggregation of risk data. Nonetheless, these efforts are best described as “work-in-progress” from what was, in many cases, a lower starting point than in some major jurisdictions. The full implementation of the OCC’s “Heightened Standards” will add impetus to these efforts, as would a clearer delineation of the contribution of boards and senior management in supervisory assessments.

Mandate, independence and cooperation (CP 1-3)

7. The U.S. system of multiple FBAs with distinct but overlapping responsibilities continues to put an absolute premium on effective cooperation and collaboration. The FBAs will need to ensure that the significant improvements in collaboration in recent years become fully engrained in the *modus operandi* of each agency. Internationally, the establishment of supervisory colleges and crisis management groups (CMGs) has given greater urgency to information-sharing arrangements and there are no legal or other impediments to the ability and willingness of the FBAs to cooperate and collaborate with foreign supervisors. The dual banking structure does pose a challenge for international cooperation, and state banking agencies with Foreign Banking Organization (FBO) presence do not always inform or coordinate enforcement actions with home supervisors.

8. The FBAs are operationally independent, and have clear mandates for safety and soundness of the banking system. However, the FBAs also have other objectives, and the primacy of the safety and soundness objective needs to be better enshrined in legislation or mission

statements to ensure a clear focus on this objective in different phases of the business cycle. In principle, the creation of a stand-alone Consumer Financial Protection Bureau (CFPB) should help establish a greater delineation between individual consumer issues and prudential issues and give the FBAs a clearer sense of purpose, but the delineation is not yet sharp. There is no evidence of direct interference by industry and government in supervisory priorities or decisions. The high level of public and congressional scrutiny and resulting sentiment may have an indirect effect in creating a perception of “cyclical” supervisory responses.

Licensing, permissible activities, transfer ownership and major acquisitions (CP 3-6)

9. The dual banking structure with charter choice adds to the challenge of cooperation and collaboration across multiple agencies. Banks may in principle choose to operate under a federal or state charter that best accommodates their business or strategic needs. Further, state-chartered banks may choose between being supervised primarily by the FDIC or primarily by the Federal Reserve as a member bank, in addition to the supervision of their state supervisory authority. Concerns have been raised that this choice can give rise to “regime shopping” that can undermine the integrity of U.S. regulatory arrangements. The DFA has restricted the ability of weak and troubled banks to change charters, but charter conversions of (well-rated) banks and savings associations continue on a modest scale. The FBAs need to guard against perceptions of differences in supervisory style or treatment in their regional offices that could sway the choices made by banks in charter conversions.

Supervisory approach, processes and reporting and sanctioning powers (CP 8-10)

10. The FBAs have significantly increased their level of resources and intensity of supervision of the largest firms, and have articulated a tiered approach built on asset-based thresholds to achieve the desired proportionality. The traditional focus on on-site examinations has changed a little as there has been a shift towards more stress testing, analysis and horizontal reviews. Overall, the supervisory regime is effective and risk-based. There is an increasing focus on resolution (for the larger firms). There remains scope for better prioritization of matters requiring attention and their communication to banks and for aligning supervisory planning cycles across agencies.

11. The FBAs have a long-established and effective regulatory reporting framework, with the flexibility to expand reporting requirements in response to pressing supervisory needs. There are safeguards built in to guard against redundant data items and information overreach. A lacuna is that supervisory data is not collected from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries), which means supervisors and market participants may not have the information to test whether a bank is adequately capitalized on a stand-alone basis. In practice this omission has little prudential significance under current circumstances as bank subsidiaries tend to be small relative to the parent bank and can only undertake limited activities that the bank itself could undertake in its own name, but supervisors should closely monitor the development of banking groups and consider introducing solo level reporting if the number or size of bank subsidiaries were to expand or banking groups become less transparent.

12. The FBAs have a wide range of supervisory actions available to address safety and soundness concerns and do not hesitate to use them, although follow-up needs to be stricter.

The PCA framework is the main plank of the early intervention framework and has clear triggers. The authorities could consider implementing rules for promoting early action for other triggers than bank capital as well as introduce more explicit rules and processes to deal with ageing of MRAs/MRIAs.

Consolidated and cross-border supervision (CP 12-13)

13. Following up on the 2010 FSAP, there have been major improvements in the ability of the FBAs to implement a comprehensive framework for consolidated supervision.

Work still remains outstanding, though, on developing regulatory and supervisory rules, guidance, and a formal rating system for SLHCs, as well as on developing a capital rule for corporate and insurance company SLHCs.

14. Reflecting the large cross-border activities of U.S. banks and of foreign banking groups in the U.S., there is a comprehensive framework of policies and processes for co-operation and exchange of information between the FBAs and foreign supervisory authorities.

As noted above, this is currently being strengthened by the work in supervisory colleges and in CMGs. The authorities should continue their efforts to establish agreements with their foreign counterparts on a framework of communication strategies, especially for crisis situations. While national treatment is the underlying principle, there remain some instances in which specific rules apply only to foreign institutions, such as the shorter run-off period for foreign branches in liquid asset requirements and requirements on FBOs to set up intermediate U.S. holding companies.

Corporate governance (CP 14)

15. Reflecting the global learnings from the crisis, major changes have taken place in supervisors' demands on banks' corporate governance and in the banks' own approaches.

Laws and regulations have gradually raised the requirements and there is clearly heightened focus by boards and management on corporate governance issues. The demands on board involvement and skills have increased substantially and this has, in many instances, led to changes in board composition and calls for wider skill sets of directors. In general, supervisory expectations are tailored to be less strict for smaller, non-systemic banks. This means that there is a shortfall from the criteria, but the assessors judged that this was not sufficiently material to alter their overall conclusions. The assessors welcome that supervisors are encouraging medium and small banks with higher risk activities to adopt better practices in corporate governance and risk management that are appropriate for the risk profile of these firms, moving them closer to the criteria and some of the principles outlined in the requirements for the larger banks.

Risk management, capital adequacy and prudential framework (CP 15-25)

16. There have been substantial improvements in the risk management processes of banks, and risk aggregation has been greatly facilitated by the stress testing requirements.

Given the enormity of the task of achieving and sustaining meaningful risk aggregation across the Global Systemically Important Banks (GSIBs), this remains very much work in progress and may take years to complete. Other areas in which progress needs to be made are a better delineation in supervisory guidance of the responsibilities of the board and management and more emphasis on contingency planning, particularly at the smaller end of the banking sector. The level of commitment to stress testing is substantial and there is considerable consensus that the outputs and outcomes of that process were significant in improving risk aggregation. Supervisors and firms were becoming more efficient with each iteration and standards required were also increasing, although there is some way to go before supervisory led stress tests achieve an optimum state of data granularity. There is still room for improvement in firm-led stress testing, where firms seem to be struggling to determine the appropriate severity, whilst maintaining a scenario that remains business relevant.

17. There is a robust and comprehensive approach to setting prudent and adequate capital adequacy requirements, although the U.S. capital regime is in a state of transition. The FBAs have implemented major elements of the Basel II advanced approaches from 1 January, 2014 and the U.S. standardized approach based on Basel II will begin to come into effect from 1 January, 2015. The broad adoption of the Basel III definition of capital, when applicable to most banks from 1 January 2015, will improve the quality of bank capital by limiting the extent to which certain intangibles, which had previously counted for a high proportion of bank capital, can be included in capital. Stress testing is entrenching a forward-looking approach to capital needs and engaging boards and senior management more fully in the capital planning process. The introduction of risk-based capital rules based on Basel standards for most savings and loan holding companies removes an anomaly created by the previous case-by-case determination of capital requirements for such companies, although a comprehensive capital framework for all savings and loan holding companies is not in place. There are a number of differences between the new U.S. capital regime and the relevant Basel framework, particularly the absence of a capital charge for operational risk and for Credit Value Adjustment (CVA) risk in the U.S. standardized approach, which provides the “floor” for the advanced approach banking organizations and applies to all other banking organizations.

18. The long-established and rigorous process for evaluating banks’ approaches to problem assets and the maintenance of adequate provisions and reserves will be bolstered by accounting changes currently on the anvil. The FBAs have shown a consistent willingness to challenge unrealistic bank estimates of provisions and reserves and to secure increases they judge necessary. This steadfastness in approach will be tested as the U.S. economy continues to improve. Supervisory judgments in this area have been constrained by the “incurred loss” approach of U.S. GAAP, but the introduction of the FASB’s proposed Current Expected Loss Model (CELM) will permit more forward-looking provisioning.

19. The supervisory framework to guard against concentration risk and large exposures needs to be strengthened. The FBAs have an effective supervisory framework for dealing with credit concentration risk. Guidance has been issued on specific areas of concentration of credit risk and this is followed up in supervisory reviews. Supervisors are also giving more attention to the treatment of concentration risk in counterparty credit risk management and stress testing

frameworks. However, the new BCP methodology has expanded this Core Principle to also include market and other risk concentrations “where a bank is overly exposed to particular asset classes, products, collateral, or currencies”. While there is some evidence of punctual supervisory action on this front (for instance, funding concentration), at this point a detailed supervisory framework and supervisory guidance for these other risk concentrations is not well developed. Although the widening of the definition of large exposures under the DFA has brought the large exposure thresholds more into line with the requirements of the BCP, some anomalies and omissions remain. The separate and additional limits available to banks for money market investments and security holdings continue to leave open the possibility of excessive risk concentrations. The 50 per cent limit on exposures to a corporate group is also problematic. The authorities are also encouraged to finalize the large exposures framework, with legal limits, for large bank holding companies and foreign banking organizations.

20. In addition, there remain gaps in the related party exposure framework that may heighten concentration risk in the system. There are no formal requirements for prior board approval of transactions with affiliated parties or the write-off of related party exposures exceeding specified amounts, or for board oversight of related party transactions and exceptions to policies, processes and limits on an ongoing basis. However, in practice the FBAs expect banks to apply a high degree of board oversight and monitoring of affiliate and insider transactions and review this as a matter of practice on offsite and onsite examinations. Statutes impose a set of limits on a bank’s exposures to affiliates and insiders that, with one exception, are at least as strict as those for single counterparties or groups of counterparties. The exception is the aggregate limit for lending to insiders of 100 per cent of a bank’s capital and surplus (and 200 per cent for smaller banks). As noted in the 2010 FSAP, this limit is higher than prudent practices and creates the risk that a small group of insiders could deplete the own funds of a bank. There is no formal limit framework for holding company transactions with their affiliates or insiders, which is needed for a comprehensive framework for transactions with related parties. Finally, the “related party” regime in the U.S. regulatory framework does not appear as broad as required by this CP.

21. The approach to interest rate risk in the banking book (IRRBB) is in marked contrast to other key risks and could be usefully updated. The regimes for market and liquidity risks are tiered to support a risk-based approach and are comprehensive and robust, though the former would benefit from the introduction of a *de-minimis* regime for all banks and the latter from more granular and frequent reporting. The framework for IRRBB stands out with no tiering for example (although supervisory practice seems proportionate to the risk) and the philosophy is firmly principles-based. No specific capital is being set aside against a change in interest rates, nor are any supervisory limits set. Given the stage of the U.S. economic cycle, the inherent interest rate exposure is high and there are particular concentrations in the small bank sector. Updating the 1996 guidance to include more quantitative guidance is merited, as the risk of a principles-based approach is its inconsistency across a sector and across time; as such banks, or a group of banks may be overly exposed.

22. Similarly, the overall regime for operational risk outside the AMA banks has not reached a sufficient level of maturity. There is no overall definition of operational risk, or structured guidance on identification, management and mitigation of operational risks. Guidance for banks under AMA (at the time of this assessment, only 8 banks) is well specified, however for all other bank operational risk management falls within the scope of “general” risk management. Guidance for other banks is disparate, and the weakness is compounded by the absence of a comprehensive reporting regime. There is not a standardized capital charge for operational risk. At the time of the assessment, several initiatives were underway. The FBAs are placing increasing emphasis on operational risk issues and are coordinating on the production of additional inter-agency guidance, as well as identifying and seeking mitigation of a number of issues in their vertical and horizontal reviews. They are also alert to the changing threat landscape, such as the escalation of fines and other penalties from litigation as well as cyber risks. Dealing with cyber risk is a top priority across all agencies and will pose coordination and operational challenges given the nature of the risk and the pressing need to collaborate with other arms of government.

Controls, audit, accounting, disclosure and abuse of financial services (CP 26-29)

23. The bar for audit and control functions has clearly been raised in the wake of the crisis, while further refinements are needed in the framework for abuse of financial services. The internal audit function is the subject of greater supervisory attention and expectations have been significantly raised though, in contrast, there is little mention of the compliance function except with reference to the regime of the Bank Secrecy Act and Anti-Money Laundering. Further, while significant resources are deployed by both the authorities and the firms to meet the BSA/AML standards, the attention to vulnerabilities to other forms of criminal abuse (e.g. theft, burglary) is more disparate. In addition, the regulatory framework at the time of the assessment did not include adequate identification of the ultimate beneficiary owner of legal entity clients, or processes for dealing with domestic Politically Exposed Persons (PEPs). On the external audit front, there is no requirement for an external auditor to report immediately directly to the supervisor, should they identify matters of significant importance, although this gap is mitigated by the frequent contact between supervisors and auditors in the course of planning and examinations.

24. The disclosure regime represents best practice in some respects. The public disclosure of supervisory call reports promotes market discipline and is worthy of global emulation. There remain a few gaps though. Not all banks are required to issue full financial statements that are reviewed by an independent accountant in accordance with independent audit requirements and the U.S. definition of “reporting on a solo basis” differs in that it does not collect or disclose data on a “bank stand-alone basis.”

INTRODUCTION

25. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in the United States has been completed as part of a FSAP update undertaken by the International Monetary Fund (IMF) from 21 October to 10 November 2014. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in the broader FSAP exercise.

26. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on the three FBAs as the main supervisors of the banking system, and did not cover the specificities of regulation and supervision of other financial intermediaries, which are covered by other assessments conducted in this FSAP. The assessment did not cover supervision conducted by local State regulators,² the supervision of credit unions, or the activities of the CFPB. As the three federal agencies are the primary regulators of most depository institutions in the country, this assessment should provide a useful picture of current supervisory processes applicable to banks in the United States.

A. Information and Methodology Used for Assessment

27. The U.S. authorities agreed to be assessed according to the Revised BCP Methodology issued by the BCBS (Basel Committee of Banking Supervision) in September 2012. The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2009. It is important to note, for completeness' sake, that the two assessments will not be directly comparable, as the revised BCP have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, raising the bar to measure the effectiveness of a supervisory framework (see box for more information on the Revised BCP).

28. The U.S. authorities also chose to be assessed and rated against not only the Essential Criteria, but also against Additional Criteria. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) were usually the only elements on which to gauge full compliance with a CP. The additional criteria (AC) are recommended best practices against which the U.S. authorities have agreed to be assessed and rated. This option was not available to assessed countries before the 2012 Revised BCP. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met. A four-part grading system is used:

² The assessment team did not assess State supervisors, but met with their representatives to hear their views on issues such as cooperation, regulatory framework, implementation of reforms, and mandates.

compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section.

29. The assessment team³ reviewed the framework of laws, rules, and guidance and held extensive meetings with U.S. officials, and additional meetings with banking sector participants and other stakeholders (auditors, associations, etc). The authorities provided a self-assessment of the CPs rich in quality and comprehensiveness, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff and systems.

30. The team appreciated the very high quality of cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided excellent cooperation, including extensive provision of documentation and access, at a time when staff was burdened by many initiatives related to the implementation of global regulatory changes under Basel III and further national regulatory changes under the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA).

31. The standards were evaluated in the context of the U.S. financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

32. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the U.S. authorities with an internationally consistent measure of the quality of its banking supervision in relation to the CPs, which are internationally acknowledged as minimum standards.

³ The assessment team comprised John Laker (former Australian Prudential Regulatory Authority), Göran Lind (Swedish Riksbank), and Lyndon Nelson (Bank of England). Fabiana Melo (IMF) helped coordinate the work of the assessors and the drafting of this report.

Box 1. The 2012 Revised BCP

The revised BCPs reflect market and regulatory developments since the last revision, taking account of the lessons learnt from the financial crisis in 2008/2009. These have also been informed by the experiences gained from FSAP assessments as well as recommendations issued by the G-20 and FSB, and take into account the importance now attached to: (i) greater supervisory intensity and allocation of adequate resources to deal effectively with systemically important banks; (ii) application of a system-wide, macro perspective to the microprudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; (iii) the increasing focus on effective crisis preparation and management, recovery and resolution measures for reducing both the probability and impact of a bank failure; and (iv) fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

The revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. The supervisors are now required to assess the risk profile of the banks not only in terms of the risks they run and the efficacy of their risk management, but also the risks they pose to the banking and the financial systems. In addition, supervisors need to consider how the macroeconomic environment, business trends, and the build-up and concentration of risk inside and outside the banking sector may affect the risk to which individual banks are exposed. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

The number of principles has increased from 25 to 29. The number of essential criteria has expanded from 196 to 231. This includes the amalgamation of previous criteria (which means the contents are the same), and the introduction of 35 new essential criteria. In addition, for countries that may choose to be assessed against the additional criteria, there are 16 additional criteria.

While raising the bar for banking supervision, the BCP must be capable of application to a wide range of jurisdictions. The new methodology reinforces the concept of proportionality, both in terms of the expectations on supervisors and in terms of the standards that supervisors impose on banks. The proportionate approach allows assessments of banking supervision that are commensurate with the risk profile and systemic importance of a wide range of banks and banking systems.

33. To determine the observation of each principle, the assessment has made use of five categories: compliant; largely compliant, materially noncompliant, noncompliant, and non-applicable. An assessment of "compliant" is given when all EC and ACs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented). A principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is assessed "noncompliant" if it is not substantially implemented, several ECs are not complied with, or supervision is manifestly ineffective. Finally, a category of "non-applicable" is reserved for those cases that the criteria would not relate the country's circumstances.

B. Institutional and Market Structure—Overview⁴

34. The U.S. has a large, diverse financial sector, with assets stabilizing at about 480 percent of GDP since the crisis. Depository institutions (mostly banks), pension funds, mutual funds and insurance companies account for around 70 percent of the financial sector assets. The structure of the financial system, by sectors, has been relatively stable since the last FSAP. Only mutual funds' assets have increased whereas Asset Backed Securities (ABS) issuers have continued to reduce their balance sheets and the proportion of credit market debt owed by Government-Sponsored Enterprises (GSEs) has increased. The structure of the financial system, by instruments, has also not changed drastically in the last four years. However, the corporate equities' market has grown in size and the mortgage market has shrunk. Financial sector's share of corporate profits has reached a record high in early 2000s, after dipping to a record low in 2008 and returning to its longer-term trend by 2013 while its contribution to gross value added has remained relatively stable. The U.S. financial system contributes about 20 percent to the U.S. GDP and around 25 percent of U.S. corporate profits.

35. Credit intermediation is decentralized. While depository institutions are present in almost every credit market, no single sector dominates the overall credit market. GSEs and banks are the main providers of mortgage credit (the largest credit market). Banks also play an important role in consumer credit market (together with finance companies) and in the market for agency and GSE-backed securities (together with Fed and mutual funds). Broker-dealers are the main players on securities repos market, whereas insurance sector and mutual funds are the main source of financing of corporate debt securities

36. The pension funds sector is the largest financial sector accounting for about 20 percent of total financial sector assets. Private pension funds account for one half of pension funds' assets and the other half pertains to federal, state and local government retirement funds. The structure of the pension system has been stable since 2010, with defined benefit plans (45 percent of pension funds' liabilities) representing the largest share of the system.⁵ The sector's assets are diversified across debt securities and shares and the remainder across investments in MMF and mutual funds shares and private equity.

37. The banking sector holds 16 percent of all assets held by financial institutions. Banks are the second largest financial sector after pension funds. The overall number of banks has been on a downward trend since early 1990s and has fallen to an all time low level in 2014q1. The number of problem banks has decreased significantly, from around 500 at the peak in 2010 to around 200, but still above the number before the crisis.

⁴ This part of the document draws from the self assessment presented by the authorities, as well as from Article IV reports and other documents produced for the FSAP, some of which at the time of this assessment were not yet finalized. Unless otherwise stated, figures used in this section refer to December 2013.

⁵ Only 70 percent of defined benefit schemes are funded at the end of 2013.

38. Banks' balance sheets and income statements have strengthened. Comparing to a period before the crisis, banks now hold more liquid assets, grant less loans and hold less trading account assets (both in absolute and relative terms). At the same time, banks have attracted more deposits, hold more capital, rely less on credit borrowing and are less leveraged. Profits have reached pre-crisis levels (in nominal terms) mainly due to lower provisions and lower interest expenses. The coverage ratio has stabilized since 2009, and the net charge off rate is slightly above the level before the crisis. However, the results from the CCAR stress tests show that, if hit by a severe global market shock, banks' capital ratios would fall significantly and banks would face sizable losses from trading activities. For investment banks, a non-trivial dependence on wholesale funding continues to be a source of vulnerability in periods of severe financial market distress.

39. The U.S. banking system is less concentrated than the banking systems of other industrialized countries. The five largest banks account for about 45 percent of the U.S. banking system's total assets⁶ (which is twice the share 10 years ago) and around 40 percent of GDP. Eight large banks are designated as G-SIBs. While the proportion of the largest five banks has stabilized over the last four year, the share of banks with asset size larger than \$10 bn has continued to increase since 2009.

40. The insurance sector assets correspond to a half of the banking sector assets. Life insurers account for largest part of insurance sector assets. Three U.S. insurers, AIG, Prudential and MetLife have been designated as G-SIIs. The first two have been designated by the Financial Stability Oversight Council (FSOC) as non-bank SIFIs and the latter is in the process of designation. The insurance sector in the U.S. is less concentrated than in other countries—top 10 insurers account for 58 percent (life insurance), 71 percent (health insurance) and 46 percent (in P&C) of the market.

41. Financial intermediation outside the traditional banking system is estimated at 90 percent of GDP, and the debt securities market is dominated by corporate debt securities, treasury securities and GSE backed securities. While the banking sector has continued to grow after the crisis, the size of the shadow banking system⁷ has contracted substantially since the peak in 2007 mainly due to lower borrowing of ABS issuers. GSEs are the only segment of the shadow banking system that is now larger than before the crisis. The nominal value of outstanding debt securities at end-2013 amounted to about \$39 trillion (230 percent of GDP). Corporate bonds, including ABS securities, accounted for a third of this, of which half were issued by non-financial corporations and 10 percent by ABS issuers (down from 30 percent before the crisis). The proportion of treasury securities has almost doubled since 2007 (from 17 percent to 32 percent).

⁶ Herfindahl–Hirschman index (HHI) is equal to 0.045. A HHI index below 0.15 indicates an unconcentrated system.

⁷ The definition of “shadow banking” is based on Pozsar and others (2010) and includes open market papers, overnight repos, net securities lending, liabilities of GSEs and ABS issuers and total shares outstanding of MMFs.

42. The U.S. derivatives market represents 1/3 of the world market. The notional amount of outstanding contracts totaled \$237.0 trillion⁸ (1400 percent of GDP) and has been relatively stable since 2010. The market is dominated by a small group of large financial institutions—four large commercial banks (JPMorgan Chase, Citibank, Bank of America and Goldman Sachs) represent 93 percent of the total banking industry notional amounts.⁹ Derivative contracts are concentrated in interest rate products, which comprise 82 percent of total derivative notional amounts. Foreign exchange contracts represent 12 percent of the derivatives market and credit derivatives (mostly Credit Default Swaps) 5 percent of total derivatives notionals. Swap contracts represent the bulk of the derivatives market (64 percent of all notionals) followed by futures and forwards (18 percent) and options (14 percent).

Structure for banking supervision

43. The United States operates under a “dual banking system.” A bank charter may be issued by the federal government or by a state. Federal bank charters for “national banks” and “federal savings associations” are issued by the OCC. Each of the 50 states has a banking authority that charters banks under its own laws and regulations. These banks are generally referred to as “state banks” or “state savings associations.” Each U.S. bank, whether chartered under state or federal law, is subject to regulation, supervision, and examination by a primary federal banking supervisor, irrespective of whether the bank is part of a broader organization:

- for national banks and federal savings associations, the OCC;
- for state banks that choose to be members of the Federal Reserve System (state member banks), the Federal Reserve;
- for state banks that choose not to become members of the Federal Reserve System (nonmember banks) and state savings associations, the FDIC.

⁸ Based on reports of derivatives activities of 1,383 insured U.S. commercial banks and savings associations at the end of the fourth quarter 2013.

⁹ Most of the contracts are held for trading purposes.

Table 1. Summary of Primary Federal Supervisory Responsibilities

Component	Supervisor and Regulator
Holding companies (including financial holding companies)	Federal Reserve
Nonbank subsidiaries of holding companies	Federal Reserve/Functional Regulator
National banks	OCC
State banks Members Nonmembers	Federal Reserve FDIC
Savings and loan associations (aka "savings associations")	OCC or FDIC based on federal or state charter, respectively
U.S. offices of FBOs - subs, branches and agencies* State-licensed Federally licensed *There are some grandfathered, insured FBO branches. If these grandfathered branches are state-chartered, the primary federal supervisor is the FDIC and if federally chartered, the primary federal supervisor is the OCC.	Federal Reserve OCC
Designated Nonbank Financial Company	Federal Reserve

44. The FDIC operates the federal deposit insurance program. In addition to its authority to examine state nonmember banks, the FDIC has the authority to examine for insurance purposes any bank, either directly or in cooperation with state or other federal supervisory authorities. The FDIC has backup enforcement authority over all banks. The FDIC can recommend that another federal banking agency take action against a bank in appropriate circumstances and may take such action directly if the other agency does not take action.

45. The OCC is responsible for chartering, regulating, and supervising all national banks and federal savings associations and for supervising federal branches and agencies of foreign banks.

46. Holding companies are supervised by the Federal Reserve. The Federal Reserve is responsible for regulating and supervising any company that owns or controls a national or state bank. BHCs and their subsidiaries may engage in activities that are closely related to banking. Certain BHCs that, along with their depository institution subsidiaries, meet enhanced capital and managerial standards, may elect to become financial holding companies (FHCs) and engage in a broader array of financial activities, including securities, insurance, and merchant banking. The

Federal Reserve is the consolidated supervisor of all BHCs and FHCs on a worldwide consolidated basis. The Federal Reserve also regulates and supervises SLHCs, which, like BHCs, may choose to be treated as FHCs if they and their depository institution subsidiaries meet enhanced capital and managerial standards and, thereby, engage in a broader array of financial activities.

Table 2. Supervised Institutions

(As of June 30, 2014)

Agencies	Supervised Institutions	
	Number	Total Assets (\$ billions)
OCC	1,628	10,408
FDIC	4,131	2,536
Federal Reserve System		
<i>State Member Banks</i>	860	2,188
<i>Bank Holding Companies</i>	4,452	17,429
<i>Savings and Loan Holding Companies</i>	314	2,230
<i>Foreign Banking Organizations (Program FBOs)</i>	165	5,337

Source: Federal Reserve Board

47. FBOs may do business in the United States under a policy of “national treatment” which gives FBOs the same powers and applies the same limitations as are given and applied to domestic banks. No FBO may establish a branch or an agency, or acquire ownership or control of a commercial lending company, without the prior approval of the Federal Reserve. All banks and branches or agencies of FBOs have a primary federal regulator. If the FBO chooses a federal license for a branch or agency, then it is supervised and examined solely by the OCC. If an FBO elects to open a branch or agency under a state license, then it is typically examined by the state banking authorities and also by the Federal Reserve on a joint or alternate (i.e., rotating) basis. The Federal Reserve relies on the OCC or state banking agencies to perform examinations and supervision depending on the form of organization and the charter the FBO receives to take in the country.

48. Since the last FSAP, important changes have taken place in the legal and regulatory framework for banks. In response to the crisis, the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or DFA).¹⁰ The Act creates an interagency council to monitor and coordinate responses to emerging threats to the financial system (FSOC); requires that large bank holding companies and systemically designated nonbank financial firms be subject to enhanced prudential standards to reduce the risks they may present to the financial system; provides for the consolidated supervision of all systemically important financial institutions; gives the government an important additional tool to safely wind down financial firms whose failure could pose a threat to U.S. financial stability; and provides for the strengthened supervision of systemically important payment, settlement, and clearing utilities.

¹⁰ For a comprehensive summary of the legislative changes introduced since the last FSAP, see authorities' self-assessment (<http://www.treasury.gov/resource-center/international/Pages/us-fsap.aspx>.)

49. The Dodd Frank Act has made important changes related to banking regulation and supervision. The Act: (i) enhances the limitations on transactions among a BHC, a subsidiary bank, and its affiliates;¹¹ (ii) incorporates a financial stability factor into the statutory analysis of transactions governed by the Bank Holding Company Act (BHC Act) and the Bank Merger Act;¹² (iii) incorporates financial stability considerations into the supervision of holding companies; (iv) enhances the requirement for holding companies to be eligible to engage in expanded activities;¹³ (v) generally eliminates the limitations under the Gramm-Leach-Bliley Act that restricted the Federal Reserve's ability to examine, obtain reports from, or take enforcement action against a functionally regulated subsidiary of a BHC, such as a broker-dealer or insurance company;¹⁴ (vi) authorizes the Federal Reserve to examine the activities of nonbank subsidiaries of holding companies—other than functionally regulated subsidiaries—that are permissible for the organization's subsidiary banks in the same manner, subject to the same standards, and with the same frequency as if such activities were conducted in the organization's lead subsidiary depository institution; (vii) prohibits a depository institution that is subject to a formal enforcement order or memorandum of understanding with respect to a significant supervisory matter from converting its charter unless the current and proposed supervisors establish a plan that addresses the problems at the depository institution and that will be implemented and monitored by the new supervisor; and (viii) applies the national bank and savings association loans-to-one borrower limitation to credit exposures arising from derivative transactions and securities financing transactions.¹⁵

¹¹ Specifically, the DFA clarifies that a "covered transaction" for the purposes of sections 23A and 23B of the Federal Reserve Act includes any credit exposure of a bank to an affiliate arising from derivative transactions or securities borrowing and lending transactions with such affiliate. In addition, the Act eliminates certain exemptions from sections 23A and 23B for subsidiaries of BHCs and requires that any purchase of assets by a bank from an insider must be on market terms.

¹² Sections 163 and 604 of the DFA require the appropriate federal banking agency to take into account risks to the stability of the U.S. banking or financial system in approving the relevant applications under the BHC Act and the Bank Merger Act. Similarly, section 173 of the DFA adds financial stability to the list of factors that the Federal Reserve may consider when acting on an application by a foreign banking organization to open an office in the U.S. Specifically, the Federal Reserve may consider whether the foreign banking organization's home country has adopted or is making demonstrable progress toward adopting a financial regulatory system that mitigates risk to the stability of the U.S. financial system.

¹³ Section 606(a) of the DFA provides that a BHC must be well capitalized and well managed at the holding company and bank levels in order to become and remain a financial holding company (FHC) eligible to engage in expanded activities. The Federal Reserve has clarified that these requirements also apply to SLHCs. In addition, section 163(b) provides that in order to use authority under section 4(k) of the BHC Act to acquire a nonbank company with \$10 billion or more in assets, a designated nonbank financial company that is supervised by the Federal Reserve or a BHC with \$50 billion or more in consolidated assets must obtain the Federal Reserve's prior approval. Further, section 164 applies restrictions on management interlocks to designated nonbank financial companies supervised by the Federal Reserve.

¹⁴ See section 604 of the DFA (124). The Federal Reserve, however, must continue to rely on examinations conducted by the subsidiary's primary bank supervisors or functional regulators to the fullest extent possible and notify such supervisors before conducting an examination of the subsidiary.

¹⁵ "Securities financing transactions" mean repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions.

50. The Dodd-Frank Act also established a new Financial Stability Oversight Council (FSOC) charged with important duties such as monitoring and identifying emerging risks to financial stability across the entire financial system, identifying potential regulatory gaps, and coordinating the agencies' responses to potential systemic risks. The voting membership of the FSOC is composed of the Treasury Secretary (who is also chairperson of the FSOC); the heads of the three FBAs (FBAs); the heads of the Consumer Financial Protection Bureau (CFPB), Securities and Exchange Commission (SEC), Commodities Futures Trading Commission (CFTC), Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA); and an independent member with insurance expertise appointed by the President and confirmed by the Senate.

51. In addition, the FSOC has the task to designate as systemically important large, interconnected nonbank financial firms. Once designated, these nonbank financial companies are subject to consolidated supervision by the Federal Reserve and enhanced prudential standards. The FSOC has designated three nonbank financial companies: American International Group, Inc., General Electric Capital Corporation, Inc., and Prudential Financial, Inc. In addition, the Act authorizes the FSOC to designate financial market utilities (FMUs) as systemically important if the FSOC determines that the failure of or a disruption to the functioning of the FMU could pose a threat to U.S. financial stability. Designated FMUs are also subject to heightened prudential and supervisory provisions. In 2012, the FSOC designated eight FMUs as systemically important: The Clearing House Payments Company L.L.C. (on the basis of its role as operator of the Clearing House Interbank Payments System); CLS Bank International; Chicago Mercantile Exchange, Inc.; The Depository Trust Company; Fixed Income Clearing Corporation; ICE Clear Credit LLC; National Securities Clearing Corporation (NSCC); and The Options Clearing Corporation.

52. The DFA also requires the Federal Reserve to conduct and publish summary results of annual stress tests of systemic nonbank financial firms and BHCs with \$50 billion or more in assets. Such firms also are required to conduct their own stress tests on a semiannual basis. The DFA requires financial firms with more than \$10 billion in assets to conduct annual stress tests in accordance with regulations established by the respective primary federal financial regulatory agency.

53. The new legislation requires that foreign banking organizations with U.S. non-branch assets of \$50 billion or more be required to establish a U.S. intermediate holding company over their U.S. subsidiaries. The foreign-owned U.S. intermediate holding company generally will be subject to the same risk-based and leverage capital standards applicable to U.S. bank holding companies. The intermediate holding companies also will be subject to the Federal Reserve's rules requiring regular capital plans and stress tests. Like U.S. BHCs with assets of \$50 billion or more, a foreign banking organization with combined U.S. assets of \$50 billion or more will be required to establish a U.S. risk committee and employ a U.S. chief risk officer, and will be required to meet enhanced liquidity risk-management standards. FBOs with total consolidated assets of \$50 billion or more, but combined U.S. assets of less than \$50 billion, are subject to enhanced prudential standards. However, the capital, liquidity, risk-management, and stress testing requirements

applicable to these foreign banking organizations are substantially less than those applicable to foreign banking organizations with a larger U.S. presence.

54. Finally, the DFA dissolved the Office of Thrift Supervision (OTS) and transferred its plenary regulatory and supervisory authority, including the authority to supervise, issue rules, and take enforcement actions, with respect to SLHCs and savings associations to the FBAs: the Federal Reserve regulates SLHCs, the OCC regulates federally chartered savings associations, and the FDIC regulates state-chartered savings associations.

C. Preconditions for Effective Banking Supervision¹⁶

Macroprudential framework and cooperation¹⁷

55. In addition to the FSOC's coordinating role, the FFIEC plays an important role in developing uniform approaches among the FBAs and acts as a forum for sharing of technical information. To promote consistency in the examination and supervision of banks and holding companies, in 1978 Congress created the Federal Financial Institutions Examination Council (FFIEC). The FFIEC is composed of the chairpersons of the FDIC and the National Credit Union Administration, the Comptroller of the Currency, the Director of the CFPB, and a governor of the Federal Reserve. As the result of legislation in 2006, the Chair of the FFIEC State Liaison Committee serves as a sixth member of the FFIEC. The State Liaison Committee is composed of five representatives of state agencies that supervise financial institutions. The FFIEC's objectives are to prescribe uniform federal principles and standards for the examination of depository institutions, to promote coordination of bank supervision among the U.S. FBAs, and to encourage better coordination of federal and state regulatory activities. Through the FFIEC, state and U.S. FBAs may exchange views on important regulatory issues. Among other things, the FFIEC has developed uniform financial reports for federally supervised banks to file with their appropriate federal regulator. In addition to the FFIEC and longstanding information sharing practices, FSOC was created to provide a central body for coordinating the activities of the federal financial regulators, including the FBAs. Among other activities, FSOC has the ability to issue a nonbinding recommendation to any of its member agencies to take a particular action.

Financial Safety Nets and Crisis Management¹⁸

56. Numerous liquidity back-stops were provided by the Fed during the crisis but subsequent legislative changes appear to limit its ability to similarly respond in the future. During the crisis additional backstops were provided to mitigate specific risks, for example: (i) run

¹⁶ This section draws from other documents produced for the FSAP, some of which at the time of this assessment were not yet finalized. A complete analysis of the macroeconomic framework is contained in Article IV reports.

¹⁷ See above, and separate Technical Note on Systemic Risk Oversight, Macroprudential framework, for a more complete description of FSOC's attributions.

¹⁸ See separate Technical Notes on Systemic Risk Oversight, and on Resolution Framework.

risk in the money market funds sector; (ii) collateral fire sale risk faced by primary dealers in TPR, and (iii) funding risk faced by depository institutions. The DFA (section 214) and changes to the Federal Reserve Act (section 13.3) now seem to limit the provision of such assistance. The Fed's standing credit facilities ("discount window") may benefit from reform. The primary credit facility, for higher rated institutions, allows for borrowing on a 'no questions asked' basis while access to the secondary credit facility has conditions attached. But in both cases, activity must be disclosed under the Freedom of Information Act with a two year lag. Separating the two more clearly might help reduce stigma that is still associated with 'normal' use and with it, reluctance to access the facility (this would focus stigma on the 'emergency' use facility).

57. The resolution regime for financial institutions has been enhanced. Title II ("Orderly Liquidation Authority", OLA) of the DFA, enacted in July 2010, has extended the Federal Deposit Insurance Corporation's (FDIC) resolution authority to "financial companies". OLA mandates the appointment of the FDIC as receiver if the Secretary of the Treasury (in consultation with the President) determines that a financial company for which a systemic risk determination has been made is in default or in danger of default, would have a serious adverse effect on the financial stability and no viable private sector alternative is available to prevent the default.

58. Detailed requirements for 'living wills' seek to ensure the feasibility of a rapid and orderly resolution, but recent reviews of large banks suggest major shortcomings. The DFA requires covered financial companies to prepare plans for the orderly winding-up of such companies in the event of material financial distress or failure. While financial companies generally have made progress in the preparation of these plans, the Board of Governors of the Federal Reserve System and the FDIC concluded in August 2013 that the plans submitted by the eleven largest banking organizations (still) reflect important shortcomings, including failures to address structural and organizational impediments to orderly resolution. The affected organizations have been instructed to improve their resolvability and update their recovery plans accordingly by July 2015.

Market discipline, business environment, accounting and auditing¹⁹

59. Business laws in the United States, including contract, bankruptcy, and property law, are well-developed and reliable. Contract law is established by the combination of common law and state statute. The enforceability of contracts is well-established and enforced by the courts. Laws establishing the enforceability of security interests (i.e., interests in property conveyed to collateralize loans) are governed, primarily, under Article 9 of the Uniform Commercial Code. The enforcement of mortgages of real property is upheld under (non-uniform) state laws. Federal bankruptcy laws incorporate protections for both creditors and debtors. Property rights are protected under the Bill of Rights of the U.S. Constitution and under state laws.

¹⁹ This is a summary of existing FSAP documents. For detailed information on market discipline, accounting and auditing framework, see separate IOSCO assessment.

60. Business law disputes are typically resolved in state trial courts of general jurisdiction.

Federal courts are available when the claim involves federal law or when a state law claim involves parties from different states. A right of appeal exists in both the federal and state systems. Contracts, both commercial and consumer, are sometimes permitted to also provide for mandatory arbitration rather than dispute resolution through the courts.

61. The United States possesses an independent judiciary and well-regulated accounting, auditing, and legal professions.

The judicial system is comprised of both federal and state systems. Judges in both federal and state courts must be members of the bar and generally have significant experience as practicing lawyers before becoming judges. Federal judges are appointed by the President with the advice and consent of the Senate and receive lifetime appointments. States vary in their methods of judicial appointment. Some follow a system similar to the federal system, i.e., the state governor appoints judges with some input from the legislature. Some states, however, appoint judges through a general election.

62. Lawyers must receive a license to practice law from a state or states. All states but one (Wisconsin) require applicants who are not already members of another state's bar to pass a bar examination prior to receiving a license. In addition to controlling admission into the profession, the states also regulate the profession. Regulation is often delegated to a self regulatory organization, i.e., a state bar association. Lawyers are also subject to ethical standards set by the states.

63. U.S. accounting standards (U.S. GAAP) are established by the Financial Accounting Standards Board (FASB). Both the FASB and International Accounting Standards Board are currently working on a convergence program, designed to bring U.S. and international financial reporting standards (IFRS) into a single framework.

64. Financial statement audit requirements are robust, having been considerably strengthened in 2002 with the passage of the Public Company Accounting Reform and Investor Protection Act (also known as the Sarbanes-Oxley Act). The Sarbanes-Oxley Act enhanced audit scrutiny, toughened auditor independence requirements, required various management attestations about the reliability of financial accounts, and expanded disclosure requirements with the objective of providing the users of financial statements with greater security as to their accuracy and reliability.

DETAILED ASSESSMENT

65. The assessment of compliance of each principle is made based on the following four-grade scale: compliant, largely compliant, materially noncompliant, and noncompliant. A “not applicable” grading can be used under certain circumstances.

- **Compliant:** a country will be considered compliant with a Principle when all essential criteria applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for the aspect of banking supervision addressed by the Principle to be considered effective.
- **Largely compliant:** A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed that do not raise any concerns about the authority’s ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment “largely compliant” can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.
- **Materially non-compliant:** A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. It is acknowledged that the “gap” between “largely compliant” and “materially non-compliant” is wide, and that the choice may be difficult. On the other hand, the intention has been to force the assessors to make a clear statement.
- **Non-compliant:** A country will be considered non-compliant with a Principle whenever there has been no substantive implementation of the Principle, several essential criteria are not complied with, or supervision is manifestly ineffective.

A. Supervisory Powers, Responsibilities and Functions	
Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ²⁰ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ²¹
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ²² are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>As discussed more fully in CP 5, the United States operates under a “dual banking system” under which a bank may choose to be chartered by the federal government or by a state. Each U.S. bank, whether chartered under federal or state law, is subject to regulation, supervision and examination by a primary federal banking agency (FBA), irrespective of whether it is part of a broader organization. Following the DFA reforms, the division of responsibilities for the FBAs are:</p> <ul style="list-style-type: none"> • the OCC has responsibility for national banks and federal savings and loan associations (“savings associations”), and for supervising federal branches and agencies of foreign banks; • the Federal Reserve has responsibility for state banks that choose to be members of the Federal Reserve System; and • the FDIC has responsibility for state banks and savings associations that choose not to be members of the Federal Reserve System. <p>In addition, the FDIC has the authority to examine, for deposit insurance purposes, any bank, either directly or in cooperation with state banking agencies or other FBAs.</p> <p>The Federal Reserve has responsibility for supervision of bank holding companies and savings and loan holding companies, as well as for certain nonbank financial companies designated by the FSOC, which is discussed below. The Federal Reserve also has broad supervisory oversight over the U.S. banking operations of foreign banking organizations, but relies on the OCC or state banking agencies, as appropriate, to conduct examinations and supervision.</p> <p>In effect, then, each domestic bank has at least two regulators. For example, an insured national bank that is part of a Bank Holding Company (BHC) will be subject to supervision by</p>

²⁰ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

²¹ The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

²² Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

the OCC, the Federal Reserve and the FDIC. If the bank has assets above \$10 billion, it and its affiliates will also be overseen by the Consumer Financial Protection Bureau (CFPB) with respect to compliance with certain consumer financial protection statutes (see below).

Each FBA operates pursuant to an express statutory grant of authority. In addition, agencies are mandated to administer various specific statutes that contain implicit or explicit goals (e.g., related to fair lending, community reinvestment, or bank secrecy and anti-money laundering/counter terrorist financing). FBAs also exercise competition authority powers with respect to bank mergers, using Department of Justice criteria. Legislation creating the agencies does not contain explicit and clear statements of mission or mandate. However, the substantive requirements imposed on agencies by statute provide the basis for the agencies' publicly reported and longstanding objectives and responsibilities.

State supervisory agencies also operate pursuant to an express statutory grant of authority. These agencies are outside the scope of this BCP assessment (as is the CFPB). However, the assessors did meet with state supervisory agencies and their representatives to understand the mechanisms in place to coordinate and collaborate with their federal counterparts.

The DFA resulted in significant changes to the U.S. regulatory structure. The changes included dissolution of the Office of Thrift Supervision (OTS) and the creation of two new bodies—an independent Consumer Financial Protection Bureau (CFPB) within and funded by the Federal Reserve, and the FSOC.

The CFPB has rulemaking authority for most federal consumer financial protection statutes, as defined in the DFA. It also has authority to conduct examinations, require reports and take enforcement actions with respect to these statutes in the case of banking organizations with assets of more than \$10 billion and their affiliates. For smaller banking organizations, consumer compliance examination authority has remained with the applicable FBA.

The FSOC is charged with: monitoring and identifying risks to financial stability across the entire U.S. financial system; identifying regulatory gaps; promoting market discipline; and coordinating agencies' responses to potential systemic risks. However, the FSOC has no formal responsibility for overseeing financial crises or for guiding the development and implementation of consistent policy responses. The voting membership of the FSOC is composed of the Treasury Secretary (who is also chairperson of the FSOC); the heads of the three FBAs; the heads of the Consumer Financial Protection Bureau (CFPB), Securities and Exchange Commission (SEC), Commodities Futures Trading Commission (CFTC), Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA); and an independent member with insurance expertise appointed by the President and confirmed by the Senate. The FSOC is instructed by the DFA to designate as "systemically important" large, interconnected nonbank financial firms that are to be subject to consolidated supervision by the Federal Reserve and enhanced prudential standards. The FSOC has no direct supervisory powers but may make recommendations to its member agencies on the development of financial policies and rule making. The assessors met with staff from the FSOC.

In addition to the operation of the FSOC, formal and informal mechanisms are in place to encourage cooperation and information sharing among the financial regulatory agencies. Foremost of the formal mechanisms is the FFIEC, with representatives from the FBAs and CFPB at head-of-agency level and from regulators of state-chartered banks and credit unions. The FFIEC's objectives are to prescribe uniform federal principles and standards for the examination of depository institutions, to promote coordination of bank supervision among the FBAs and to encourage better coordination of federal and state regulatory agencies. The assessors met with the FFIEC. The range of informal mechanisms is discussed

	in CP 3.
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	<p>Each FBA has the objective of promoting safe and sound banking practices in the U.S. and maintaining stability and public confidence in the banking system. The FBAs have authority to issue regulations or guidelines as deemed necessary to ensure the safety and soundness of the banks under their jurisdiction. See e.g., 12 U.S.C. § 93a (OCC); 12 U.S.C. § 1819 (FDIC); 12 U.S.C. §§ 248, 1844 (Federal Reserve); 12 U.S.C. § 1831p-1 (all FBAs). In addition, under the DFA, the FBAs and other financial regulatory agencies are required to supplement their traditional supervision and regulation of individual firms or markets with consideration of threats to the stability of the financial system as a whole.</p> <p>At the same time, the FBAs each have other objectives that they see as complementary, rather than subordinate, to their safety and soundness objectives. The OCC has the added objectives of assuring fair access to financial services and fair treatment of customers. The Federal Reserve has the objectives of maintaining the stability of the financial system and containing systemic risk that may arise in financial markets and influencing money and credit conditions in the economy in pursuit of full employment and stable prices. The FDIC has an additional objective of minimizing the disruptive effects that can occur within the financial system when bank or nonbank financial firms fail.</p>
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ²³ and systemic importance. ²⁴
Description and findings re EC3	<p>Under existing legislation, the FBAs have delegated authority for the imposition of prudential standards and they also issue guidance and manuals that describe supervisory expectations. The banking statutes, regulations and certain guidelines establish a framework of minimum prudential standards that banks and holding companies must meet, while policy statements, interpretations, and supervisory guidance and manuals (including the Federal Reserve’s Supervision and Regulation (SR) Letters) establish best practices that banks and holding companies are expected to meet. Taken together, the regulatory framework addresses such matters as capital adequacy, loan underwriting, single borrower and related party exposure limits, asset quality, loan losses and provisioning, risk management (including requirements for addressing specific types of risks), internal controls and audits, accounting standards, liquidity, Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and anti-fraud measures, among others.</p> <p>In addition, certain large bank holding companies, including foreign banking organizations and systemically significant nonbank financial companies, are subject to enhanced prudential standards. The DFA requires the enhanced prudential standards established by the Federal Reserve under section 165 to be more stringent than those standards applicable to other bank holding companies and nonbank financial companies that do not present similar risks</p>

²³ In this document, “risk profile” refers to the nature and scale of the risk exposures undertaken by a bank.

²⁴ In this document, “systemic importance” is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>to U.S. financial stability (12 U.S.C. § 5365(a)(1)(a)). The standards must also increase in stringency based on the systemic footprint and risk characteristics of companies subject to section 165 (12 U.S.C. 5365(a) (1) (B)). Generally, the Federal Reserve has authority under section 165 to tailor the application of the standards, including differentiating among companies subject to section 165 on an individual basis or by category.</p> <p>The FBAs generally have the authority to examine affiliates of banks under their supervision. In addition, the Federal Reserve generally has the authority to examine and obtain reports from a holding company and its affiliates so that it can be informed of, among other things, the companies' conditions and stability of the U.S. financial system. The DFA eliminated previous restrictions on the Federal Reserve, imposed under the Gramm-Leach-Bliley Act, on the Federal Reserve's ability to examine, obtain reports from, or take enforcement action against a functionally regulated subsidiary of a BHC, such as a broker-dealer or insurance company.</p>
EC4	<p>Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.</p>
Description and findings re EC4	<p>Several factors ensure that banking laws and regulations are regularly reviewed and updated as necessary to remain effective and relevant to changing industry and regulatory practices. A number of statutes require the FBAs to review their regulations at regular intervals to ensure that they remain relevant and effective and to reduce the burden on regulated entities. These reviews are conducted through a process that allows for widespread public (including industry) participation in developing more efficient and relevant rules.</p> <p>In many instances, changes in statutory provisions are adopted by Congress in response to specific crises or market failures, industry concerns or recommendations, or to update banking laws to address changes in the marketplace. Changes also may be made in response to judicial decisions.</p> <p>In some cases, the FBAs have the discretion to determine the most effective form (e.g., regulations, guidelines, supervisory guidance, interpretations, etc.) in which to promulgate revised or new requirements. Depending on the urgency or nature of issues to be addressed, change may be made as part of the agencies' regular, periodic review of regulations, or may occur more quickly through the development and issuance of policy statements or guidelines.</p>
EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	<p>The FBAs have broad statutory authority to obtain a broad array of information from supervised entities and their affiliates, including financial data and information on their activities, operations, structure, corporate governance, risk management and any other details, in the form and with such frequency as the agencies deem necessary to determine and enforce compliance with applicable laws and ensure the safety and soundness of banks.</p> <p>Banks and their affiliates must provide the FBAs with full and complete access to their books, records and employees; failure to do so can result in the imposition of administrative</p>

	<p>sanctions. These duties extend to the foreign operations of banks and their affiliates, although the laws of foreign host countries may restrict U.S. banks in such countries from sharing certain information with the FBAs. The FBAs must also have full and complete access to the work papers, reports and other relevant materials of external auditors responsible for conducting an external audit of the banks. Institutions are subject to potentially significant monetary penalties for failure to make available information or reports, to submit reports on a timely basis, or for submitting or publishing any false or misleading report or information.</p> <p>As an essential component of consolidated supervision, the Federal Reserve maintains an understanding of all material parts of banking groups and nonbank financial groups subject to its supervision, including their domestic and cross-border operations. The Federal Reserve generally relies to the fullest extent possible on relevant primary supervisors and functional regulators for information about financial institutions within holding companies (see CP12).</p> <p>The local operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those applicable to domestic banks. In general, these requirements can be found in the statutes and regulations applicable to domestic banks and in the International Banking Act and its implementing regulations (see CP13).</p> <p>The assessors saw a range of supervisory material confirming the access of the FBAs to bank boards and staff, and relevant records, to conduct detailed examinations.</p>
EC6	<p>When, in a supervisor’s judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank’s license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	<p>The FBAs have broad authority to take (or require a bank to take) remedial measures when, in their judgment, a bank or holding company is not complying with laws or regulations or is, or is likely to be, engaged in an unsafe or unsound practice. In general, these authorities provide supervisors with both a range of proactive and remedial measures to address matters of concern and the discretion to determine when to employ them. The measures include restricting the current activities and operations of the organization, requiring new remedial activities, withholding or conditioning approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or restricting the powers of managers, board directors or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, closing an institution and revoking its banking license, and issuing monetary fines against institutions and individuals (The Federal Reserve’s ability to appoint a conservator or receiver to close a bank is more limited by statute than the OCC’s or FDIC’s). The FBAs have the authority to cooperate and collaborate to achieve an orderly resolution of a bank; by statute, the FDIC is always appointed the receiver for closed insured banks. In general, remedial measures are imposed according to the extent and severity of the problem being addressed (see CP11). The assessors reviewed a number of examples of the different types of remedial measures.</p>
EC7	<p>The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of</p>

	the bank and the banking group.
Description and findings re EC7	As noted in EC5 above, as an essential component of consolidated supervision, the Federal Reserve maintains an understanding of all material parts of banking groups and nonbank financial groups subject to its supervision, including their domestic and cross-border operations. The Federal Reserve has the power to review the activities of parent holding companies and of companies affiliated with those and uses this power to determine and ensure the safety and soundness of bank subsidiaries. In addition, the OCC may examine affiliates of national banks. See 12 U.S.C. § 481.
Assessment of Principle 1	Largely Compliant
Comments	<p>The DFA reforms have resulted in some rationalization of responsibilities in the U.S. supervisory structure, with the dissolution of the OTS and the absorption of its responsibilities for federal savings associations by the OCC. Taken on its own, the assessors see this as a positive step forward. In principle, the establishment of a specialized, stand-alone consumer protection regulator should also help to provide greater clarity of purpose for the FBAs. Nonetheless, the problems associated with multiple regulators with distinct but overlapping mandates, highlighted in the 2010 Detailed Assessment Report (DAR), differ only in form but not substance. In particular, the supervisory structure involves substantial duplication of supervisory effort, carries a significant burden of ensuring cooperation and coordination, and runs the ongoing risk of inconsistent messages from the agencies.</p> <p>The assessors readily acknowledge the legislative constraints on the FBAs and welcomed the obvious determination of the FBA staff with whom they met to ensure that the revamped supervisory structure works effectively. The assessors also acknowledge the substantial commitment of the FBAs to safety and soundness. Within the legislative constraints, however, the assessors recommend further effort in two particular, and related, areas.</p> <p>The first is the mandate of the FBAs. Each of the mandates refers in different ways to the objective of safety and soundness. This objective has been underscored by the DFA and is manifest in the substantial commitment of additional resources in each of the agencies to safety and soundness. Nonetheless, the legislative mandates do not make explicit that the primary objective of each agency is to promote the safety and soundness of banks and the banking system, as this CP emphasizes. The FBAs have asserted that there is no confusion on the part of the agencies, the public or industry that the focus of bank supervision and regulation relates to safety and soundness. This may well be the case in the aftermath of the financial crisis, but the emphasis may shift over time if political or economic pressures were to bring other priorities, such as employment growth, to the fore. The assessors recommend that, in the absence of legislative change, each of the FBAs revisit their “mission and vision” statements to ensure they give primacy to safety and soundness and to clarify that the pursuit of other objectives must be consistent with, and if necessary subordinate to, that goal. The assessors note that an international peer review of the OCC’s supervision of large and mid-sized institutions made a similar recommendation in respect of the OCC.</p> <p>The second is the division of responsibilities between safety and soundness, and consumer protection. In other jurisdictions, the establishment of a specialized consumer regulator has freed the bank supervisor to focus on safety and soundness matters. In those jurisdictions, the supervisor needs to be able to respond to operational and reputational risks associated with a bank’s poor performance in dealing with customers, but it does not generally become involved in particular consumer matters. The U.S. arrangements as they stand may not, in the assessors’ view, achieve this greater clarity of purpose. The FBAs retain their responsibilities for consumer protection issues in banking institutions with assets of \$10 billion or less and,</p>

	<p>as the assessors understand it, for particular consumer issues in institutions above that threshold. Given the legislative framework and the current resourcing of the CFPB, these arrangements may be the only way forward at this point. Nonetheless the assessors recommend that the FBAs and the CFPB explore ways to reduce duplication of effort, in matters such as risk reviews, and over time look to pursue opportunities for a more coherent division of responsibilities between safety and soundness, and consumer protection.</p> <p>In the assessors' view, there remains further work on making the new supervisory structure more focused and effective, and they judge that a "Largely Compliant" rating is warranted.</p>
Principle 2	Independence, accountability, resourcing and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	<p>As discussed under CP 1, each FBA operates pursuant to an express statutory grant of authority and has clearly defined objectives and responsibilities. Statutes and regulations provide supervisors clear and broad authority to address compliance with laws and the safety and soundness of institutions under their jurisdiction. In general, these authorities provide supervisors with both a range of proactive and remedial measures to address matters of concern and the discretion to determine when to employ them. Federal statutes also provide for the operational independence of each FBA.</p> <p>In addition to this statutory protection, other factors are intended to ensure the operational independence and accountability of each FBA, and these are discussed further below. They include the circumstances for appointment and removal of agency heads; the self-funding nature of the agencies and independence from the congressional budget process; accountability to, consultations with and testimony before and other submissions to Congress; multiple provisions for external review of, or public reporting on, agency operations; requirements to make records of the agency available to the public through various specified means, including upon request, under certain circumstances; adherence to requirements for establishing, meeting and reporting publicly on periodic operational performance targets; availability of judicial review for agency decisions; required annual reporting on regulatory and supervisory actions taken during the year; legal protection for supervisory staff acting within the scope of their employment; and conflicts of interest, financial disclosure and other similar restrictions applicable to agency personnel, including supervisory staff.</p> <p>The assessors saw no evidence of any constraints or intrusions on the operational independence of the FBAs by government or industry (see also EC 4 below). Clearly, however, the financial crisis has considerably increased political scrutiny of the agencies and raised expectations of stronger agency performance, which the assessors consider has been reflected in more intense and conservative supervisory approaches.</p> <p>For the FBAs, the organizing statutes, implementing regulations, guidelines and other resources are (and are required to be) made publicly available, including on the website of</p>

	each agency. (See 5 U.S.C. § 552(a)).
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	Laws establishing the FBAs specify the appointment process for the heads of the agencies, which is for a fixed term, but there are no laws specifying the reasons for removal of agency heads. The U.S. President, with the advice and consent of the Senate, appoints the heads. The Comptroller of the Currency is appointed to a five-year term, but can be removed by the President for cause prior to the expiration of his/her term, with the reasons to be laid before the Senate. During the Comptroller's tenure, he/she also serves as a director of the FDIC, as does the Director of the CFPB. The FDIC's three remaining directors are appointed by the President to six-year terms, although one of the appointed members is designated as Chairman for a five-year term. Members of the Federal Reserve Board of Governors are appointed to a full or to an unexpired portion of a 14-year term. One of the members is designated to serve as Federal Reserve Chairman, and another of the members is designed to serve as Vice Chairman, for a four-year term. All of these FBA positions are non-partisan, and there is no expectation that agency heads will resign at the conclusion of the term of the President who appointed them. See 12 U.S.C. § 2 (OCC); 12 U.S.C. § 242 (Federal Reserve); and 12 U.S.C. § 1812 (FDIC).
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ²⁵
Description and findings re EC3	<p>Each of the FBAs complies with the Government Performance and Results Act of 1993, which requires federal agencies, in consultation with Congress and outside stakeholders, to prepare a strategic plan covering a multiyear period and submit an annual performance plan and performance report. See 5 U.S.C. § 306 and 31 U.S.C. § 1115. The performance plans and assessments are incorporated into the agencies' annual reports, which are required to be made public. The agencies also are required, by separate statute, to report annually on regulatory and supervisory actions taken during the year.</p> <p>The FBAs' strategic plans and performance reports related to regulation and supervision are high-level documents. They set out broad strategic objectives and, though the formats differ between the agencies, they provide discussion on roles and responsibilities, potential risks and challenges, and means and strategies. Few objective performance targets or measures are specified; those that are relate mainly to the completion of examination cycles or the initiation of enforcement actions within timeframes prescribed by statute or agency policy. In the assessors' view, the strategic plans and performance reports are helpful in improving public understanding of the priorities and activities of the FBAs, and the assessors would encourage the agencies to develop performance metrics related to outcomes as well as activities.</p> <p>Oversight and accountability to Congress occur through various statutory reporting and frequent extensive hearings on various financial regulatory issues. This scrutiny has become more intense since the financial crisis began. The independence of agencies in expressing their views to Congress in testimony is specified by law. On behalf of Congress, the</p>

²⁵ Please refer to Principle 1, Essential Criterion 1.

	<p>Government Accounting Office (GAO) conducts and publishes audits of the agencies' performance. In 2009, the GAO placed the U.S. financial regulatory structure on its "high risk" list of matters warranting attention by Congress and the Executive branch of government. This was because of the GAO's view that significant market developments in recent decades have outpaced a fragmented and outdated regulatory structure and significant reforms to the U.S. regulatory system are critically and urgently needed. The GAO considers that the U.S. financial regulatory structure remains on its "high risk" list; issues of continuing concern are the large regulatory agenda still to be completed, the challenge for regulators in identifying and monitoring systemic risk, and whether current initiatives will be effective in addressing the "too-big-to-fail" problem.</p> <p>In addition to oversight by the GAO, each FBA has an independent Inspector General (IG) that performs audits and evaluations of its operations. The IGs are also required by legislation to perform material loss reviews (which are published) of any bank failure that cost the FDIC insurance fund more than a specified materiality threshold level (now set at \$50 million). In September 2011, the IG of the Federal Reserve published its "lessons learned" from a series of community bank failures in the crisis; a common theme from the supervision perspective was that, even when key safety and soundness risks had been identified, supervisors did not take sufficient action in a timely manner. This IG advised the assessors that the "pipeline" of failed banks subject to material loss reviews has shrunk considerably, allowing the IG to reallocate resources to assess aspects of the supervision of systemically important financial institutions.</p>
EC4	<p>The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.</p>
Description and findings re EC4	<p>Each of the FBAs has a unique internal governance and accountability structure for supervision and regulation involving authority and review at various regional or central levels. Within each agency there are processes for delegation of various supervision and regulation functions. For example, within the Fed system, Reserve Bank Presidents have delegated authority for supervisory matters from the Board. In each agency, considerable day-to-day authority for supervision decisions (such as ratings of institutions) is vested in the examiner-in-charge (EIC) for each bank. Each agency has review processes that can result in changes in these assessments in exceptional cases. The structure of the various agencies leads to their own internal review and coordination processes, which differ somewhat from agency to agency. There are also processes to allow banks to appeal formal decisions of the FBAs including ratings and proposed enforcement actions.</p> <p>The agencies have sought to improve these internal governance and accountability arrangements in response to the crisis and to lessons learned. The assessors discussed the changes with each of the FBAs. Broadly, the changes have involved more centralized direction and oversight, improved reporting of risk issues to newly established high-level risk committees, and greater coordination between head office and regional and field offices to achieve a better blending of horizontal and vertical assessments of risk.</p> <p>The governance rules (legislation and/or by-laws) for the Federal Reserve district banks allow for two-thirds of the boards of these banks to be appointed by the regulated commercial banks. These boards, in turn, have the right to appoint the officers of the Reserve Banks (including those in charge of supervision) and to have a say in their compensation, and are involved in approving the budget. In principle, this may raise concerns—actual or perceived—about potential conflicts of interest in the governance structure of the Federal</p>

	<p>Reserve in the handling of supervisory matters. Federal Reserve staff advised the assessors that, in practice, the boards are not involved in any way in operational supervisory matters and the assessors saw no indications to the contrary. Nonetheless, these longstanding governance rules for Federal Reserve district banks appear out of line with the importance now being attached globally to board independence and are worthy of review. At the least, board charters should make explicit that boards do not engage in supervisory matters and a robust conflict of interest framework is in place.</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings re EC5	<p>The FBAs require that agency heads and all staff maintain high professional standards and exhibit high integrity. Federal laws and regulations, as well as individual conflict-of-interest rules and codes of conduct of each of the FBAs, help to ensure that these standards are met. For some of the agencies, there are specific statutes governing ethical conduct. For example, the Comptroller of the Currency and Federal Reserve staff are subject to statutory restrictions on activities and affiliations that might raise conflicts of interests. See, e.g., 12 U.S.C. §§ 11 (unlawful for the Comptroller to hold an interest in a national bank) and 241, 242 (respectively prohibiting Federal Reserve members from holding office in or stock of a member bank). Similarly, FDIC employees are prohibited from owning stock in any FDIC-regulated entity. In addition, members of the FDIC Board of Directors are prohibited from holding any office, position or employment in any bank or holding company during their time in office and for two years after they leave office, subject to certain exceptions. See 12 U.S.C. § 1812.</p> <p>Senior examination staff of the FBAs are generally subject to a one-year post-employment “cooling off” period with respect to entities they supervised. Violators are subject to civil monetary penalties, can be removed from office and can be prohibited from participating in the affairs of the bank, the holding company, or any other company for up to five years. Examiners also are prohibited from accepting loans or gratuities from banks that they examine. OCC employees are also barred from representing another party before the Federal Government in a matter in which they participated as an OCC employee; the restriction is either two years or permanent. These standards are reinforced by a number of criminal statutes, including those prohibiting corruption, bribery, theft and fraud by agency employees. These laws are actively enforced. The FBAs have administrative policies to ensure that appropriate codes of conduct are being followed. These policies outline the requirements for examiners and other supervisory staff concerning investment prohibitions, borrowing prohibitions and recusal requirements based on considerations such as family, debt, or prior employment relationships.</p> <p>The assessors were impressed by the caliber of the agency staff they met, and banks and banking associations also attested to the professionalism and integrity of FBA staff.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and

	<p>independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks;</p> <p>(d) a budget and program for the regular training of staff;</p> <p>(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and</p> <p>(f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g. supervisory colleges).</p>
Description and findings re EC6	<p>Each of the FBAs is self-funding and, thus, is not subject to the congressional budget process or congressional appropriations. The assessors were advised by each agency that it has the budget needed to increase the intensity of its supervision and oversight, which has been a major priority in recent years. Indeed, since the crisis the FBAs have achieved a significant build-up of staffing resources, particularly in the supervision of large banking organizations, policy implementation and stress testing. The Federal Reserve, in particular, has significantly increased staffing in its supervision and regulatory policy areas.</p> <p>Each of the FBAs sets its own salary scales for its employees, having regard to salaries paid to other financial regulatory agencies, federal government and private sector salaries. Although the FBAs do not seek to match higher-end private sector salary scales, the subdued market conditions over recent years have enabled the FBAs to attract experienced hires from the financial and banking community to supplement their traditional preference for entry-level recruitment.</p> <p>The FBAs have intensified their staff training to match the influx of recruits. The FBAs also indicated to the assessors that they have the budget to meet travel needs associated with on-site work (including reviews of the offshore operations of U.S. banking institutions) and to participate in relevant policy fora and supervisory colleges.</p>
EC7	<p>As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.</p>
Description and findings re EC7	<p>Each of the FBAs undertakes an internal evaluation process to ensure that it has the staffing resources and skills to meet its supervisory needs. The assessors were advised that staffing requirements are generally determined from the "ground up" in the process of developing strategies and performance plans, and the assessors saw documents on this process. Active hiring and retention programs are used to attract and retain staff with the necessary critical skills. The FBAs offer comprehensive training for their staff, including a structured skills enhancement program to qualify as an examiner-in-chief. The FBAs also have the flexibility to bring in specialist staff on a fixed-term basis, as the FDIC has done to manage the significant increase in the number of bank workouts during the crisis.</p>
EC8	<p>In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.</p>
Description and findings re EC8	<p>By statute, the FBAs are required to conduct a full-scope, onsite exam of each bank at least once during each twelve-month period. However, the agencies can lengthen this cycle to 18 months for banks that meet certain asset size thresholds and supervisory rating criteria. See 12 U.S.C. § 1820(d)(4). Figures provided to the assessors (see table in CP 9) show that institutions subject to the longer review cycle account for a majority of regulated institutions</p>

	<p>but only a small percentage of total system assets.</p> <p>The FBAs utilize a risk-based supervisory approach. As part of this approach, supervisory programs are applied that are appropriate to the geographic scope and degree of specialization, sophistication, risk, size and complexity of the activities and organization of banks. In general, those entities presenting the greatest risk receive the most intense, frequent and comprehensive scrutiny.</p> <p>Supervisory programs allocate resources to each risk area, taking into account the intended frequency and intensity of risk assessments. As noted throughout this BCP assessment, each of the FBAs has increased the staffing resources allocated to the supervision of large banking organizations, reflecting the complexity and systemic importance of these organizations and the heightened supervisory focus on stress testing.</p>
EC9	<p>Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.</p>
Description and findings re EC9	<p>The FBAs and their staffs are generally protected against lawsuits for actions and/or omissions made while discharging their duties in good faith. Sovereign immunity bars lawsuits without specific statutory authorization to pursue such litigation. Common law qualified immunity protects FBAs' heads and staff from liability for the violation of an individual's Constitutional rights in connection with the performance of discretionary functions, as long as the employee's conduct does not clearly violate established statutory or Constitutional rights. Lawsuits are permitted against FBAs' employees for acts and/or omissions that cause injuries while acting within the scope of their employment. In such a case, the U.S. would substitute itself as the defendant upon the Attorney General's certification that an employee was acting within the scope of his office or employment. Moreover, an exception to the relevant act protects employees from lawsuits involving the execution of a statute or regulation or the exercise/ failure to exercise a discretionary function, whether or not the employee abused the discretion involved.</p>
Assessment of Principle 2	Compliant
Comments	<p>Since the crisis, political and community expectations about the performance of the FBAs have heightened and the FBAs have responded by strengthening their accountability and transparency. This would be aided by further development of performance measures focused on supervisory outcomes. The FBAs have also improved their internal decision-making processes and have stepped up their supervisory intensity, particularly towards large banking organizations. Delivery on these various initiatives has required a substantial commitment of additional resources and specialized skills. The assessors welcome the success of the FBAs in strengthening their capacities. The challenge ahead will be to retain those capacities as U.S. economic conditions continue to improve and specialist skills in areas such as stress testing and risk modeling become even more attractive to industry. The assessors encourage the FBAs to keep their hiring programs flexible and responsive, and their training programs fully funded.</p> <p>As noted in the 2010 DAR, the independence of the Federal Reserve's supervisory role would be further assured if the governance rules for the boards of Federal Reserve district banks were made consistent with emerging global good practice; at the least, greater clarity and transparency about the role of these boards in operational supervisory matters is needed.</p>

Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ²⁶
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>The FBAs have broad statutory powers to share information with other domestic banking supervisors. See e.g., 12 U.S.C. §§ 1817 (a)(2)(A) and (C) on sharing with FDIC, a state or federal agency with supervisory or regulatory authority over the bank or other entity, or any appropriate person and 3412(e) on sharing of financial records, reports of examination or other information about a bank, holding company or bank or holding company subsidiary among and between the five FFIEC member supervisory agencies, as well as the SEC, CFTC, FTC and CFPB.</p> <p>The FBAs have a number of formal and informal mechanisms for information sharing, which forms an integral part of supervisory programs for the consolidated supervision of banks and holding companies. The FBAs routinely share information with each other. This typically occurs at the time of formation of a banking group, authorization of a new activity, changes in a banking group’s structure, as well as during supervisory activities, in crisis situations, and as part of periodic meetings among supervisors. Examination findings are also shared between the FBAs, as appropriate.</p> <p>Since the crisis, the FBAs have enhanced their collaboration in a number of ways, including: the sharing of supervisory plans for review and comment; quarterly meetings of examiners of large banks to discuss heightened risk areas and upcoming targeted reviews; increased joint supervisory presence at examinations of systemically important banks; joint participation in the Federal Reserve’s horizontal reviews; and a stronger commitment to issue joint supervisory guidance when possible.</p> <p>The FBAs routinely exchange information with state supervisory agencies. The assessors were advised, however, that these agencies do not necessarily consult with the FBAs (or with foreign supervisors) when the agencies take enforcement actions. The FBAs are also seeking to improve information with functional regulators, such as the SEC and the CFTC, related to securities companies in a banking group or a financial conglomerate that includes a bank. A MoU between the OCC and the SEC was finalized in September 2014. The FBAs also have formal arrangements with state insurance supervisors to coordinate and plan supervisory activities, both on a routine and an emergency basis, with respect to particular banking groups that have significant insurance operations. The Federal Reserve makes available relevant information to other banking agencies and functional regulators regarding the financial condition, risk-management policies and operations of a holding company that may have a material impact on an individual regulated subsidiary. The other FBAs make information about bank subsidiaries of holding companies available to the Federal Reserve and to each other. Other functional regulators also provide information to the FBAs</p>

²⁶ Principle 3 is developed further in the Principles dealing with “Consolidated supervision” (12), “Home-host relationships” (13) and “Abuse of financial services” (29).

	<p>concerning regulated entities within U.S. banking groups that may have an adverse effect on the banks within the group.</p> <p>As noted in CP1, the FSOC facilitates regulatory coordination and information sharing among the member agencies, among other responsibilities. The Federal Reserve, OCC, CFPB and FDIC are members.</p>
EC2	<p>Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.</p>
Description and findings re EC2	<p>The FBAs have broad statutory authority to share relevant supervisory information with foreign financial sector (banking and functional) supervisors of banks and banking groups of interest to the home or host supervisor (see, e.g., 12 U.S.C. § 3109). The FBAs may disclose information obtained in the course of exercising their supervisory or examination authority; they may also assist foreign banking supervisors by investigating and collecting information and evidence where the foreign supervisor is conducting an investigation to determine whether a person has violated, is violating or is about to violate any law or regulation enforced by that supervisor.</p> <p>The FBAs have entered into bilateral formal information-sharing and cooperation arrangements (e.g., memoranda of understanding and statements of cooperation) with a number of foreign supervisors, and additional arrangements are in process. These arrangements cover the sharing of confidential supervisory information, with an emphasis on host-to-home sharing to support home supervisors' consolidated supervision of the financial groups for which they have responsibility. The arrangements contain a number of requisite provisions to govern the confidentiality of information. The arrangements also provide for on-site examinations by home authorities of cross-border operations in the host jurisdiction. The FBAs are authorized to share relevant supervisory information even in the absence of a formal arrangement, and in practice they share significant information whether acting in a home or host capacity.</p> <p>The assessors saw evidence that these arrangements are working in practice.</p>
EC3	<p>The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.</p>
Description and findings re EC3	<p>The FBAs are subject to a general statutory prohibition on disclosing certain types of confidential financial information unless the law specifically authorizes such sharing. In addition, each FBA's regulations, which have the force of law, require confidential treatment of a broad range of non-public supervisory information. In general, prior to engaging in information sharing, the FBAs require assurances that the information will be used only for lawful supervisory purposes and will be kept confidential. Under the International Banking Act, the FBAs must determine that disclosure to a foreign bank supervisor is appropriate and would not prejudice the interest of the U.S. (see 12 U.S.C. § 3109(a)). In addition, the FBAs must obtain, to the extent necessary, the recipient's agreement to keep the information confidential to the "extent possible under applicable law" (see 12 U.S.C. § 3109(b)).</p>
EC4	<p>The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand</p>

	(other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	<p>The FBAs are able to deny demands for confidential information in their possession except in limited situations. Such information may be subpoenaed by a court, a grand jury or a committee of the U.S. Congress. When feasible, an agency that is being compelled to provide confidential information received from another supervisor (domestic or foreign) will notify such supervisor and make reasonable efforts to resist disclosure. The FBAs also must notify and provide information to U.S. law enforcement authorities if they receive indications of a possible violation of criminal law.</p> <p>Under the International Banking Act, confidential material provided by a foreign supervisor will have broad protection from compelled onward disclosure if certain conditions are met. If these conditions are met, the FBAs could not be compelled to disclose such information except to a committee of the U.S. Congress or to comply with an order of a U.S. court.</p>
EC5	Processes are in place for the supervisor to support resolution authorities (e.g. central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	<p>The broad statutory authority of the FBAs to share information with other domestic and foreign financial authorities would include sharing relevant recovery- and resolution-related information with foreign resolution authorities, central banks and finance ministries with responsibility for resolution. See, e.g., 12 U.S.C §§ 1817(a)(2)(A) and (C); 12 U.S.C. § 3109. Such information may be provided on a bilateral basis under existing memoranda of understanding (or similar arrangements) or in response to specific requests. In the U.S., the FDIC is both the resolution authority and a direct supervisor. Therefore, coordination is an integral part of the FDIC’s activities as the resolution authority, and ongoing relationships with the other FBAs and state supervisory agencies provide the basis for effecting resolutions in an orderly and timely manner. Recovery and resolution planning also takes place in the CMGs established for large U.S. banking groups. The U.S. regulatory authorities have been working with their foreign counterparts to complete cooperation agreements (COAGs) that will facilitate work in the CMGs by establishing a framework for cooperation and the protection of sensitive supervisory information.</p> <p>The FBAs participate as home and host authorities of firms designated as global systemically important financial institutions by the Financial Stability Board in numerous firm-specific CMGs for the purposes of developing crisis management strategies and resolution plans for such firms. The FBAs also participate as home and host authorities in supervisory colleges established for a number of banking institutions at which recovery plans created by those institutions are reviewed.</p>
Assessment of Principle 3	Compliant
Comments	The U.S. system of multiple FBAs with distinct but overlapping responsibilities puts an absolute premium on effective domestic cooperation and collaboration if consolidated supervision is to be targeted, comprehensive and timely. The assessors are satisfied that the FBAs have made a substantial effort since the crisis to improve their performance in this

	<p>area, and this was also acknowledged in meetings with staff from all three agencies. The improvements are evident in the sharing of strategic planning and institution-specific supervisory plans, the greater frequency of interagency meetings, the increased number of examinations and other visits conducted jointly, the sharing of information, and efforts to ensure consistent messaging to banking organizations. However, consistency may not always be achieved when the FBAs bring different perspectives to a current issue, a concern raised by banks with which the assessors met in the context of recent guidance on leveraged lending.</p> <p>It is important that the effort be maintained and that collaboration becomes fully engrained in the modus operandi of each agency, so as to avoid any temptation to “go it alone” when crisis pressures next emerge. To this end, the assessors recommend that the FBAs ensure that the preparation of supervisory plans is on the same cycle or, when that is not practicable, that supervisory strategies for individual institutions are carefully coordinated and that necessary specialized resources are available.</p> <p>Internationally, the establishment of supervisory colleges and CMGs has given greater urgency to information-sharing arrangements, which have moved or are moving to more formal footings. The assessors have accepted the views put by each of the FBAs that there are no legal or other impediments to their ability and willingness to cooperate and collaborate with foreign supervisors. The actual performance of supervisory colleges was beyond the scope of this assessment and the assessors did not review papers from supervisory colleges. International cooperation would be further strengthened if state supervisory agencies consulted fully, in all cases, with the FBAs and foreign supervisors on impending enforcement actions. The assessors were made aware of circumstances where this was not the case. Although this is a clear deficiency in cooperation arrangements, the assessors did not judge it as sufficient to lower the “Compliant” rating for CP 3, but improvements in such consultations should be a high priority.</p>
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	<p>Federal and state laws expressly provide for the establishment, operation, permissible activities and transactions, and supervision of entities referred to as “banks.” In general, a “bank” is an institution (a) incorporated or chartered either under federal or state law; (b) authorized to engage in activities as specified under applicable law, typically including accepting demand deposits and engaging in the business of making loans; and (c) subject to supervision by state or federal authorities. Hence, the term “bank” is defined in terms of its range of permitted activities.</p> <p>Laws also provide for the establishment of specialized institutions that engage in some activities also permitted banks, but that generally are not called “banks.” These include “savings associations.” They provide many of the same services as banks and are supervised similarly. There is a small number of other more specialized institutions supervised by the FDIC that are not subject to the full gamut of banking regulations (e.g., industrial loan companies, trust companies, credit card banks and single purpose banks). These latter institutions, through “grandfathering clauses,” provide typical banking services and may remain in the deposit insurance scheme. Collectively, however, they have only a small share of the U.S. banking market.</p>

EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	<p>Federal and state banking laws and regulations provide clear parameters on permissible activities and transactions for banks. The National Bank Act, the Home Owners' Loan Act and implementing regulations specify the permissible activities of national banks and federal savings associations, respectively. In general, banks are limited to a set of activities considered to be "banking" or related and necessary to banking activities. Under certain circumstances, banks can be permitted to engage in a broader range of "financial" activities through particular subsidiaries or by parent companies; in general, however, banks cannot engage in additional activities through a subsidiary that they would not be able to engage in directly. Bank holding companies and savings and loan holding companies are permitted to engage in a variety of activities that are closely related to banking.</p> <p>The state laws under which state banks and state savings associations are chartered specify the permissible activities of such institutions. Federal law provides an "overlay" to the states' authority to determine the permissible activities and transactions of such institutions. In general, insured state chartered banks and savings associations may only engage in activities permissible for national banks and federal savings associations, respectively, unless the FDIC determines that an activity poses no significant risk to the deposit insurance fund, is related to the business of banking and engaged in directly, and the banks or savings associations continue to meet applicable capital requirements.</p>
EC3	The use of the word "bank" and any derivations such as "banking" in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	No entity may operate as a "bank" and engage in banking operations in the U.S. without a charter from a federal or state banking agency. 12 U.S.C. § 378 makes it a crime for any person or entity to purport to be a bank that accepts deposits if the entity is not licensed as such by an appropriate banking agency. In addition, states generally prohibit a corporation from using the word "bank" in its name unless it has a bank charter. Federal law also makes it a crime to make unauthorized use of terms, such as "national," "Federal," "United States," "reserve" or "Deposit Insurance", that indicate a federal banking charter, membership in the Federal Reserve or federal deposit insurance. The FBAs issue public alerts about known unauthorized use of these terms but do not have the power to take enforcement actions themselves against such usage.
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ²⁷
Description and findings re EC4	12 U.S.C. § 378 stipulates that all persons or entities engaged in demand deposit-taking are required to be subject to some degree of regulation, supervision or oversight by federal or state authorities. Persons violating this requirement are subject to criminal penalties, including fines and imprisonment. In practice, entities engaged in retail deposit-taking (except credit unions) are generally licensed and subject to supervision as banks or savings

²⁷ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

	associations.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	Collectively through the FFIEC, and separately, the FBAs publish and regularly update information on banks and holding companies (domestic and foreign, and including U.S. branches and subsidiaries of foreign banks) subject to their jurisdiction. Information accessible through the FFIEC's National Information Center includes detailed financial information and organizational charts.
Assessment of Principle 4	Compliant
Comments	There is a well-established framework for defining the permissible activities of banks and protecting the integrity of the term "bank". Though not a specific responsibility of the FBAs, it is important that the U.S. authorities closely monitor the disclosure practices of "bank-like" institutions, such as mutual funds offering deposit-like products, to ensure the community is well informed about the security of their savings.
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ²⁸ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	Banks, whether organized under federal or state law, are regulated and supervised by their licensing authority, as discussed in EC 2 below. They are typically also subject to concurrent regulation and supervision by one or more additional banking agencies. Establishing a de novo bank often involves obtaining related authorizations (i.e. federal deposit insurance, membership in the Federal Reserve System) from more than one agency. In particular,

²⁸ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms "board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	<p>foreign banks establishing a branch, agency or a subsidiary bank in the U.S. must obtain approval from the Federal Reserve as well as from the relevant licensing authority (see EC 10). The relevant agencies have well-established practices and procedures to communicate and coordinate investigations on related licensing and deposit insurance applications, and often conduct joint investigations on such applications. The assessors saw examples of interagency communications and information sharing on license applications.</p> <p>The licensing authorities/supervisors generally have the authority to impose prudential conditions or limitations on newly licensed banks, as appropriate.</p>
EC2	<p>Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.</p>
Description and findings re EC2	<p>The authority to license banks and the criteria to be considered are set out in statutes and regulations. The OCC is the licensing authority for national banks (see 12 U.S.C. §21 et seq) and federal savings associations (see 12 U.S.C. § 1464(a)), while each of the states has the authority to license (“charter”) banks headquartered and operating within its jurisdiction. Typically, the OCC and the states make licensing approvals for de novo banks conditional on the receipt of deposit insurance coverage. The FDIC alone is authorized to make determinations regarding deposit insurance under the Federal Deposit Insurance (FDI) Act.</p> <p>The OCC may deny an application if it determines that the applicants have not met the established criteria or if the information provided is inadequate. The FDIC and the Federal Reserve may also deny authorizations within their respective competences. The agencies must evaluate the evidence and, in this respect, may conduct investigations and exercise independent judgment based on all the information collected. Providing false or misleading information can be a basis for civil, administrative and criminal liability, and the penalties can include license revocation. See 12 U.S.C. §93 (a). The primary supervisor must consult with other relevant agencies on action to revoke a license. The FDIC is the resolution authority for banks.</p>
EC3	<p>The criteria for issuing licenses are consistent with those applied in ongoing supervision.</p>
Description and findings re EC3	<p>Although not expressly required by statute, the criteria for issuing licenses are generally consistent with those applied in ongoing supervision. For example, the OCC considers whether an applicant bank: (a) has organizers who are familiar with national banking laws and regulations; (b) has competent management that has ability and experience relevant to the type of products and services to be provided, and the scope and size of the projected risks; (c) has capitalization, access to liquidity, and risk-management systems that are sufficient to support the projected volume and type of business; (d) can reasonably be expected to achieve and maintain profitability; and (e) will operate in a safe and sound manner. See 12 CFR 5.20(f)(2). The OCC evaluates these same factors and others in the course of ongoing supervision. Supervisory material provided to the assessors confirmed a thorough license evaluation process.</p> <p>When evaluating applications for deposit insurance, the FDIC considers seven statutory factors enumerated in Section 6 of the FDI Act. These factors assess: the financial history and condition of the proposed depository institution and its parent organization; capital structure; proposed ownership and management; earnings prospects; activities to be conducted; convenience and needs of the community to be served; and potential risks to the Deposit Insurance Fund. The FDIC also considers the complexity and unique nature of the underlying proposal and business plan, including the conditions under which the proposed</p>

	institution will operate. Supervisory material provided to the assessors confirmed a thorough process for evaluating applications for deposit insurance.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ²⁹ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	The FBAs acknowledge that developing a complete understanding of the proposed legal, managerial, operational and ownership structures of a bank, on both a stand-alone and consolidated basis, is an essential component of the licensing process. In order to fulfill its responsibility for protecting the safety and soundness of banks, each banking agency must have a clear understanding of proposed internal operating and external ownership (including group) structures and be able to assess (at authorization and during ongoing supervision) the impact that those structures may have on the integrity of a bank. The importance of structural assessments to safety-and-soundness evaluations is emphasized in the “Joint Agency Statement on Parallel-Owned Banking Organizations” (April 23, 2002). If impediments exist or arise, the agencies may take appropriate remedial measures, including denying or terminating a bank’s license, deposit insurance coverage or Federal Reserve membership. The assessors understand that, in the light of crisis experience, the FBAs have a strong preference for business models that are transparent and are viable without an over-reliance on affiliates.
EC5	The licensing authority identifies and determines the suitability of the bank’s major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	As part of the licensing process, applicants are required to identify prospective shareholders and key decision-makers, including ultimate beneficial owners. The OCC may require each prospective principal shareholder (generally, those owning or controlling 10 per cent or more of a class of a bank’s shares) and key decision-makers of an applicant to provide detailed information on their current and past work experiences and financial holdings. The OCC conducts a background check and/or field investigation for information on criminal convictions, financial capacity and expertise in the financial industry. The FDIC also conducts background investigations of prospective principal shareholders, directors and executive officers during its review of deposit insurance applications. The assessors saw ample evidence of these evaluation processes. Assessments regarding principal shareholders primarily consider whether they have the ability to provide financial support to the proposed bank. A necessary part of this assessment is identifying the sources of initial capital from and the liquidity position of principal shareholders, and ensuring transparency of ownership structures. The FDIC’s “Final Statement of Policy on Qualifications for Failed Bank Acquisitions” (September 2, 2009) confirms that complex and functionally opaque ownership structures in which the beneficial ownership is difficult to ascertain with certainty, the responsible decision-makers are not clearly identified, and ownership and control are separated, would

²⁹ Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

	not be granted approval to own an insured depository institution.
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	<p>In general, a de novo depository institution must have a minimum amount of initial capital, which is available and ready to be deployed. For de novo banks, the OCC does not stipulate a minimum dollar amount of capital but it requires the bank to have sufficient initial capital (net of pre-opening expenses) to support the projected volume and type of business to be conducted. However, a de facto minimum of \$2 million applies since that is the FDIC’s minimum capital requirement for inclusion in the deposit insurance scheme. Generally, the OCC expects a de novo bank to remain above the “well-capitalized” level for purposes of Prompt Corrective Action throughout the first three years of its operation, and requires it to meet a minimum leverage ratio, measured in terms of tier 1 capital to on-balance sheet assets, of 8 per cent throughout that period, based on a realistic business plan. In most cases, a newly insured bank requires initial capital of significantly more than \$2 million to reach a size and scale that enables it to operate and compete in its identified geographic market(s). For de novo federal savings associations, there is a statutory minimum initial required capital of \$2 million (see 12 CFR 1431.3(b)).</p> <p>In addition to its minimum capital requirement for all depository institutions, the FDIC requires institutions to maintain an adequate Allowance for Loan and Lease Losses (ALLL) (see CP 18). For state nonmember institutions, the FDIC requires that the minimum leverage ratio of 8 per cent be met throughout the first seven years of operation. Furthermore, depending on a de novo institution’s anticipated risk profile, and regardless of charter type, the FDIC and/or other appropriate agency may impose a minimum leverage ratio requirement in excess of 8 per cent.</p> <p>The assessors questioned the FBAs about the de facto \$2 million minimum capital requirement for de novo banks and savings associations, which is much lower than the corresponding requirement for small banks in many other jurisdictions. The assessors were advised that the limit has become largely irrelevant and is in need of review; the OCC provided information that initial capital in a range of \$10-20 million is more typical for smaller de novo banks.</p>
EC7	The licensing authority, at authorization, evaluates the bank’s proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank. ³⁰ The licensing authority determines whether the bank’s Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	The FBAs, as applicable, evaluate proposed directors and senior management with respect to expertise, integrity and any potential for conflicts of interest. The OCC, for example, generally considers each individual’s: (a) financial institution and other business experience; (b) duties and responsibilities with respect to the proposed bank and, if applicable, holding companies and affiliates; (c) personal and professional financial responsibility, e.g., indicated by earlier professional experiences; (d) reputation for honesty and integrity, e.g., verified by (lack of) criminal convictions; and (e) familiarity with the economy, financial needs and

³⁰ Please refer to Principle 14, Essential Criterion 8.

	<p>general character of the community in which the bank will operate. Applicants must demonstrate that each prospective director has sufficient competence, experience and ability to direct the policies of the bank in a safe and sound manner, taking into account the circumstances and plans of the organization. Officers must show their ability to perform their proposed duties successfully, e.g., in interviews with licensing staff. The assessors saw ample evidence of this evaluation process.</p>
EC8	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.³¹</p>
Description and findings re EC8	<p>Applicants must show that the proposed business plan is viable and that the proposed management team has the ability to implement the plan successfully. The plan generally must: (a) establish the bank's ability to achieve a reasonable market share; (b) show that the bank has reasonable earnings prospects and the ability to attract and maintain adequate capital; (c) demonstrate that management is knowledgeable of and has plans for serving the community's needs; and (d) be supported by adequate policies, procedures and management expertise so that the bank can be operated in a safe and sound manner. Typically, applicants must provide a documented analysis of the market environment and realistic financial projections based on reasonable assumptions related to interest rates, growth, expenses and potential losses.</p> <p>To evaluate corporate governance structures, the licensing authorities seek to understand the board's involvement in setting and enforcing clear lines of responsibility and accountability by reviewing organizational charts, business plans and proposed policies and procedures. The agencies specifically determine how a bank's board will approve, oversee and communicate the bank's strategic objectives and otherwise exercise its fiduciary responsibilities. Board members are expected to exercise the duties of loyalty and care, which require them to act as prudent and diligent business persons in conducting the affairs of the bank.</p> <p>The agencies also consider the relationship between the proposed bank (its affiliates and holding company, if applicable) and any related parties. This includes evaluating potential conflicts of interest, terms and conditions of any transactions, contracts or business relationships, and the terms of compensation plans.</p> <p>With respect to risk-management systems and policies, applicants must develop appropriate written investment, loan, funds management and liquidity policies. They must also establish an acceptable internal control structure and audit program, including policies and procedures necessary to prevent the bank from being used for criminal purposes (including money laundering and terrorist financing) and for exercising appropriate oversight over outsourced functions. The operational structure and risk-management framework are expected to be consistent with the complexity, risk and scope of proposed operations. Plans that involve high-risk lending, a special purpose market or significant funding from sources other than core deposits, or that otherwise diverge from conventional bank-related financial services, require specific documentation as to the suitability of the proposed activities for a</p>

³¹ Please refer to Principle 29.

	<p>bank. Similarly, additional documentation is required where markets to be entered are intensely competitive or economic conditions are marginal.</p> <p>As noted above, supervisory material provided to the assessors confirmed that the evaluation processes of the agencies were detailed, probing and comprehensive, and incorporated a range of financial information as well as thoughtful supervisory judgment.</p>
EC9	<p>The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.</p>
Description and findings re EC9	<p>The OCC evaluates the inherent risks of the applicant’s business model and reasonableness of the financial projections as a critical element of the licensing process. Also critical is an assessment of the adequacy of financial strength, including capital levels, to support the proposed strategic plan. Estimates must be fully documented, supported and based on established growth patterns in the applicant’s specific market area. The OCC also evaluates concentrations of funding sources for safety and soundness concerns and determine whether contingency funding plans are adequate for the bank’s complexity and risk profile.</p> <p>With respect to asset growth projections, the OCC generally reviews the nature and risk profile of the asset mix, identify high-risk asset concentrations and consider whether risk-management systems and policies sufficiently measure, identify, and control risks. Depending on the risk profile of the assets contemplated, the OCC may require stress tests to show that the bank can maintain required minimum capital ratios and adequate profitability under adverse market conditions. Applicants must demonstrate that the proposed bank can achieve stabilized operations and generate an adequate profit within a reasonable period of time (typically, three years).</p>
EC10	<p>In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.</p>
Description and findings re EC10	<p>Foreign banks establishing a branch, agency or a subsidiary bank in the U.S. must obtain approval both from the licensing authority (the OCC or a state licensing authority) and from the Federal Reserve. The licensing authority may, and the Federal Reserve generally must, determine that the foreign bank, and any parent foreign bank, is subject to comprehensive and consolidated supervision by its home country supervisor. The licensing authority and the Federal Reserve also assess the extent, if at all, to which home country supervisors oversee or monitor any operations between a foreign bank and any foreign nonbank parent. The adequacy of home country supervision is evaluated at authorization and as part of ongoing supervision. The licensing authority and the Federal Reserve routinely contact the home country supervisor during the application process and, in making a decision on an application, take into account whether the home country supervisor has approved (or expressed no objection) to the proposal. See 12 CFR 28.12(b)(6) (OCC). The assessors saw evidence of this process. A foreign entity that is not a BHC must obtain Federal Reserve approval before establishing or acquiring a subsidiary savings association in the U.S. If the foreign entity is a foreign bank, the Federal Reserve must determine that the foreign bank and any foreign bank parent are subject to comprehensive and consolidated supervision by the home country supervisor.</p>
EC11	<p>The licensing authority or supervisor has policies and processes to monitor the progress of</p>

	new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	<p>The FBAs monitor the progress of de novo institutions in meeting their business plans and underlying strategic objectives. These reviews also include consideration of whether the banks have complied with any other conditions imposed as part of licensing. After the de novo period, changes in a bank's activities, if permissible under state and federal law, are subject to review during periodic safety-and-soundness examinations. In addition, de novo banks are required to give the FDIC prior notice of any change to the bank's business plan during the first three years of operation. As a condition of deposit insurance, the FDIC requires de novo state nonmember banks to submit pro forma financial statements and a business plan for operating years four through seven or longer, if deemed appropriate, before the end of the bank's third year of operation. The FDIC monitors compliance with such plans during the annual examination process and requires prior non-objection for any material deviations from or material changes to the plan.</p> <p>Based on experience in the financial crisis, when a number of de novo banks failed in their fourth to eighth years, the FDIC has stepped up the intensity of its supervision of de novo banks and, as noted in EC 6, has extended the period of application of the minimum leverage ratio of 8 percent.</p>
Assessment of Principle 5	Compliant
Comments	<p>Under the U.S. dual banking structure, banks may in principle choose to operate under a federal or state charter that best accommodates their business or strategic needs, although all banks will have a primary Federal supervisor. State-chartered banks may choose between supervision by the FDIC or by the Federal Reserve as a member bank, in addition to the supervision of their state supervisory authority. The evaluation processes for banks seeking a national charter and access to the deposit insurance fund appear thorough and testing. The assessors did not review the parallel evaluation processes of state supervisory authorities, which were out of scope for this assessment.</p> <p>Concerns have been raised, including in the U.S. Treasury White Paper on Financial Regulatory Reform (2009), that the choice of supervisor available to banks can give rise to "regime shopping" that can undermine the integrity of U.S. regulatory arrangements. The financial crisis highlighted egregious examples. Since the crisis, the authorities have taken steps to reduce banks' incentives for inappropriate charter conversions. In 2009, the FFIEC "Statement on Regulatory Conversions" addressed proposed conversions by institutions with less than satisfactory ratings (a CAMELS rating of 3, 4 or 5) or that have a material corrective action program in place or being contemplated, as well as those subject to serious or material enforcement actions. Such conversion applications require consultation with the FDIC and Federal Reserve (in the event of a holding company); in practice, the FBAs will not accept conversions involving a 4 or 5 rated institution. Key aspects of the FFIEC Statement were given statutory force by the DFA, which also resulted in the dissolution of the OTS. Section 612 of that Act generally prohibits charter conversions, in either direction, while the institution concerned is subject to any formal enforcement actions that involve a significant supervisory matter. Exceptions to this conversion prohibition are possible in certain defined circumstances, which are expected to be rare. The FFIEC Statement remains in place, since it covers a broader range of circumstances than section 612.</p> <p>A large number of (well-rated) banks and savings associations currently fall outside the scope of these conversion restrictions and there has been a steady stream of charter conversions in both directions, although the numbers are not large in absolute terms. The</p>

	<p>FBA's have explained to the assessors that state banks generally convert to federal charters if they have national ambitions, while national banks and savings associations converting to state charters generally claim that state supervisory authorities are more attuned to local economic conditions and the needs of smaller community banking organizations. The FBA's explained to the assessors that charter conversions that fall outside the scope of the FFIEC Statement are generally subject to handover "protocols" that would discourage inappropriate regime shopping. The assessors see merit in incorporating these protocols in the FFIEC Statement.</p> <p>The choices made by banking organizations between the three FBA's can, over time, have important implications for the staffing and sustainability of regional offices. The FBA's need to guard against creating perceptions of differences in supervisory style or intensity in these offices that could sway the choices made by banks on charter conversions.</p>
Principle 6	Transfer of significant ownership. The supervisor ³² has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest".
Description and findings re EC1	<p>Federal statutes and their implementing regulations define controlling interest but not significant ownership. They address proposed changes in ownership, control, or structure of banks. In general, prior authorization by the appropriate FBA is required for any person to acquire "control" of a bank. "Control" for this purpose is defined as "the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 per cent or more of any class of voting securities of an insured depository institution." See The Change in Bank Control Act (CIBC Act) 12 U.S.C. §1817(j)(8)(B). Under limited circumstances a presumption of control arises when a person would own, control, or hold the power to vote 10 percent or more of any class of voting securities. In certain cases, a five percent voting share may be assessed as "a rebuttable threshold" for deeming a person to having control. A "person" for purposes of the CIBC Act includes an individual, a group of individuals acting in concert, or certain entities (e.g. corporations, partnerships, and trusts) that own shares of banks but that do not qualify as bank holding companies.</p> <p>Further, prior authorization of the Federal Reserve is generally required under the Bank Holding Company Act (BHC Act), 12 U.S.C. § 1842(a), for a company that is subject to the BHC Act to directly or indirectly acquire control of a bank or BHC. "Control" for this purpose generally includes direct or indirect ownership, control, or the power to vote 25 percent or more of any class of voting securities of a bank or BHC. "Control" is further defined to include (a) control over the election of a majority of directors or persons exercising similar functions; or (b) the power to exercise directly or indirectly a controlling influence over the management or policies of the bank or BHC (see 12 CFR 225.2(e)(1)). For existing BHCs, Federal Reserve authorization is required before the BHC can acquire, directly or indirectly, 5 percent or more of any class of voting shares of another bank (see 12 U.S.C. § 1842(a)(3)). The Federal Reserve generally is required to consult with the state banking agency and/or the OCC (as appropriate) in processing the request for authorization (see 12 U.S.C. §</p>

³² While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	<p>1842(b)(1)). By statute, the Federal Reserve cannot approve a BHC application under certain enumerated circumstances (see 12 U.S.C. § 1842(c) and 12 CFR 225.13).</p> <p>Prior authorization of the Federal Reserve is required under the Home Owners' Loan Act (HOLA), 12 U.S.C. § 1467a (e), for a company directly or indirectly to acquire control of a savings association or savings and loan holding company (SLHC). The definition of "control" under the HOLA is similar to the BHC Act definition of control. Approval criteria for SLHC applications are similar to the approval criteria for BHC Act applications, and by statute the Federal Reserve cannot approve a SLHC application under certain circumstances (see 12 U.S.C. § 1467a (e) (2)). See EC3 for a more detailed account of the conditions for approval/denial. In addition, subject to statutorily enumerated exceptions, Federal Reserve approval is required before an SLHC can acquire, directly or indirectly, more than 5 percent of a class of voting securities of another savings association or SLHC (see 12 U.S.C. § 1467a (e) (1) (A) (iii)).</p> <p>As noted above, there is a clear definition of the concept of "control". However, there is no definition or use of the concept "significant ownership". That said, there is a threshold for the bank to annually report to the supervisors all shareholders having five percent or more of the total votes. Additionally, Federal Reserve approval is required for SHLC acquisitions exceeding five percent of a class of voting securities of another savings association of SHLC. This may be interpreted as a measure of "significant ownership".</p>
EC2	<p>There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.</p>
Description and findings re EC2	<p>The U.S. FBAs have statutory authority under the CIBC Act, 12 U.S.C. § 1817(j), to review, reject, and impose conditions on proposals involving significant changes in ownership or control of banks. As noted above, prior authorization by the appropriate federal banking agency is generally required for any person to acquire "control" of a bank or BHC.</p> <p>The implementing regulations for the CIBC Act, the BHC Act, and the HOLA set forth procedures that must be followed to effect a change in ownership (including beneficial ownership), the exercise of voting rights over a particular threshold, or control of a bank or holding company. Submission of a prior notice under the CIBC Act is normally required, but the CIBC Act exempts various categories of transactions from this requirement (including some grandfathering of control existing before 1979) or requires a 90-days after-the-fact notice for other categories of transactions (this applies for instance to "unexpected transactions" such as gifts, changes in other persons' shareholdings etcetera) .</p> <p>Similarly, the Federal Reserve's regulations provide for the filing of either an application or prior notice with respect to a company's acquisition of a bank, identify a limited set of transactions not requiring agency approval, and allow for a waiver of filing requirements under certain circumstances (see 12 CFR part 225.12). OCC regulations pertaining to application requirements and procedures are found at 12 CFR 5.33 (national banks) and 12 CFR 163.22 (federal savings associations).</p>
EC3	<p>The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.</p>

<p>Description and findings re EC3</p>	<p>The FBAs have the power to reject a proposal for a change in ownership. In general, the factors considered with respect to proposed changes in significant ownership, including beneficial ownership, or control of banks are comparable to those used in approving new banks. For example, the agencies evaluate change in control notices based on the statutory factors enumerated in section 7(j) of the Federal Deposit Insurance Act (FDIA). These factors include whether the proposal would result in a monopoly; whether the effect of the proposal in any section of the country may be to substantially lessen competition, or in any other manner be in restraint of trade; the financial condition of the acquiring party and its potential impact on the bank or depositors; the competence, experience or integrity of any acquiring person or proposed management; whether any acquiring party neglects, fails, or refuses to furnish information required by the appropriate federal banking agency; and the effect on the Deposit Insurance Fund.</p> <p>Criteria vary under the other applicable statutes, such as the Bank Merger Act, CIBC, BHC Act, and Home Owners' Loan Act, but the relevant federal bank agency generally considers (a) the financial condition and integrity of the ownership group; (b) the competence, experience, and integrity of management; (c) the future prospects of the resulting entity; (d) business plans of the resulting entity; (e) the impact of the proposal on the safety and soundness of the resulting entity; (f) the convenience and needs of the community(ies) to be served; and (g) the impact of the proposal on financial stability. In addition, the FBAs generally also consider the competitive effects of the proposal, along with compliance with applicable consumer protection and anti-money laundering statutes, and activities covered by the CRA. A request for authorization under any of these applicable statutes may be denied on any of the grounds considered, or an agency may impose conditions on authorization limiting an acquirer's exercise of voting rights.</p> <p>If a change in significant ownership was based on false information, the FBAs have various powers to impose penalties and affirmative requirements, potentially including divestiture of ownership. See e.g., 12 U.S.C. § 1818(b)(6) (authority to require appropriate affirmative action due to a violation of law or regulation); see also 12 U.S.C. § 1817(j)(15)(B)(ii) (authority to seek relief necessary to prevent violation of the CIBC Act, including divestiture).</p>
<p>EC4</p>	<p>The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.</p>
<p>Description and findings re EC4</p>	<p>The agencies obtain from banks and holding companies through annual reporting and/or on-site examinations, the names of all significant shareholders, including those that may exert a controlling influence, and the identities of beneficial owners. The Federal Reserve, for example, requires the annual submission of the identities of those shareholders who own or control 5 percent or more of a class of voting shares of a bank or BHC. (The other FBAs apply corresponding rules to savings banks and SHLCs). On-site or off-site examinations will periodically include review of the ownership of significant shareholders.</p>
<p>EC5</p>	<p>The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.</p>
<p>Description and findings re EC5</p>	<p>The agencies require after-the-fact requests for authorization for changes in control made without necessary notice to, or approval of, the agencies. In evaluating such requests, the agencies consider whether the failure to request authorization in the first instance was a knowing violation of the law. (Such a violation could result in the imposition of civil monetary penalties against participants and sanctions against any "institution-affiliated</p>

	party” up to, and including, debarment.) The agencies also consider whether appropriate policies and procedures have been put in place to ensure that further violations do not occur. The agencies have the authority to deny or condition an after-the-fact request for authorization. For instance, they may bar the shareholder from voting or from appointing directors in the bank. Ultimately, they may require that the stockholding be divested.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	Although there is no explicit regulatory requirement, the agencies expect (on general grounds such as the safety and soundness prerequisites) controlling shareholders, or the bank with which they are affiliated, to provide the agencies with timely notice of any material information that would impact the shareholders’ continued suitability.
Assessment of principle 6	Compliant
Comments	<p>The FBAs have comprehensive definitions for “controlling interest”, taking into account both quantitative and qualitative factors of control. There are clear rules for prior approval or notifications of changes in ownership. Supervisors may deny improper changes in ownership and may in certain circumstances require the reversal of completed transactions or require other remedial actions. The assessors saw evidence of supervisors taking such actions.</p> <p>The concept of “significant ownership” is not defined per se. However, in practice the international practice of a five percent threshold for the reporting of significant shareholders is applied. The assessors saw evidence, including supervisors’ responses to applications for ownership changes, that the above rules and policies are applied in practice.</p> <p>There is no explicit regulatory requirement for a bank to immediately report if they find that a major shareholder is no longer suitable. Nor did the assessors see any evidence of such reporting in the written documentation. The assessors recommend that such a supervisory requirement is introduced, with the aim to ensure that supervisors are promptly informed if a major shareholder is no longer suitable, since this might have a negative impact on the safety and soundness of the bank. Assessors chose to address this shortcoming under CP 9.</p>
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	<p>Laws or regulations clearly define:</p> <p>(a) what types and amounts (absolute and/or in relation to a bank’s capital) of acquisitions and investments need prior supervisory approval; and</p> <p>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank’s capital.</p>
Description and findings re EC1	Federal and state laws limit and define the types of acquisitions or investments banks may make. For banks, the permissible activities and investments are set forth in the statutes discussed under Principle 4 and the agencies’ implementing regulations. The agencies have

	<p>established regulatory criteria for prior approval of major acquisitions or investments of banks. Although not every investment or acquisition must be approved in advance by the regulatory authorities, procedural criteria have been designed to allow the banking supervisors to review acquisitions or investments that could have a significant effect on a bank’s condition (e.g., mergers and acquisitions of subsidiaries). See summary table³³ below.</p> <p>Under the Federal Reserve’s Regulation K (12 CFR part 211), foreign investments by member banks may be made under general consent, prior notice, or application procedures. In general, prior approval is necessary for new or large investments, while post-notice is sufficient for smaller investments. However, “well capitalized and well managed” FHCs are allowed to execute a wider range of acquisitions and investments on a general consent basis. (12 CFR 211.9) Similarly, the FDIC’s International Banking regulations (12 CFR part 347) authorize state nonmember banks to make foreign investments under general consent or with prior approval after the filing of an application. The regulations set forth criteria for determining the appropriate procedure in 12 CFR 347.117, 347.118, and 347.119. Under 12 CFR 28.3, national banks acquiring an interest in an Edge or agreement corporation, foreign bank, or other foreign organization must provide notice to the OCC.</p> <p>The OCC’s regulations for federal savings associations on Lending and Investment, 12 CFR part 160 (in particular 160.36), and Subordinate Organizations, 12 CFR part 159 apply to both domestic and foreign activities and investments. CFR 12 CFR 24.4 and 24.5 requires that OCC approves a written request for investments exceeding in aggregate 5 percent of the acquiring institution’s capital and surplus. The BHC Act and section 10 of the HOL Act set forth the permissible activities of BHCs and SLHCs, respectively (see 12 U.S.C. §§ 1843(c) and 1843(k) and 12 U.S.C. § 1467a(c)). The Federal Reserve’s SLHC regulation applies to both domestic and foreign activities and investments. For both BHCs and SLHCs, there are clear regulatory directions as to when an application for prior supervisory approval is necessary or when post-notice is sufficient for an acquisition.</p> <p>Nationally chartered banks may only acquire minority stakes (i.e. a minority in the investment target) in non-bank activities. Furthermore, these must be related to banking, such as investments in service corporations.</p> <table border="1" data-bbox="418 1226 1409 1745"> <thead> <tr> <th></th> <th>Prior Notice</th> <th>Prior Approval</th> <th>General Consent</th> <th>Post Notice</th> <th>FDIC Statutory Approval</th> </tr> </thead> <tbody> <tr> <td>All Bank Holding Companies</td> <td>Investments abroad above a specific dollar amount or amount of capital</td> <td>Acquisition of a bank or thrift Purchase of more than 5% of a bank New non-banking activities. Purchase of more than 5% of a non-bank company</td> <td>Investments abroad below a specific dollar amount or amount of capital</td> <td></td> <td>Acquisition of an uninsured entity that takes deposits by an insured depository institution</td> </tr> </tbody> </table>						Prior Notice	Prior Approval	General Consent	Post Notice	FDIC Statutory Approval	All Bank Holding Companies	Investments abroad above a specific dollar amount or amount of capital	Acquisition of a bank or thrift Purchase of more than 5% of a bank New non-banking activities. Purchase of more than 5% of a non-bank company	Investments abroad below a specific dollar amount or amount of capital		Acquisition of an uninsured entity that takes deposits by an insured depository institution
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³³ The FBAs noted the major acquisitions framework is too complex to be adequately reflected in a table. This summary table is therefore not exhaustive and only highlights main points required by this EC.

	<p>Well Capitalized and Well managed BHC and FHC</p> <p>BHC and FHC above \$50bn of assets</p> <p>All National Banks</p>	<p>Investments abroad above a specific dollar amount of capital</p> <p>As above</p> <p>New activities that are permissible banking activities</p> <p>Minority interests where there is an exit strategy</p>	<p>Acquisition of a bank or thrift</p> <p>As above</p> <p>Mergers with other banks</p> <p>New Branches</p>	<p>Investments abroad below a specific amount of capital</p> <p>Acquisitions that do not give rise to financial stability concerns</p>	<p>Reporting of acquisitions of nonbank companies</p>		
EC2	Laws or regulations provide criteria by which to judge individual proposals						
Description and findings re EC2	<p>Implementing regulations specify the criteria by which individual proposals are to be evaluated. In some instances, these criteria also are specified by statute, which may include the Bank Merger Act, CIBC Act, BHC Act, and HOL Act. Factors considered in reviewing such proposals generally include competitive concerns, financial and managerial resources, future prospects of the resultant bank, the convenience and needs of the community to be served, CRA compliance, anti-money laundering compliance, the impact of the proposal on the risk to the stability of the U.S. banking or financial system, and compliance with consumer protection statutes (see e.g., 12 U.S.C. 1828(c)(5); 12 CFR 5.33(e)).</p> <p>Where acquisitions by a holding company of a bank require agency approval, applicable statutes and regulations provide review criteria. The FBAs expect that investments and foreign activities, whether conducted directly or indirectly, will be confined to activities of a banking or financial nature and those necessary to carry on such activities. At all times, investors must act in accordance with high standards of banking or financial prudence, with due regard for diversification of risks, suitable liquidity, and adequacy of capital. To be eligible to make foreign investments, the investor and its parent(s) must be in compliance with applicable minimum capital adequacy standards. In order to make investments under general consent authority, the investor and any insured parent bank must have received at least a composite rating of "satisfactory" at the most recent examination.</p>						
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where						

	appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ³⁴ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	In all instances in which a notice or application is required for a proposed acquisition or investment, the agencies assess whether the acquisition or investment would expose a bank to undue risk or would hinder effective supervision. Such assessment would include analysis of the host country supervision. When evaluating proposals by organizations to establish foreign operations (including an office or subsidiary), the FBAs require the applicants to show, and the FBAs must determine, that the laws or regulations of the foreign jurisdiction would not prohibit the FBAs from obtaining information needed to determine and enforce compliance with U.S. banking regulations. The FBAs have the authority to deny a request for authorization if they determine that they would not be able to obtain adequate information for the exercise of consolidated supervision. See Principles 12 and 13 for further information and 12 CFR part 28, subpart A and 12 CFR 211.13(a)(3).
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	For those proposals requiring authorization, the FBAs consider whether the bank or holding company has the financial, managerial and organizational resources to support the acquisition or investment. See, e.g., 12 U.S.C. 1828(c)(5) and 1842(c); 12 CFR 5.33(e); 12 CFR 225.13. This evaluation includes, but is not limited to, an assessment of the amount and source of initial funding, the resulting capital condition of the acquirer, the impact of the acquisition on the examination ratings of the acquirer, and the policies and procedures to be implemented at the target (including compliance with BSA/AML requirements). A three-year projection of the financial impact of the acquisition on the acquiring institution is required. For examples, see OCC's Licensing Manual: Business Combinations; Investment in Subsidiaries and Equities, Subordinate Organizations, and Combination with a National or State Bank booklets. For those proposals not requiring authorization, the supervisors will typically be informed of investments/acquisitions through its off-site monitoring and on-site examinations. Supervisors will then, as warranted, assess the impact of the investments/acquisitions on the bank and holding company.
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	Significant nonbanking activities must be approved in advance by the applicable FBAs. See, e.g., OCC's Licensing Manual: Investment in Subsidiaries and Equities and Subordinate

³⁴ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

findings re EC5	Organizations booklets. The Federal Reserve is responsible for approving the establishment of BHCs, SLHCs, and their nonbank subsidiaries, and examines the activities of BHCs and SLHCs on a consolidated basis. Any investment in nonbanking activities by a BHC or SHLC requires prior approval by the Federal Reserve. Well capitalized and well managed FHCs may, however, make such investments and notify after-the-fact. There are statutory provisions designed to protect a bank from suffering losses in transactions with affiliates. For instance, lending from the bank to another affiliate of the group may not exceed 10 percent of the bank's capital and the aggregate lending to all other affiliates may not exceed 20 percent. During examinations, supervisors regularly review transactions between the bank and its affiliates to determine compliance with such provisions. If there are transactions that pose safety and soundness concerns for the bank, federal supervisors can take actions to ensure that corrective action is taken and that the bank is protected. The FBAs consider the ability of the organization to manage the risks associated with the activities as part of the approval process. See, e.g., 12 U.S.C. § 1843; 12 CFR 225.26.
Additional criteria	
AC1	The supervisor reviews major acquisitions or investments by other entities in the banking group to determine that these do not expose the bank to any undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ³⁵ Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.
Description and findings re AC1	The FBAs review acquisitions within the banking group, as described above. See Principle 7, EC 1. Direct or indirect investments by banks in entities engaged in nonbanking activities would be subject to approval by the appropriate federal supervisor. See 12 CFR 5.39 (financial subsidiaries of national banks), 12 CFR part 208 subpart G (financial subsidiaries of state member banks), and 12 CFR part 362 (financial subsidiaries of state nonmember banks). Other direct or indirect investments by a BHC or SLHC would be subject to review by the Federal Reserve. See 12 CFR part 211 subpart A; 12 CFR part 225 subparts C and I (nonbank investments by BHCs); 12 CFR part 238 subparts F and G (nonbank investments by SLHCs). Major acquisitions would be subject to prior approval requirements, while other investments may qualify for limited or post-notice. To the extent that an acquisition was approved, but raised significant potential issues, the approving agency could impose conditions on its approval to mitigate any concerns. Assessors have reviewed files that included acquisitions by the broader group.
Assessment of Principle 7	Compliant
Comments	Laws and regulations exist to define which acquisitions and investments that require prior approval by the authorities, a notification after-the-fact or may be made under general consent. There are also clear criteria by which the authorities assess the applications. Legislation and regulations also put clear restrictions on the scope of permissible investments and acquisitions, such as in non-bank related activities. Assessors saw evidence, including supervisors' reports on banks' applications for

³⁵ Please refer to Footnote 33 under Principle 7, Essential Criterion 3

	investments/acquisitions, that the above rules and policies are applied in practice.
Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	<p>The supervisor uses a methodology for determining and assessing on an on-going basis the nature, impact and scope of the risks:</p> <ul style="list-style-type: none"> (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
Description and findings re EC1	<p>All Banks</p> <p>The U.S. firmly adopts a risk-based approach to supervision. This is both in terms of its focus on risk within banks, but also adjusting that approach in proportion to the risk banks pose to the system. The supervisory process is highly structured with a high proportion of mandated reviews, a uniform rating process and an extensive planning process that agrees the supervisory strategy going forward. U.S. regulators have a statutory responsibility to ensure and evaluate safety and soundness. The multiple regulators also look at different aspects of banking groups and their structure – for example Federal Reserve looking at Bank Holding Companies and OCC looking at banks.</p> <p>During each supervisory cycle, the supervisors formally assess the risk profile of each bank and holding company in order to determine the supervisory strategy to be followed by examination staff and prioritization of agency resources. Risk assessments are updated on a regular basis through off-site monitoring programs and on-site examinations. These risk assessments use a common framework that promote and facilitate comparisons across banking organizations. Supervisors maintain continuous off-site monitoring programs to determine and assess on an on-going basis the nature, importance, and scope of risks to which banks and holding companies are exposed. These programs draw on financial data, prior supervisory assessments, regulatory reports specifying changes in activities, and other internal and publicly available sources of information to identify banks and holding companies requiring a heightened supervisory focus. Banks and holding companies showing signs of significant deterioration or making significant changes in their business focus may be subject to immediate on-site or targeted examination under policies and procedures maintained by the banking agencies. The adequacy of internal controls is evaluated during on-site or targeted examinations and is also taken into consideration when determining the need for additional supervisory work. In addition, the banking agencies collect information on the scope of each bank’s and holding company’s external audit to help to gauge the quality of internal controls, and require audited financial statements and additional reporting on the quality of internal controls for banks and holding companies of significant size (banks</p>

exceeding a minimum asset threshold of \$500 million).

The Federal Reserve uses a ratings system known as RFI to assign supervisory ratings for Bank Holding Companies on a consolidated basis. The R rating component provides a framework for assessing and assigning risk ratings across Bank Holding Companies. In addition, all the agencies' Uniform Bank Performance Report allows supervisors and supervisory staff to compare financial trends across groups of peer banks to identify outlier or high-risk banks. The agencies also use a common Uniform Financial Institution Rating System (UFIRS), known as CAMELS, that provides a consistent methodology and terminology for assessing and assigning risk ratings across banks. Similar uniform rating systems are used to assess holding companies, information technology, trust, and consumer compliance systems. The ROCA rating system is used for FBOs. Each agency has additional tools and systems, such as horizontal examinations of a group of banks that it uses to supplement these interagency tools.

The Prompt Corrective Action (PCA) statute provides the agencies with authority to promptly resolve capital deficiencies at insured depository institutions, and thereby reduce bank failures. The PCA imposes mandatory and discretionary restrictions on an insured depository institution's capital position to ensure a minimum level of capital is maintained or, in the absence of maintaining the minimum level of capital, requires the chartering government agency to close or seize the insured depository.

Generally the supervisors use a \$10bn threshold as a key dividing point in the intensity of supervision—typically it is the point where supervisors carry out continuous assessment of firms usually supported by resident examination teams, rather than a periodic examination, which is based on a twelve-month cycle (or eighteen months in certain circumstances).

Banking Institutions with at least \$10bn of Assets

Above the \$10bn threshold, the supervisors typically adopt a process of continuous assessment. This will normally involve resident examination teams.

Banking Institutions with at least \$50bn of Assets

The most intensive form of supervision is reserved for those institutions above \$50bn. These firms will typically have the greatest level of resources devoted to their supervision.

The U.S. supervisory approach was further broadened with a new supervisory program aimed at large, complex financial institutions. The Federal Reserve issued supervisory guidance in 2012 that builds upon the lessons learned from the financial crisis by strengthening both micro prudential supervision and regulation and macro prudential supervisory considerations to reduce potential threats to the financial system. This guidance supports a tailored approach that accounts for the unique risk characteristics of each firm. The guidance embodied in SR 12-17 covers core areas of supervisory focus. The guidance specifies the Federal Reserve's expectations around two main areas: 1) enhancing the resiliency of a firm that includes guidance on capital and liquidity planning and positions; corporate governance; recovery planning; and management of core business lines, and 2) reducing the impact of a firm's failure that includes guidance on management of critical operations; support for banking offices; resolution planning; and additional macro prudential supervisory approaches to address risk to financial stability. The guidance covers firms supervised by the Federal Reserve with consolidated assets of \$50 billion or more (for Large FBOs with combined assets of U.S. operations of \$50 billion or more). The supervisory guidance embodied in SR 12-17 does not apply to regional or community banking organizations—regional organizations with total consolidated assets less than \$50 billion.

	<p>Additionally, under the DFA, systemically-significant bank holding companies or nonbank financial firms are required to submit periodic reports to the agencies providing the plan of the company for rapid and orderly resolution in the event of material financial distress or failure. The DFA also provides for the orderly liquidation of covered financial companies. Thus, the U.S. supervisory approach also includes a framework for early intervention and resolution of banking organizations if they become non-viable.</p> <p>Supervisors develop and maintain an understanding of the operations of individual banks and holding companies, to evaluate and ensure their safety and soundness and compliance with applicable laws and regulations, and to monitor the stability of the banking and financial system. Under the DFA, the agencies, in their capacity as FSOC members, are required to report annually and testify before the U.S. Congress on significant financial market and regulatory developments, potential emerging threats to financial stability, determinations of companies that pose a threat to financial stability in the U.S., and recommendations that the primary financial regulatory agencies apply new or heightened standards and safeguards for a financial activity.</p>
<p>EC2</p>	<p>The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.</p>
<p>Description and findings re EC2</p>	<p>All Banks</p> <p>U.S. FBAs carry out on-site reviews and off-site analyses to develop a thorough understanding of the risk profile of banks and holding companies. Under U.S. law, the agencies conduct full-scope on-site examinations of banks at least once every year (for banks that have assets of at least \$500 million or that are not considered well-managed or well-capitalized) or 18 months (for banks that have assets of less than \$500 million and that are considered well-managed and well-capitalized—CAMELS ratings of 1 or 2). BHC inspections are mandated on an annual or two year basis depending upon size, complexity, and rating, with smaller (less than \$1 billion in assets) banks subject to off-site reviews. See CP9 for more on this.</p> <p>A full-scope examination addresses all key areas of a bank’s operations, including capital adequacy, asset quality, management strength and quality of oversight from the bank’s board of directors, compliance with laws and regulations, quality and sustainability of earnings, adequacy of liquidity sources to support on-going cash needs, and sensitivity of a banking organization’s earnings and capital position to market risk.</p> <p>The assessors did see evidence of supervisors employing a forward-looking perspective on their assessments—for example making assessments of the way credit risk and margins will migrate.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>For many larger banks and holding companies (typically those over \$10bn of assets), full scope examinations/inspections consist of a series of targeted reviews during the examination cycle which culminate in a roll-up process where ratings are assigned based upon the results of these targets and the continuous monitoring activities. The requirements and mandates for these on-site activities can be found in the individual agencies’ examination manuals. Additionally, for many of the largest banks and holding companies, one or more of the banking agencies maintains a full-time, on-site examination staff to monitor the banking organizations’ condition and activities.</p> <p>During the period of time in between full-scope, on-site examinations, the agencies maintain</p>

a thorough understanding of the bank's and holding company's risk profile. This is accomplished through the analysis of quarterly financial statements filed with their relevant agency and the review of regulatory reports that banks and holding companies must file to notify the agencies of changes in their activities and structure. Further, supervisors may request and review key management information reports including, but not limited to, internal audit information, and, in the case of publicly traded banks and holding companies, the consideration of market indices that may provide insight into the market's assessment of the risk profile. These sources are supplemented by discussions with the banking organization's management, meetings with its internal and external auditors, and, where no full-time on-site examination staff is maintained, on-site visits to maintain an up-to-date understanding of the financial condition. In addition, the agencies maintain various analytical tools that can help identify emerging risks or changes in the risk profile that may require specified follow-up steps.

The CFPB has primary supervisory and enforcement authority with respect to certain federal consumer financial protection laws as applied to banking organizations with assets greater than \$10 billion (and their affiliates), and it is responsible for confirming that these organizations appropriately manage their consumer compliance programs for these laws. The Federal Reserve, FDIC, and OCC have primary supervisory and enforcement authority with respect to (i) these same federal consumer financial protection laws as applied to banking organizations with assets of \$10 billion or less and (ii) all other federal consumer financial protection laws. The agencies conduct regular Consumer Compliance examinations to confirm that the organization is appropriately managing its compliance risk and complying with U.S. consumer protection laws and regulations.

The DFA also requires all financial institutions supervised by the Federal Reserve, FDIC, and OCC with total consolidated assets greater than \$10 billion to conduct and submit results from regular company-run stress tests using supervisory-provided financial scenarios designed to help these institutions identify vulnerabilities. The FBAs issued the annual company-run stress testing rules for banks and savings associations in October of 2012. Interagency guidance on DFA stress testing for firms with total assets greater than \$10 billion but less than \$50 billion was issued on March 13, 2014.

Banking Institutions with at least \$50bn of Assets

The Federal Reserve issued a Capital Plan Rule in November 2011 that requires all U.S.-domiciled, top-tier Bank Holding Companies with total consolidated assets of \$50 billion or more to develop and maintain a capital plan supported by a robust process to assess capital adequacy. A guidance note explaining supervisory expectations and range of current practice was issued in August 2013 to support the rule. The preamble to the Capital Plan Rule outlines the elements on which the Federal Reserve evaluates the robustness of a BHC's internal capital planning process, known as "CAP."

Stress testing is now an integral part of the U.S. supervisory approach. The Federal Reserve, OCC and FDIC, with respect to banks and savings associations under their supervision, have tailored expectations for institutions of different sizes, scope of operations, activities, and systemic importance. The FBAs have conducted stress-testing programs on the largest banking organizations, which have evolved since 2009 when the Supervisory Capital Assessment Program (SCAP) initiated the forward-looking assessment of risk for individual institutions. SCAP, which was applied to 19 institutions, which was followed by the annual Comprehensive Capital Assessment Review (CCAR), applicable to holding companies with total assets greater than \$50 billion. The DFA also requires supervisory stress tests, conducted by the Federal Reserve, which are designed to assess the resiliency of banking

	organizations' capital positions under various baseline, adverse, and severely adverse supervisory-provided economic conditions. This program provides for the collection and analysis of a significant amount of granular institution-specific asset and liability data to better assess idiosyncratic and systemic risks to these firm's capital positions.
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>All Banks</p> <p>Examinations address all key areas of a bank's operations, including capital adequacy, asset quality, management strength and quality of oversight from the bank's board of directors, compliance with laws and regulations, quality and sustainability of earnings, adequacy of liquidity sources to support on-going cash needs, and sensitivity of a banking organization's earnings and capital position to market risk.</p> <p>During regular on-site examinations, the U.S. FBAs complete a series of testing procedures, contained in the agencies' examination and inspection manuals, to confirm banks' and holding companies' compliance with prudential regulations and other legal requirements. In addition, compliance with some rules is monitored on an on-going basis through the collection and analysis of financial and structure reports that are required to be filed by banking organizations. U.S. federal banking supervisors confirm that banks and holding companies also maintain policies and procedures designed to ensure their compliance with applicable laws and regulations. These internal compliance programs are evaluated by the banking agencies during on-site examinations. U.S. FBAs have developed and maintained extensive supervisory guidance to evaluate compliance programs and specific areas including internal controls, audit, consumer protection, fair credit reporting, home mortgage disclosure, real estate settlement procedures, and anti-money-laundering, among others. A complete listing of the guidance is available through each agency.</p>
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>All Banks</p> <p>On an on-going basis, supervisors monitor and assess banks and holding companies through financial statements that each are required to file. These financial statements consist of a balance sheet, income statement, and supporting financial schedules. Using aggregations of these data, the banking agencies complete analyses addressing overall conditions within the banking industry. These analyses highlight earnings performance, industry capitalization levels, lending concentrations, and many other fundamental and specialized areas of the bank's or holding company's operations, and are used to assess trends, developments, and risks for the banking system as a whole. The agencies also make use of higher-level risk committees, made up of senior agency officials, to evaluate and assess the macroeconomic risks facing the financial system. In addition, the results of formal off-site monitoring programs, which use the submitted financial data to identify emerging problems in supervised banks and holding companies, are also used to monitor banking industry trends.</p> <p>The agencies also maintain contacts with a variety of market and industry analysts to obtain insights on emerging risks that may affect the banking system and financial markets as a whole. For example, the OCC has a Financial Markets Group specifically dedicated to monitoring and analyzing market developments and trends, and maintaining contact with</p>

	<p>market participants. This group conducts periodic meetings with various market analysts, hedge fund managers, and other key players to get their insights on emerging risks. The U.S. President’s Working Group on Financial Markets facilitates coordination among the agencies and other market regulators on issues and risks that cut across the financial sector. The FSOC, created under DFA, is another important organization that monitors cross-sectoral financial developments, including developments in non-banking sectors. The heads of the Federal Reserve, OCC, CFPB, and FDIC are all members of the FSOC and these agencies also participate at the staff level. The agencies also periodically consult with the supervisors of major non-bank organizations in the U.S., including the SEC in the case of broker-dealers and the state insurance authorities in the case of insurance companies, to help to evaluate the impact of these institutions’ activities on the condition of holding companies.</p> <p>OCC also has a structure of risk committees that feed into the National Risk Committee. The Federal Reserve has also recently created a Risk Council. Both of the groups serve as a conduit for risks coming up from the vertical firm-facing supervisors and also the macro-economic view coming down.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>The DFA requires an annual company-run stress test to be conducted at the bank and holding company level for certain large financial institutions</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve is required to conduct an annual supervisory stress test on all large Bank Holding Companies and nonbank financial companies designated by the FSOC to evaluate whether they have sufficient capital to absorb losses resulting from adverse economic conditions. The annual supervisory stress test, conducted as part of the annual CCAR exercise, includes economic scenarios (baseline, adverse, and severely adverse) provided by the Federal Reserve that define the annual supervisory assessment. Each firm subject to CCAR is required to maintain sufficient capital to withstand nine quarters of a severely adverse macroeconomic environment. In addition, the aggregate assessment for the most recent CCAR exercise indicated a significantly higher level of aggregate capital since the initial SCAP review was conducted during the crisis for the largest BHCs.</p> <p>In addition to the annual supervisory-run stress tests conducted by the Federal Reserve at Bank Holding Companies with total consolidated assets of more than \$50 billion, the Federal Reserve requires that these institutions conduct a second company-run stress test each year. These company-run stress tests are designed to assess the potential impact of stressed economic conditions on the institutions consolidated earnings, losses and capital over a nine quarters planning horizon, taking into account the institution’s current condition, risk, exposures, strategies and activities. The stress test scenarios (baseline, adverse, and severely adverse) required to be used for the company run stress test are developed in coordination by the agencies but generally the agencies expect that these scenarios will typically mirror the scenarios applied by the Federal Reserve under the supervisory-run stress tests.</p>
<p>ECS</p>	<p>The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks’ problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.</p>

<p>Description and findings re EC5</p>	<p>All Banks</p> <p>Each of the U.S. FBAs employs off-site surveillance procedures for measuring and monitoring the risk profiles of individual banks and holding companies and the banking environment as a whole for possible systemic risks. These surveillance systems focus heavily on identifying banks and holding companies that are exhibiting problems or deteriorating so that examination resources can be directed to troubled organizations. They also flag banks and holding companies engaging in new or complex activities. These programs use a mix of predictive econometric models, expert systems based on judgmentally determined screens, and market-based financial measures to identify banks and holding companies warranting a heightened supervisory focus. For example, the agencies have adopted a standardized request for electronic loan files that supervisors can use to analyze, sample, and report on the contents of a loan trial balance. Other examples include the Federal Reserve’s SR-SABR model, the OCC’s Canary System, and the FDIC’s Large Insured Depository Institution (LIDI) program. Through their on-going risk assessment processes, the agencies also look for risks that may be increasing or risk-management systems that may need improvements. For example, the OCC, FDIC, and Federal Reserve have risk assessment systems that evaluate whether the direction of a bank’s risk profile is increasing, decreasing, or stable.</p> <p>The agencies use a variety of means to convey actions to bank boards and senior management. The assessors found that regulators can make recommendations, criticisms, matters requiring attention (MRA), matters requiring board attention (MRBA) and matters requiring immediate attention (MRIA). The range of these approaches and for some firms (the sheer volume of them) makes prioritization difficult. The assessors also noted that some of the matters requiring attention could be outstanding for a considerable amount of time.</p> <p>The agencies also conduct annually a joint review of the largest, complex credits that are shared by three or more banks. This annual review provides an opportunity for the agencies to identify trends in underwriting and credit classification practices, as well as overall commercial credit conditions, across the banking system. The 2013 review included over 9,300 credit facilities totaling \$3.0 trillion extended to approximately 5,800 borrowers.</p> <p>The FSOC is charged with identifying risks to the financial stability of the U.S.; promoting market discipline; and responding to emerging risks to the stability of the U.S. financial system.</p> <p>The assessors saw some very good management reports one example from the OCC showing trends in credit (e.g. concentrations by industry, geography and type of institution, and trend in probability of defaults) and counterparty credit was very useful.</p>
<p>EC6</p>	<p>Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank’s resolvability where appropriate, having regard to the bank’s risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of on-going business.</p>
<p>Description and findings re EC6</p>	<p>All Banks</p> <p>The Prompt Corrective Action statute and implementing regulations by the Federal Reserve, the FDIC and OCC provide the agencies with authority to promptly resolve capital deficiencies at insured depository institutions and thereby reduce bank failures. In addition the assessors found that additional FDIC resolution scrutiny was triggered either because of an alert (such as high growth) from their remote monitoring system or because the CAMELS</p>

	<p>rating is a 3, 4 or 5. Resolution work for most banks is therefore on a risk basis.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Additionally, under the DFA, systemically-significant bank holding companies or nonbank financial firms are required to submit periodic reports to the agencies providing the plan of the company for rapid and orderly resolution in the event of material financial distress or failure.</p> <p>To implement the DFA’s requirement for resolution plans for certain banking organizations, the Federal Reserve and FDIC issued regulations in November 2011. The regulations require all domestic bank holding companies and FBOs with total consolidated assets of \$50 billion or more and non-bank financial companies designated by FSOC (covered companies) to submit annually their plans (resolution plan or living will) for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure. The Federal Reserve and FDIC do not approve resolution plans, but they may jointly find a plan is not credible or would not facilitate an orderly resolution in bankruptcy. If a resolution plan is found to have deficiencies, a covered company will have 90 days to resubmit a plan; if deficiencies are not corrected, the firm may become subject to more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations. A covered company’s resolution plan may not rely on extraordinary government support. These company prepared plans are used to support the FDIC’s planning for the exercise of its resolution authority under the DFA and FDI Act by providing the FDIC with an understanding of the company’s structure, complexity, strategies and processes.</p> <p>These resolution plans promote financial system stability by minimizing the potential impact of a resolution of a covered company. The resolution plans consider the direct and indirect effects of a resolution of a covered company on market and public confidence while ensuring accountability by having the failed company’s investors bear the losses arising from a failure. Resolution plans ensure that no taxpayer credit supports a failing covered company and implements a process for assessing the industry to cover payments associated with the resolution of a covered company. Resolution plans preserve day-to-day operations in order to promote market confidence and implement an expedient process for resolution.</p>
<p>EC7</p>	<p>The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.</p>
<p>Description and findings re EC7</p>	<p>All Banks</p> <p>The Prompt Corrective Action statute and implementing regulations by the Federal Reserve, the FDIC and OCC provide the agencies with authority to promptly resolve capital deficiencies at insured depository institutions and thereby reduce bank failures.</p> <p>In addition regulators carried out additional intensive supervision for banks with CAMELS ratings of 3, 4 or 5. For example, the OCC has roughly 70 banks (and thrifts) in their Special Supervision function.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Additionally, under the Dodd Frank Act, systemically-significant bank holding companies or nonbank financial firms are required to submit periodic reports to the agencies providing the plan of the company for rapid and orderly resolution in the event of material financial distress or failure. See EC6</p>

<p>EC8</p>	<p>Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.</p>
<p>Description and findings re EC8</p>	<p>When bank-like activities are performed outside the regulatory perimeter, the FBAs are able to raise the issue with Congress, which would be responsible for addressing the issue through legislation. Supervisors have the authority to prevent or preclude restructuring for purposes of evading the regulatory perimeter.</p> <p>The FSOC is charged with identifying risks to the financial stability of the U.S.; promoting market discipline; and responding to emerging risks to the stability of the U.S. financial system. This would include identifying risks from financial activities that reside or have been pushed out of the existing regulatory perimeter.</p> <p>Supervisors generally expect banks and holding companies to notify them of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements. Supervisors identify deviating or new bank-like activities primarily through onsite examination work. Other means that alert supervisors to new activities include formal off-site monitoring programs and required regulatory reports on structure to identify banks and holding companies substantively changing their activities. Regardless of the structure of the entity, if impermissible activities are detected there are a number of actions and strategies the agencies may employ in order to curtail or eliminate these activities. Supervisors can require impermissible or unsafe and unsound activities be eliminated through informal corrective actions and formal corrective actions. Informal corrective action programs include bilateral agreements that provide direction and instruction to the supervised institution. Formal corrective action programs, which are enforceable through court action, provide instruction to institutions to take specific corrective action to resolve the outstanding issue(s).</p> <p>In approving applications, generally, the U.S. banking agencies may impose conditions that require banks or bank holding companies to provide prior notice of any changes to the business plans or related documents submitted in conjunction with the underlying application or filing. For example, in the case of new banks and holding companies, U.S. banking agencies routinely include a condition in their approval orders that requires prior notice of any change to the new organization’s business plan during the first three years of operation. After this period, changes in the activities, if permissible under state and federal law, would be subject to review during periodic safety and soundness examinations. For state non-member banks, the FDIC also includes a condition in the approval order that requires the bank to submit pro forma financial statements and a business plan for operating years four through seven to the appropriate FDIC office within 60 day before the end of the bank’s third year of operation. The FDIC monitors compliance with such plans during the annual examination process and requires prior non-objection for any material deviations or material changes from the plan. Further, U.S. FBAs may impose notification requirements formally or informally as determined by supervisors.</p>
<p>Assessment of Principle 8</p>	<p>Compliant</p>
<p>Comments</p>	<p>The U.S. system of regulation is changing rapidly. Some of that change is internally driven, but some is external – either from legislative change (such as the DFA) or from international policy agreements. The combination of these changes has broadened the role of supervision</p>

	<p>and has introduced a greater level of tiering into the regime (e.g. Banking Institutions with at least \$50bn of Assets).</p> <p>The assessors find that the net effect of these changes has been positive. The supervisory regime is effective and risk-based. There is an increasing focus on resolution (for the larger firms).</p> <p>The range of approaches the regulators use to communicate issues (EC 5) that are important to them and on which they seek action does run the risk of confusing messages. The supervisors should consider some simplification of this system and ideally it might be something that the supervisors could agree an interagency approach—at the moment all make use of Matters Requiring Attention, with the Federal Reserve using Matters Requiring Immediate Attention and also Matters Requiring Board Attention which is used by Federal Reserve and the OCC. Furthermore where supervisors have a substantial agenda of issues to be resolved—the assessors saw some firms with over 100 matters requiring attention, the supervisors should consider clearer methods of prioritization and communication. This should not be to devalue the individual items themselves, but should instead be thought of as a better way to convey supervisory issues and themes to the Boards of Banks.</p> <p>The assessors were also concerned to see that some matters requiring attention had been outstanding for a long time—three years for example. Supervisory management was aware of these cases and indeed had good management information to track ageing of matters requiring attention. The assessors agreed with Supervisor Senior Management that the cause of the aging was not just the target banks being behind in delivery, but also that the matters requiring attention were not well drafted or had not taken adequate consideration of feasible delivery times. (See CP 11 – authorities have started addressing the issue).</p>
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site ³⁶ and off-site ³⁷ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	All Banks The U.S. firmly adopts a risk-based approach to supervision. This is both in terms of its focus on risk within banks, but also adjusting that approach in proportion to the risk banks pose to

³⁶ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

³⁷ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

the system. The supervisory process is highly structured with a high proportion of mandated reviews (both offsite and onsite), a uniform rating process and an extensive planning process that agrees the supervisory strategy going forward. U.S. regulators have a statutory responsibility to ensure and evaluate safety and soundness.

The agencies have segmented the banking organizations under their respective jurisdictions, taking into account legislative thresholds (such as those in the DFA) and adjusting, where possible, for different risk profiles and business models. Each agency has dedicated resources proportionately to the size and complexity of the supervised organization.

Supervision is accomplished through a combination of on-site examinations, off-site reviews and surveillance monitoring programs. In general, the primary federal banking supervisor conducts annual, on-site examinations of the banks within its jurisdiction.

Examination areas for all banks and holding companies include any cross-border operations. In its role as a holding company supervisor, the Federal Reserve also conducts inspections and makes risk assessments of a holding company's operations. In addition to examining national banks and their affiliates, the OCC examines federal branches and federal agencies of foreign banks. The Federal Reserve alternates with state regulators in examining state licensed branches and agencies of foreign banks. All of the U.S. FBAs examine bank service companies.

Off-site supervision involves periodic surveillance and assessment of information from a variety of sources, including standard regulatory reports and internal information received from the supervised bank and holding company. The standard regulatory reports capture a host of commercial and financial information on supervised entities. The number and the type of standard regulatory report forms that must be filed depend on the size of a bank or holding company and the scope of its operations. Off-site surveillance also includes a review of reports of recent examinations and inspections, internal management and internal and external auditor reports (when requested by supervisors), reports filed by public companies (e.g., 10-Qs and 10-Ks), application materials, and publicly available material (e.g., information published in the financial press and elsewhere). In addition, it includes information obtained from regular discussions with management, internal and external auditors, and other supervisors, both foreign and domestic.

Through on-site examinations and continuous supervision, supervisory staff generally: (1) evaluate the soundness of the bank's or holding company's assets and the effectiveness of its internal controls, policies, and management; (2) analyze key financial factors such as the bank's and holding company's capital, earnings, liquidity, and sensitivity to interest rate risk; (3) assess the bank's or holding company's exposure to off-balance-sheet risks; (4) check for compliance with banking laws and regulations; and (5) determine the bank's or holding company's overall soundness and solvency. In addition to these specific areas, supervisors also evaluate transactions between a bank or holding company and its affiliates to determine the effect of the transactions on the bank's or holding company's condition and to ascertain whether the transactions are consistent with the limitations set out in sections 23A and 23B of the Federal Reserve Act.

Each agency has the authority to take an enforcement action if, in the agency's opinion, the bank, holding company or any institution-affiliated party (IAP) is engaging or has engaged, or the agency has reasonable cause to believe that the bank, holding company or any IAP is about to engage in an unsafe or unsound practice, or is violating or has violated, or the agency has reasonable cause to believe that the bank, holding company or any IAP is about to violate a law, rule, or regulation, or any condition imposed in writing by the agency in connection with the granting of any application or other request by the bank or holding

company or any written agreement entered into with the agency. The primary FBAs generally have the authority to examine affiliates of the bank under their supervision. The OCC's process regarding a functionally regulated affiliate of a national bank are described in the Comptroller's Handbook, *Bank Supervision Process* (Sept. 2007), pages 16-18. The Federal Reserve has the authority to examine bank subsidiaries of Bank Holding Companies; however, the Federal Reserve must rely to the fullest extent possible on the bank examinations conducted by the primary federal banking or functional supervisor. The Federal Reserve is the primary federal supervisor of Savings and Loan Holding Companies and must rely to the fullest extent possible on the examinations conducted by the primary supervisor of savings banks (e.g., state savings banks regulated by the FDIC). In addition, all of the FBAs rely to the fullest extent possible on the functional supervisors of the securities and insurance subsidiaries and any other subsidiary that is subject to comprehensive supervision by a federal or state authority for supervisory information to minimize duplication and unnecessary regulatory burden on regulated entities.

The U.S. FBAs routinely share supervisory information with each other and with the functional supervisors, as needed. In addition, the U.S. Attorney General, Secretary of the Treasury, and the head of other federal agencies are required, unless prohibited by law, to disclose to the appropriate federal banking agency any information they believe raises significant concerns regarding the safety or soundness of any bank or holding company.

While each holding company and bank has a primary federal regulator, there are certain cases where there is overlapping examination authority among the federal supervisors. For example, the FDIC has the authority to conduct a special examination of any insured depository institution to independently determine the condition of that bank for purposes of the FDIC's deposit insurance.

Banking Institutions with less than \$500mn of Assets

Generally smaller banks are subject to an annual examination. However, smaller banks that satisfy certain qualifying criteria (typically CAMELS ratings of 1 or 2 for management and overall) may be examined on an 18-month cycle [see Table 9.1 for more detail broken down by, State Member Banks (SMB), FDIC and OCC]. The OCC maintains a supervision strategy for each of its nationally chartered banks and federal savings associations, and each of the U.S. FBAs retains authority to examine a bank as frequently as it deems necessary. For example, the FDIC would conduct annual examination of problem institutions (typically CAMELS ratings of 3, 4 or 5) less than \$500 million, and depending on the nature of the problems, conduct more frequent visits. Small bank holding company (less than \$10bn in assets) inspections are conducted by the Federal Reserve and the majority follow the lead bank's supervisory cycle.

Table 9.1 Total of small firms		18 month cycle	Percentage subject to 18- month cycle	Total Assets \$bn	Percentage of Total Assets
<i>Care not adjusted for double</i>					
SMB	860	425	49%	81	no data
FDIC	4180	2787	67%	450	no data
OCC	1794	951	53%	188	1.75%

Banking Institutions with at least \$10bn of Assets

For larger banks and holding companies (typically those above \$10bn in Assets), the federal banking agency maintains resident on-site supervisors who provide continuous supervision of the banking organization and at least quarterly updates on the bank's and holding company's condition and risk. In each of its designated large banks, the OCC maintains an onsite resident team that follows a specific detailed supervision strategy tailored for each national bank or Federal savings association. This includes targeted examinations that may include Federal Reserve, FDIC, and CFPB participation or collaboration.

With respect to insured depository institutions with total assets greater than \$10 billion and any affiliates, and insured credit unions with total assets of more than \$10 billion and any affiliates, the CFPB has exclusive authority to require reports and conduct examinations for the purposes of assessing compliance with the requirements of Federal consumer financial laws; obtaining information about the activities subject to such laws and the associated compliance systems or procedures of such persons; and detecting and assessing associated risks to consumers and to markets for consumer financial products and services. As applicable, the U.S. FBAs and the CFPB are required to coordinate the scheduling of examinations of insured depository institutions, insured credit unions, or other covered persons; conduct simultaneous examinations of such institutions unless the institution requests examinations to be conducted separately; share each draft report of examination with the other agency and permit the receiving agency a reasonable opportunity (which shall not be less than a period of 30 days after the date of receipt) to comment on the draft report before such report is made final; and prior to issuing a final report of examination or taking supervisory action, take into consideration concerns, if any, raised by the other agency in its comments. The CFPB, OCC, Federal Reserve, and FDIC entered into a Memorandum of Understanding, dated May 16, 2012, to facilitate the implementation of these statutory provisions.

In addition, under Section 165(i)(2) the FDIC, the OCC and the Federal Reserve require banks and savings associations with more than \$10 billion in assets to conduct annual company-run stress tests themselves. These company-run stress tests are required to be conducted annually and are designed to assess the potential impact of adverse economic conditions on the consolidated earnings, and capital over a nine quarters planning horizon, taking into account the institution's current condition, risk, exposures, strategies and activities. The stress test scenarios (baseline, adverse, and severely adverse) required to be used for the company run stress test are developed in coordination by the agencies but generally the agencies expect that these scenarios will typically mirror the scenarios applied by the Federal Reserve under the supervisory-run stress tests.

Banking Institutions with at least \$50bn of Assets

The Federal Reserve has divided its largest banks into two groups – largest, most systemically important financial institutions in the U.S. are overseen by the LISCC. The LISCC is a multi-disciplinary committee composed of senior officers representing various functions at the Federal Reserve and the 12 Federal Reserve Banks, including supervisors, economists, and market specialists. Firms supervised in the LISCC portfolio are financial institutions that may pose elevated risks to U.S. financial stability. Financial institutions included in the LISCC portfolio are referred to as "LISCC firms." Members of the LISCC Operating Committee provide the macro-prudential perspective to supervision of the LISCC firms. LISCC provides strategic and policy direction for supervisory activities across the Federal Reserve system in order to improve the consistency and quality of supervision of LISCC firms. Similarly, LISCC

	<p>supervision is supported by the Quantitative Surveillance (QS) group that identifies systemic and firm-specific risk identification through aggregate loss forecasts, stressed capital adequacy analysis and measures of interconnectedness. The QS includes staff members from the Board’s Divisions of Research and Statistics, Monetary Affairs, International Finance, and Banking Supervision and Regulation, and from the Reserve Banks. LISCC supervision also uses horizontal examinations among LISCC firms and a high degree of consultation and coordination among supervisors from the Federal Reserve System of LISCC firms.</p> <p>Generally for banks above \$50bn of assets, there is a greater level of resource allocated to supervision. The assessors also noted that there has been an increase in horizontal resources and supervision. For example the Federal Reserve’s QS group and the OCC’s Lead Expert Group. There has also been an increase in the number of horizontal examinations.</p> <p>As required by Section 165(i) of the DFA, the agencies have adopted rules requiring various BHC and bank level stress tests. Specifically, under Section 165(i)(1) the Federal Reserve requires bank holding companies with \$50 billion or more in assets to conduct annual supervisory-run stress tests, using the exposure data submitted by the institutions. These supervisory run stress tests are conducted by the Federal Reserve on the largest institutions with participation of staff from the OCC and the FDIC, on both domestic and foreign-owned institutions. The covered institutions file quarterly data submissions to support on-going analysis of their risks. The institutions are expected to maintain a well-documented risk and capital modeling process that covers all major risk areas of the institution. The results of these tests, along with both qualitative and quantitative feedback, are provided in writing to the institutions at the conclusion of the tests.</p>
EC2	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.</p>
Description and findings re EC2	<p>Each of the U.S. FBAs and the CFPB maintains written guidance for planning and executing on-site and off-site activities. Generally, agencies annually develop on- and off-site examination strategies and goals based on the risk profile of the bank or holding company. Guidance can be found in each of the agencies’ examination manuals, which are updated periodically. The guidance specifies the objectives and expected actions and outputs for these activities, and also details basic procedures for completing on-site reviews and implementing off-site surveillance programs. Coordination and information sharing between on- and off-site supervision functions is facilitated by formal off-site monitoring programs that trigger follow-up by the on-site function when banks and holding companies meet various screening thresholds. In addition, supervisory policies require the consideration of off-site monitoring results when supervisors are determining the scope and procedures for on-site reviews.</p> <p>There has been an increase in the coordination of plans between the supervisors – the assessors saw evidence of consultation on plans and also joint participation in the planning process. Jointly resourced examinations are also commonplace. However the assessors noted that planning cycles differ materially between organizations and as such this can and does limit the extent to which coordination can exist—for example a request for resource to join in on an examination may be thwarted because resources have been committed by a planning process that had begun and been completed earlier.</p>
EC3	<p>The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary</p>

	<p>corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank’s related entities, and publicly available information. The supervisor determines that information provided by banks is reliable³⁸ and obtains, as necessary, additional information on the banks and their related entities.</p>
<p>Description and findings re EC3</p>	<p>The supervisors receive a significant of information in the form of regulatory returns and also from ad hoc data requests.</p> <p>On-site examinations address all key areas of a bank’s and holding company’s operations, including capital adequacy, asset quality, management strength and quality of oversight from the board of directors, compliance with laws and regulations, quality and sustainability of earnings, the adequacy of liquidity sources to support on-going cash needs, and sensitivity of earnings and capital position to market risk. These reviews incorporate independent assessments of the effectiveness of risk management, internal controls, management reporting, and overall corporate governance. In addition, examination procedures may be directed to validating the reliability and accuracy of financial data reported to the agencies. Also, at each examination, supervisors evaluate any follow-up to supervisory concerns raised at prior examinations or as a result of off-site monitoring.</p> <p>During on-site examinations, U.S. federal banking supervisors review the most recent external auditor’s assessment of the bank’s or holding company’s financials and the work of the loan review function and internal audit. Typically, supervisors review audit testing of financial and Call Report reconcilements and accuracy.</p> <p>Section 404 of the Sarbanes-Oxley Act, requires an external auditor of a bank or holding company that is a public company annually to render an opinion on the effectiveness of the company’s internal controls over financial reporting and make a management assessment.</p> <p>Banking Institutions with at least \$1bn of Assets</p> <p>For banks over \$1 billion, section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requires a formal attestation from company management on the quality of the internal control structure. External auditors are required to attest to, and report separately on, the assertions of the bank’s management regarding internal controls.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>As part of their Report of Examination, supervisors will specify matters requiring attention from the board. These are practices that deviate from sound governance, internal control, and risk management principles, which may adversely impact earnings or the capital, risk profile, or reputation if not addressed, or that result in substantial noncompliance with laws and regulations, internal processes, or supervisory guidelines. Supervisors evaluate management plans for corrective action and consider whether they are likely to be effective. In cases of severe problems or where management has been unable or unwilling to correct deficiencies, either formal or informal actions are typically issued against the bank and holding company. These actions often require the bank or holding company to correct the most serious of examination findings and communicate progress of those corrections to the responsible agency, commonly on a quarterly basis. The U.S. federal banking agency then has the ability to render judgment on management’s progress and can in turn structure the ongoing supervisory plans accordingly.</p> <p>Continuous monitoring is also an important supervisory tool at the largest U.S. banking</p>

³⁸ Please refer to Principle 10.

	<p>organizations. Continuous monitoring activities include meetings with a banking organization’s management and directors; review of governance committee meeting notes and information packages, analysis of internal MIS reports, market indicators, and other internal and external information; review of internal and external audit and compliance findings; analysis of internal and external financial reporting including regulatory and business line reporting, cross-firm analysis, identification of emerging issues and coordination with other relevant supervisors and functional regulators and utilization of their work as appropriate.</p>
<p>EC4</p>	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerability that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
<p>Description and findings re EC4</p>	<p>As part of formal, off-site monitoring programs, the U.S. FBAs use automated screening systems, regulatory reports, standardized financial reports detailing key financial ratios and measures, and public sources of financial information to monitor the performance and condition of supervised banks and holding companies and promptly identify those requiring heightened supervisory attention. Supervisors periodically (e.g., quarterly) communicate with the bank’s or holding company’s management to discuss emerging issues or concerns. Supervisors also provide written reports following targeted or limited-scope examinations, horizontal / comparative examinations, and annual summary reports that provide the supervised institution with a consolidated overview of supervisors’ view of the institution as a whole, including assessments of significant subsidiary operations.</p> <p>Examination staff also uses off-site surveillance tools and reports to plan the scope of, and determine priorities for, on-site examination work, as well as to monitor the progress in responding to matters requiring further attention. Included in this analysis is monitoring of standardized financial data from financial reports such as the FFEIC 031 or 041 Consolidated Reports of Condition and Income (Call Report), FR-Y9 Consolidated Financial Statements for Holding Companies. Supervisors carry out comparative peer analyses of the standardized reports for all organizations. Further, supervisors require banks to submit financial reports and management analyses of the overall organization, subsidiaries, and business activities including financial, market risk, and operational risk management analyses that reflect each organization’s unique mix of activities. Supervisors also receive copies of board of directors’ minutes and exhibits, minutes and exhibits for their various committees, as well as minutes and materials for significant management committees throughout the supervised organization.</p> <p>The supervisors use a range of supervisory activities to maintain a comprehensive understanding and assessment of each firm, including:</p>

- a) In developing and executing a detailed supervisory plan for each firm, supervisors generally rely to the fullest extent possible on the information and assessments provided by other relevant supervisors and functional regulators. The supervisors actively participate in interagency information sharing and coordination, consistent with applicable laws, to promote comprehensive and effective supervision and limit unnecessary duplication of information requests. Supervisory agencies continue to enhance formal and informal discussions to jointly identify and address key vulnerabilities, and to coordinate supervisory strategies for large financial institutions.
- b) Supervisors use firm-specific examination and continuous monitoring activities (“continuous monitoring activities” include meetings with a banking organization’s management; analysis of internal MIS reports, market indicators, and other internal and external information; review of internal and external audit findings; and coordination with other relevant supervisors and functional regulators and utilization of their work as appropriate) undertaken to maintain an understanding and assessment across the core areas of supervisory focus for each firm. These activities include review and assessment of changes in strategy, inherent risks, control processes, and key personnel, and follow-up on previously identified concerns (for example, areas subject to enforcement actions or other supervisory issues), or emerging vulnerabilities.
- c) Coordinated horizontal reviews involve examination of several institutions simultaneously, encompassing firm-specific supervision and the development of cross-firm perspectives. The supervisors recognize the priority of these reviews through the dedication of multidisciplinary skills and experienced staff. Examples include analysis of capital adequacy and planning via the Comprehensive Capital Analysis and Review (CCAR) and the required annual company-run stress tests, as well as horizontal evaluations of resolution plans and incentive compensation practices. For a more detailed description of stress tests. The assessors noted the greater use of horizontal reviews, particularly for the larger banks. However the assessors noted that there were occasions where supervisory expectations of the peer-group were not clearly established and many of the contacts the assessors spoke to, suggested that supervisory expectations drifted and became relative to the peer-group, rather than absolute in terms of rules or guidance.
- d) In certain instances, supervisors may be able to rely on a firm’s internal audit or internal control functions in developing a comprehensive understanding and assessment if deemed effective.

Supervisors also review corporate governance, risk management systems and practices, as well as the internal control systems, including operations, management information systems and audit effectiveness, in assessing an institution’s overall condition. These reviews seek two primary objectives:

1. Enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary. Each firm is expected to ensure that the consolidated organization (or the combined U.S. operations in the case of FBOs) and its core business lines can survive under a broad range of internal or external stresses. This requires financial resilience by maintaining sufficient capital and liquidity, and operational resilience by maintaining effective corporate governance, risk management, and recovery planning; and
2. Reducing the impact on the financial system and the broader economy in the event

	<p>of a firm’s failure or material weakness.</p> <p>Each firm is expected to ensure the sustainability of its critical operations and banking offices under a broad range of internal or external stresses. This requires, among other things, effective resolution planning that addresses the complexity and the interconnectivity of the firm’s operations.</p> <p>The assessors found business model analysis much improved since the last BCP assessment, but still evolving. At the moment the assessors judged that it was adequately serving the prudential agenda but there was scope for further improvement to support more strategic assessments.</p> <p>In terms of communication, the assessors found that the size of some letters and reports were extensive and could often lose key messages - particularly when addressed to Board of Directors. This is particularly the case where there are extensive MRAs or observations in terms of particular credit loans or transactions. In some examples the assessors found supervisors had used what the assessors considered to be excessive praise in their communication to banks. The assessors regard this as different from supervisors making sound judgments and producing a balanced piece of feedback to the banks. Also the assessors noted some examples of communication that seemed to spend a large amount of time recounting the recent events in the bank to the bank themselves. This is not to say that supervisors should not put their own judgments into context, but the assessors felt that the histories could be reduced a little with no loss of context.</p>
<p>EC5</p>	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerability that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
<p>Description and findings re EC5</p>	<p>All Banks</p> <p>Supervisory agencies use analysis from their own staff economists and financial analysts, who monitor trends in domestic U.S. financial markets and global markets, for emerging risks or concentrations of risk in supervised institutions. The OCC has a formal risk monitoring process known as the National Risk Committee (NRC). The objectives of the NRC are to identify primary and emerging risks to the national banking system; stay abreast of evolving business practices and financial market issues; inform the OCC’s Executive Committee of material risks facing the national banking system; and facilitate communication of risk issues and OCC supervisory efforts to address those issues. The NRC issues a semi-annual report, in the Spring and Autumn. The supervisors internally use horizontal examinations or comparative analysis to detect institutions with concentrations of risk, or where trends in risks taken appear to constitute a threat to safety and soundness of the institutions. Similarly, the supervisors also look at trends in the functioning of bank operations, including studies or horizontal examination work aimed at the operations of supervised institutions, to identify emerging risks as well as best practices. Findings of these are communicated to institutions through a number of means. Where the findings affect a single institution or a small group of institutions, a direct supervisory letter might be the means of communication. Where the risk is emerging but not a threat, discussion with management, public comment by supervisory leaders, informal written guidance from supervisors such as Bulletins, Financial Institution Letters, Supervision & Regulation or</p>

	<p>Community Affairs Letters, Handbooks and Examination Manual updates are all used.</p> <p>The Federal Reserve has also just created a Risk Council to bring together their view of risks within regulated firms.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>Supervisors require an annual company-run stress test to be conducted at the bank level. These company-run stress tests are designed to assess the potential impact of stress under various economic conditions on the institution’s consolidated earnings, losses and capital over a nine quarters planning horizon, taking into account the institution’s current condition, risk, exposures, strategies and activities. The stress test scenarios (baseline, adverse, and severely adverse) required to be used for the company run stress test are developed in coordination by the agencies but generally the agencies expect that these scenarios will typically mirror the scenarios applied by the Federal Reserve under the supervisory-run stress tests.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Supervisory-run stress tests are conducted on the largest institutions by the Federal Reserve along with participation of staff from the OCC and the FDIC, on both domestic and foreign-owned institutions on an annual basis. The covered institutions file quarterly data submissions to support on-going analysis of their risks. On an annual basis, the institutions are expected to maintain a well-documented risk and capital modeling process that covers all major risk areas of the institution. The Federal Reserve instructs financial and bank holding companies to submit the results of their own financial stress tests each year, using financial scenarios developed by the institutions, along with stress tests for a scenario provided by the Federal Reserve. In addition, the Federal Reserve conducts its own supervisory stress tests, using the exposure data submitted by the institutions that they used for their own internal tests, to assess the impact of identical stresses on each institution’s unique business portfolios. The results of these tests, along with both qualitative and quantitative feedback, are provided in writing to the institutions at the conclusion of the tests. The results, along with any supervisory findings from the tests, then become a component of the Federal Reserve’s annual assessment of the institution. Recently the Federal Reserve has also begun conducting stress tests solely focused upon liquidity of its institutions in the LISCC portfolio. The supervisory teams that monitor each institution year-round are part of the team that conducts the tests and assesses results, in order to clearly transition findings of the tests into any necessary supervisory actions over the following year.</p>
<p>EC6</p>	<p>The supervisor evaluates the work of the bank’s internal audit function, and determines whether, and to what extent, it may rely on the internal auditors’ work to identify areas of potential risk.</p>
<p>Description and findings re EC6</p>	<p>All Banks</p> <p>The U.S. FBAs assess the quality and scope of every bank’s and holding company’s internal audit function, whether or not audits are performed by the bank’s or holding company’s own staff or an outside vendor. These assessments include consideration of the independence of the function, the appropriateness of the risk assessment program for addressing the activities and risks of the bank or holding company, the size and quality of staffing, and the effectiveness and completeness of audits performed. The results of this assessment are used in determining how reliable the resulting internal audit work product is and whether it may be relied upon in developing a supervisory assessment of a bank’s or holding company’s soundness, risk profile, and internal controls. Examination manuals maintained by the various agencies provide details of procedures used to evaluate a bank’s and holding company’s</p>

	audit function.
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	<p>All Banks</p> <p>Throughout the supervisory process, the U.S. FBAs communicate extensively with the bank's and holding company's board, non-executive directors, audit committee, and senior and middle management (including heads of individual business units and control functions). This communication facilitates the development of an understanding and assessment of such matters as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, and risk-management systems. It also provides an opportunity for the banking agencies to deliver recommendations for corrective actions as needed and follow a bank's and holding company's progress in addressing earlier recommendations. At the conclusion of each exam, the supervisor will meet with the bank's or holding company's senior management and board of directors to discuss findings including any significant issues and to obtain management's commitment to correct any weaknesses noted during the exam. The banking agencies also provide the bank's or holding company's board of directors a written report of examination for review by all directors and senior officers. The report of examination conveys the overall condition and risk profile of the bank and provides conclusions on the assigned supervisory CAMELS ratings (those ratings assess the bank's Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk); identifies any violations of law; assesses compliance with the Bank Secrecy Act (BSA); and addresses compliance with consumer financial protection laws and regulations and the CRA. The report of examination also discusses significant deficiencies, violations, and excessive risks, and details corrective action to which the board or management has committed.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>For large banks and holding companies and those exhibiting a higher degree of risk, the amount of communication by the agencies with all levels of a bank's and holding company's corporate governance structure is expanded, with the frequency and scope of this contact determined based on the size or risk profile of the bank or holding company. This contact may include an on-going, on-site presence to enable monitoring by CPC and EIC teams. The assessors saw substantial evidence that regular contact between supervisor and senior management and the Board has increased significantly over the last few years.</p>
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	<p>All Banks</p> <p>Findings of supervisory activities are written in report format and delivered to and discussed with the bank's and holding company's management and the board of directors each</p>

	<p>examination cycle. The CFPB (for Banking Institutions with more than \$10bn of assets and their affiliates) also issues supervisory letters for target reviews. The supervisory ratings assigned to the bank and holding company, as a result of supervisory activities, are also provided to the subject’s board of directors and senior management within the written examination reports. In cases where supervisory activity results in an assessment of the bank or holding company that is less than satisfactory, the bank’s or holding company’s board of directors and senior management are made aware of resulting regulatory restrictions where appropriate. Examples of these restrictions are constraints on severance payments made to IAPs, requirements regarding the appointment of new directors or senior executive officers, restrictions on dividend payments while the bank or holding company is in a problem condition, and prohibition of new branches. The manner by which agencies coordinate communication of examination activities and findings varies depending on the specific condition of the bank or holding company, structure, and in the case of state counterparts, geographic location. The assessors found evidence of joint letters being issued after examinations as well as separate letters from each agency involved in the examination. Occasionally this would also involve regulators arriving at different ratings for the same institution although these are rare.</p> <p>In terms of communication, the assessors noted that supervisors often conflated the board and senior management (a tendency the assessors also found in guidance) when in many cases the role of the two are different.</p>
<p>EC9</p>	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank’s Board if action points are not addressed in an adequate or timely manner.</p>
<p>Description and findings re EC9</p>	<p>All Banks</p> <p>U.S. supervisory authorities undertake follow-up to verify that banks and holding companies have addressed supervisory concerns and/or implemented requirements communicated to them, including early escalation to the appropriate level of the supervisory authority and to the bank’s board of directors if action points are not addressed in an adequate or timely manner.</p> <p>For instance, through the supervision process, including onsite and off-site examination activities, staff may identify Matters Requiring Attention (MRAs), Matters Requiring Board Attention (MRBAs) and Matters Requiring Immediate Attention (MRIAs) for institutions supervised by the Federal Reserve by banks and holding companies. MRAs/MRBAs/MRIAs are detailed in reports on examination and/or other communications to management and as warranted, boards of directors. Depending on the significance of the MRAs/MRBAs/MRIAs identified, an informal or formal enforcement action may be issued. MRAs/MRBAs/MRIAs and enforcement actions detail the weaknesses identified by the supervisors, the corrective actions that are expected to be taken by the company to address the concerns, and specific dates for completing the work [see also CP 8].</p> <p>The assessors did see evidence of MRAs being outstanding for some time beyond the original date. Supervisory management was aware of a wider issue of aging of MRAs and had management information to monitor them. Management was also considering issuing further guidance to examination staff to reduce the number of out aged MRAs.</p> <p>The assessors also noted that where banks had a large number of MRAs, both the relative prioritization and any broader themes could be lost.</p>

EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	<p>All Banks</p> <p>U.S. FBAs have an expectation, but not a requirement, that banks notify them in advance of any substantive changes in their activities, structure and overall condition.</p> <p>In addition supervisory staff members discuss with bank management during periodic onsite and offsite monitoring financial trends and changes in bank operations, controls, and management, and monitor the approvals of banks' boards of directors, investment committees, and business plans overall. They receive frequent, quarterly if not monthly, reports on business areas, new products. They also discuss with the internal audit departments changes in businesses.</p> <p>Some aspects are subject to statutory notification such as breaches of the BSA. In addition permitted bank and non-bank activities, as well as changes in ownership and/or control, are addressed by regulations published by a number of agencies, each focused on activities of banking institutions within each agency's jurisdiction. In addition to the on-going communication, institutions are expected to notify supervisors promptly of material adverse developments. Periodic review of management reports by supervisors helps to ensure that communications of these events occurs on a timely basis.</p> <p>The Federal Reserve is the primary regulator of financial and bank holding companies, as well as state-chartered banks that are members of the Federal Reserve System. State member banks' permissible activities may be enacted by the state laws of the states where the banks are incorporated and the states where they do business. Federal-level regulation for holding companies are documented in the FRB's Regulation Y, which addresses changes in ownership and control of financial and bank holding companies as well as banks supervised by the Federal Reserve.</p> <p>Regulation H contains the requirements for state member banks, activities they may engage in, prompt corrective action for institutions where capital is inadequate, and financial record keeping and reporting requirements.</p> <p>National Bank permissible activities are discussed in "Activities Permissible for a National Bank, Cumulative," an OCC publication. National banks must apply to the OCC for approval for certain activities, as well as for permission for activities not specifically approved by statute or OCC regulation.</p> <p>The FDIC publishes similar regulations for state-chartered banks that are not members of the Federal Reserve System.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Regulation Y also contains restrictions on, and reporting requirements for, non-bank activities of a BHC and/or its subsidiaries as well as non-bank activities of foreign banks doing business in the U.S.</p> <p>Regulation Y also contains the requirements for large bank holding companies to submit annual capital plans for review.</p>
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration

	the biases that may influence third parties.
Description and findings re EC11	U.S. FBAs do not use independent third parties, such as auditors, to conduct their prudential supervisory activities of banks and holding companies. However, on an as needed basis or during periods where staffing needs to be augmented, the agencies may use external experts to perform specific tasks such as commercial credit reviews. Tasks and deliverables are outlined in a formal contract with a defined timeline. Further, these roles are typically filled with former supervisors or subject matter experts who are supervised by agency personnel.
EC12	The supervisor has an adequate information system that facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	<p>U.S. FBAs use a variety of information systems to facilitate the processing, monitoring, and analysis of prudential information. For example, the Federal Reserve System maintains a National Information Centre (NIC) database that contains financial, regulatory, and structure report data for supervised domestic financial companies and foreign financial institutions with a presence in the U.S., as well as their subsidiaries and branches around the world.</p> <p>In addition, the Federal Reserve uses C-SCAPE (Consolidated Supervision, Comparative Analysis, Planning and Execution) that is an application used to enhance the planning and execution of supervisory activities in the LISCC, LBOs, large FBOs, and financial market utility portfolios. C-SCAPE has facilitated the migration from point-in-time document-centric supervision to an integrated consolidated supervision workflow process. These new processes, with linked workflows across supervisory analysis, planning and execution, enable continuous updates of information provided via exams and continuous monitoring that, in turn, are reflected in the Risk Assessment and analyses of capital, asset quality, earnings, and liquidity (CAEL) financial factors. The updated information directly assists planning and prioritization of supervisory activities reflecting both "bottom-up" firm-specific assessments and follow-up activities, as well as "top-down" planning for macro-prudential and horizontal matters. Robust reporting and decision support tools enable real-time horizontal views of supervisory priorities, resource needs and risk assessments</p> <p>The OCC uses several tools to support on-going supervision and analytics of institutions regulated under its purview. Planning and prioritization of supervisory strategies and activities for large and/or complex institutions are developed, reviewed and approved via the Strategy Automation Tool (SAT), with the strategy artifact automatically stored in Examiner View (EV) or eDocs. Strategies for smaller institutions are entered directly into EV. When resources external to the business unit are needed to execute the strategy, those resources, including subject matter experts, are requested and filled through the National Resource Planning Tool (NRPT). Local and national resources are scheduled via the National Scheduling Application (NSA). Conducting and documenting the results of supervisory activities uses a combination of applications, including the Large Bank Institutional Database (LBID), eDocs and EV. These applications enable continuous updating and monitoring of an institution's structure, risk profile, and supervisory ratings and issues. Specific exam areas are supported with specific tools to improve efficiency and promote consistent analysis and documentation, such as National Credit Tool, which is used in credit examinations. Additionally, on-going portfolio analysis is undertaken with the use of several analytical tools such as Financial Institution Data Retrieval System (FINDRS), Microsoft Reporting Services (SIS Reports), Data Analytics Reporting Tools (DART), Canary benchmark ratios and custom Tableau data visualizations. These tools, as well as a portfolio of standard analytic reports, facilitate supervisory risk assessments from a macro view of the institutions at several levels.</p>

Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.
Description and findings re AC1	The Government Accountability Office is authorized to conduct periodic audits of the U.S. Federal banking agencies. Such audits may include a review or evaluation of the international regulation, supervision, and examination activities of the appropriate Federal banking agency, including the coordination of such activities with similar activities of regulatory authorities of a foreign government or international organization. Additionally, the Office of Inspector General (OIG) for each of the U.S. FBAs conducts internal audits of the agency. The OIG of the Department of the Treasury has audit authority with respect to the OCC. The purpose of the OIG is: to conduct and supervise audits and investigations relating to the programs and operations of the agencies; to provide leadership and coordination and recommend policies intended to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in, such programs and operations; and to provide a means to keep the head of the agency and the Congress fully informed and up-to-date about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action.
Assessment of Principle 9	Largely Compliant
Comments	<p>The assessors found that the U.S. agencies have an array of tools and techniques to carry out their supervisory responsibilities and furthermore that they are also developing new techniques, such as stress testing and horizontal reviews.</p> <p>As noted in CP6, there is no explicit regulatory requirement for a bank to immediately report if they find that a major shareholder is no longer suitable. Nor did the assessors see any evidence of such reporting in the written documentation. The assessors recommend that such a supervisory requirement is introduced, with the aim to ensure that supervisors are promptly informed if a major shareholder is no longer suitable, since this might have a negative impact on the safety and soundness of the bank.</p> <p>Traditionally the U.S. approach has been dominated by on-site examinations and consequently (as noted in EC 10) there are few requirements for banks to report to the regulator. Although the assessors accepted that the extent of examination was a mitigant to an extent, the assessors viewed this omission as a cause for increasing concern. Not least because the assessors detected a noticeable shift towards more analysis (and, of course, stress testing takes up a significant level of resource). The assessors believe the absence of reporting poses three main risks:</p> <ul style="list-style-type: none"> • It creates a potential single source of failure should the examination process not discover the change in activity; • It removes the onus on banks to consider what they should be telling their regulator in order to be in compliance; and • it potentially leads to a delay in the ability of the supervisor's to respond until the next examination or next contact. <p>The assessors also noted that there was room for improvement in the ways the regulators communicated with banks. The assessors would make four observations:</p>

	<ul style="list-style-type: none"> • the size of some letters and reports are extensive and can often lose key messages - particularly when addressed to Board of Directors. This is particularly the case where there are extensive MRAs or observations in terms particular credit loans or transactions (EC4); • supervisors often conflated the board and senior management (a tendency the assessors also tend to find in guidance) when in many cases the role of the two are different (EC8); • in some examples the assessors found supervisors had used what the assessors considered to be excessive praise in their communication to banks. The assessors regard this as different from supervisors making sound judgments and producing a balanced piece of feedback to the banks. The assessors would recommend that supervisors should consider their communication strategy in this respect (EC4); and • The assessors also noted that supervisors seemed to spend a large amount of time recounting the recent events in the bank to the bank themselves. This is not to say that supervisors should not put their own judgments into context, but the assessors felt that the histories could be reduced a little with no loss of context (EC4). <p>The assessors were pleased to see that management were trying to tackle several issues with MRAs (the assessors were shown some draft guidance to examiners drawn up by the OCC)—such as those which had been outstanding for some time and also where they had not been drafted clearly enough to begin with. The assessors would support further clarity in this area.</p> <p>The assessors noted that the supervisors were making greater efforts to collaborate, but the assessors did note that this could go further if planning cycles were aligned. At the moment with one regulator beginning their planning much earlier, it runs the risk that resources are committed before another regulator has completed their plan and made a bid for assistance.</p> <p>As noted in EC4, there is a greater emphasis on horizontal reviews and the assessors welcomed this development. However the assessors urged that supervisory expectations should be clearly established at the outset of such reviews. The absence of such clarity, runs the risk of regulatory creep as supervision is increasingly set against the best practice within a peer-group, which may mean an inadequate standard because the peer-group as a whole does not include a good exemplar.</p>
<p>Principle 10</p>	<p>Supervisory reporting. The supervisor collects, reviews and analyses prudential reports and statistical returns³⁹ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.</p>
<p>Essential criteria</p>	
<p>EC1</p>	<p>The supervisor has the power⁴⁰ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.</p>

³⁹ In the context of this Principle, “prudential reports and statistical returns” are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

⁴⁰ Please refer to Principle 2.

Description and findings re EC1	<p>The FBAs have an extensive reporting framework and have the authority to require information needed for supervisory purposes at regular intervals and upon demand. The authority is broad, extending to affiliates of a bank or holding company and including information on a bank's or holding company's domestic and foreign operations. The FBAs collaborate on an interagency basis to maintain regulatory reports under the FFIEC.</p> <p>Banks and holding companies are required to submit information on their financial condition, performance and risks. Required reports provide information on balance sheet assets and liabilities, off-balance-sheet exposures, profit and loss, capital adequacy, asset quality, loan loss provisioning, affiliate and insider transactions. They also provide information allowing for an assessment of liquidity, large exposures, asset concentrations (including by economic sector, geography and currency), foreign exposures, interest rate risk and market risk. The volume of information reported has increased substantially since the crisis in the context of regulatory changes, enhanced supervisory oversight of capital and liquidity management, and supervisory stress testing.</p> <p>The framework for standard reporting is that individual banks must submit reports to the appropriate FBA on a consolidated basis (i.e. capturing the bank and its subsidiaries). There is no bank reporting on a solo (banking entity only) basis. Bank holding companies with consolidated assets of \$500 million or more and savings and loan holding companies of all sizes must also submit financial and supervisory information on a consolidated basis. A parent holding company must submit reports that include financial statements on a "stand-alone" basis and also include information on related party transactions. Moreover, a report must be submitted regarding certain related party transactions between the holding company and affiliates. In addition, all other U.S. nonbank subsidiaries and foreign subsidiaries of holding companies are subject to reporting requirements that include financial and supervisory information if these entities exceed certain size thresholds.</p> <p>Under the final rules giving effect to the Volcker Rule, banking entities with significant trading operations are required to calculate and report metrics of their trading activity, by trading desk, to allow the FBAs to assess whether such trading activity is consistent with permitted trading activities in scope, type, and profile. The reporting requirements are being phased in based on the type and size of the entity's trading activities.</p>
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	By statute, banks and holding companies are required to apply accounting principles that are uniform and consistent with U.S. GAAP in preparing and submitting financial reports to FBAs (see 12 U.S.C. § 1831n(a)(2)). Although they have the power to adopt more stringent requirements, the FBAs have generally chosen to adopt U.S. GAAP for regulatory reporting. In certain instances, however, reports allow the alternative of International Financial Reporting Standards (IFRS) or national accounting standards, provided the alternative is no less stringent than U.S. GAAP.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or

	regulatory reporting purposes.
Description and findings re EC3	<p>The FBAs ensure that banks develop and maintain a strong governance framework, policies and controls that ensure the effectiveness of methodologies that produce valuations. The FBAs ensure reliability of the data by verifying that banks maintain a robust validation process commensurate with the risk in valuation methodologies and models and that the validation process is comprehensive, rigorous and effective. The assessors reviewed examples of supervisory reviews of valuation processes. In situations where the validation process is deemed unacceptable, the supervisor will require adjustments to the reported amounts. The FBAs review the effectiveness of the internal audit function and verify that the bank board annually reviews and approves model risk management policies.</p> <p>U.S. GAAP applies various measurement models to different categories of assets and liabilities. Certain assets and liabilities are reported on a historical cost or amortized cost basis, while the application of lower of cost or fair value and fair value accounting (with changes in fair value reported in earnings or other comprehensive income as appropriate) is required under other circumstances. For example, loans held for investment are accounted for at historical cost and loans held for sale are measured at the lower of cost or fair value (unless the fair value option is elected), whereas trading assets and liabilities are measured at fair value with changes in fair value included in earnings. A bank or holding company that elects the fair value option is expected to apply sound risk management and control practices to the assets and liabilities accounted for at fair value. The current use of the fair value option under U.S. GAAP is generally limited to larger, more complex banks and holding companies.</p>
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	<p>The FBAs collect and analyse information quarterly from all banks, bank holding companies with consolidated assets of \$500 million or more,, and savings and loan holding companies of all sizes. All federal banks and savings and loan associations, regardless of size, need to file quarterly Call Reports. If the BHC is below the \$500 million threshold, it submits a parent-only report on a semi-annual basis. In addition, reports from other subsidiaries, such as non-bank subsidiaries, in the BHC are required to be submitted either quarterly or annually, depending of the size and nature of the subsidiary.</p> <p>At large banks or holding companies where the FBAs have on-site examination teams, supervisors receive frequent risk management reports that allow them to monitor the entity's condition and trends in key portfolios and risk segments. The FBAs may direct individual banks and holding companies to provide information on a more frequent basis, depending on their risk profile. For example, monthly reports on key risk areas may be required from banks and holding companies that are identified as posing special supervisory concerns or that are subject to certain enforcement actions. In some situations, daily reports may be received on key funding or liquidity issues; key institutions provided daily liquidity reports during the crisis and continue to do so.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	The FBAs collect reports on the same dates for all banks on a quarterly basis and for all entities in the consolidated holding company. While the frequency may differ given the size

	<p>and nature of the entity, the reporting dates are as of the calendar quarter end. Banks and holding companies are required to complete reports using a standard set of reporting instructions, thereby ensuring comparability of reported items between banks and holding companies.</p> <p>The FBAs work together to ensure, to the extent possible, that the information reported at the subsidiary level is comparable to information that is collected at the consolidated holding company level. In addition, any revisions to supplemental reports for other entities (e.g. a nonbank subsidiary report) are driven by changes made to the bank report and the holding company report, which helps ensure that comparable information is reported across the holding company.</p>
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	<p>Collectively, the FBAs have broad statutory authority to obtain a wide array of information from supervised banks and holding companies, including financial data and information on their activities, operations, structure, corporate governance, risk management and other information needed by supervisors (see CP 1, EC 5). Banks and holding companies must provide supervisors with full and complete access to their books, records and employees (including directors); failure to do so can result in the imposition of administrative sanctions. These requirements extend to the foreign operations of U.S. banks and holding companies; however, the laws of foreign host countries may restrict the sharing of information with the FBAs.</p> <p>Under their statutory authorities, the FBAs have the power to request and receive any relevant information from banks and holding companies, irrespective of their activities, where the supervisor believes that it is material to their financial situation, or to the assessment of the risks of the bank or holding company. This includes internal management information (see e.g. 12 U.S.C. § 161(a) and (c)). Affiliates of banks and holding companies that may generally be exempt from reporting certain information can also be required to do so by their FBA. In addition, an agency may request information from the functional supervisor for entities it does not supervise, although this authority is limited by the requirement that the FBAs must rely to the fullest extent possible on the relevant functional supervisor (see e.g. 12 U.S.C. §§ 1831v and 1844(c)(2)(E)).</p>
EC7	The supervisor has the power to access ⁴¹ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	The FBAs have the authority to review all books and records of a bank or holding company that are deemed necessary for supervisory purposes. The agencies have access to the bank's or holding company's board, management and staff when required to discuss supervisory matters. Furthermore, the agencies have the authority to require a bank or holding company to submit any information if there is a supervisory need, even when it would not be otherwise required to submit such information.

⁴¹ Please refer to Principle 1, Essential Criterion 5.

EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines-the appropriate level of the bank’s senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	<p>Banks and holding companies are required by statute to comply with reporting requirements and information disclosure requests of FBAs. A failure to comply (including by submitting an untimely report or through misreporting or persistent errors) can provide the basis for informal or formal enforcement measures, including cease-and-desist proceedings and the imposition of a civil monetary penalty, against a bank or holding company and/or its institution-affiliated parties (IAPs). Under certain circumstances, a culpable IAP also may be subject to suspension and debarment. See 12 U.S.C. §§ 1817(a) and 1818(b) and (i). The agencies can require banks and holding companies to amend previously filed reports when material errors have occurred. The consolidated regulatory reports for banks and holding companies require attestation by the Chief Financial Officer (CFO) and bank-level regulatory reports also require attestation by three members of the board.</p> <p>Banks and holding companies that are also public companies are required to file reports with the SEC and banks that are required to file reports with their primary FBA, are required by the Sarbanes-Oxley Act of 2002 to obtain an annual audit of their financial statements and their internal controls over financial reporting. Public company officers must acknowledge in writing that they have evaluated the company’s internal financial controls and the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are required to sign and certify that they have reported to the independent auditors and to the audit committee all information regarding material weakness and significant deficiencies in internal controls that could adversely affect the company’s ability to provide accurate financial reports. See 15 U.S.C. § 7241.</p> <p>For banks with assets of \$1 billion or more, the FDIC requires that the bank’s management annually prepare and submit to the appropriate FBA, and any appropriate state bank supervisor, a management report that includes (1) a statement of management’s responsibilities for preparing the bank’s annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with certain designated laws and regulations relating to safety and soundness; (2) an assessment by management of the bank’s compliance with such laws and regulations during the fiscal year; and (3) an assessment by management of the effectiveness of such internal control structure and procedures as of the end of the fiscal year. Banks with assets of \$500 million or more, but less than \$1 billion, must prepare and submit annually a management report that includes items (1) and (2). See 12 CFR 363.2. These particular requirements do not apply to holding companies, although statutes and regulations provide that, in certain instances, the audit requirements may be satisfied at the holding company level.</p>
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor’s own staff or of external experts. ⁴²
Description and	The FBAs review and verify regulatory reports during the course of on-site examinations of

⁴² Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

findings re EC9	banks and holding companies. In addition, the FBAs utilize extensive off-site automated programs that provide validity and quality checks (“edits”) against the regulatory reports submitted. Some edits check the mathematical accuracy of certain areas of the regulatory reports (“validity edits”) while other edits review relationships between various aspects of the reports and certain qualitative measures (“quality edits”). The assessors saw examples of quality edits. All edit exceptions must either be corrected or explained. If an edit explanation provided by a bank or holding company is found to be unacceptable by the relevant FBA, additional investigative work is performed with that bank or holding company until the edit exception is resolved (sometimes resulting in amended reports). There cannot be any validity edit exceptions on the regulatory reports and all quality edit exceptions must be considered reasonable by the FBA before the report is accepted. The FBAs do not use external experts to verify supervisory returns.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, ⁴³ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks’ operations.
Description and findings re EC10	The FBAs generally do not utilize external experts to perform supervisory tasks. However, on an as-needed basis or during periods where staffing needs to be augmented, the FBAs may use external experts to perform specific tasks such as commercial credit reviews. Tasks and deliverables are outlined in a formal contract with a defined timeline. Further, these roles are typically filled with former supervisors or subject matter experts who are supervised by agency personnel.
EC11	See EC 10 above and CP 9 EC 11. The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	When the FBAs engage consultants or external experts, such experts and consultants are under the direct supervision of on-site agency personnel and, as a result, their findings are promptly reported to the agencies.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The FBAs review all FFIEC reports for relevance on a periodic basis under the direction of the FFIEC’s Task Force of Reports. In addition, the Paperwork Reduction Act (PRA) requires periodic review of all regulatory reports and the Office of Management and Budget (OMB) must approve all reports for extensions of existing collections, as well as new and revised collections. See 44 U.S.C. §§ 3501-3521. The OMB is responsible for ensuring that regulations are based on sound analysis and that the information collected satisfies a supervisory need. This statutory review process predates the financial crisis. The FBAs conducted their most recent five-yearly review of data collected in the Call Report in November 2012. Information determined to be no longer necessary or appropriate as a result of this review will be eliminated after appropriate notice and comment pursuant to the

⁴³ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	<p>PRA.</p> <p>In addition, the FFIEC and the FBAs are required to conduct a review of all their regulations to identify outdated, unnecessary or unduly burdensome regulations applicable to insured depository institutions. The FFIEC and the FBAs must conduct this review at least once every 10 years; the next review must be completed by December 31, 2016.</p>
Assessment of Principle 10	Compliant
Comments	<p>The FBAs have a long-established and effective regulatory reporting framework, with the flexibility, demonstrated through the crisis, to expand reporting requirements in response to pressing supervisory needs. At the same time, reporting demands are subject to periodic public reviews of reporting burden and to information collection budgets in each agency. These are important disciplines to guard against redundant data items and information overreach; banks to which the assessors spoke expressed concern that some reporting requirements generate data of little use to the banks themselves or are not aligned with their way of conducting activities, requiring them to generate reports simply to satisfy supervisory needs. At the same time, cost-benefit analysis in this area can easily understate the safety-and-soundness benefits of supervisory access to timely and relevant data, which are extremely difficult to quantify. With the crisis passed, the FBAs are encouraged to review the level of granularity of data collected, particularly for stress testing and liquidity analysis purposes, to ensure that data continues to be needed at that level.</p> <p>The FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries). In principle, this would appear a significant deviation from CP 10; it means that supervisors and market participants may not have the information to test whether a bank is adequately capitalized on a stand-alone basis. However, the assessors understand that, in practice, this omission is not sufficiently material in its impact to warrant a lower rating for CP 10 under current circumstances. U.S. bank subsidiaries tend to be small relative to the parent bank and can only undertake limited activities that the bank itself could undertake in its own name. Nonetheless, the assessors recommend that future Core Principles assessments verify that these circumstances have continued to apply. Supervisors should closely monitor the development of banking groups and consider introducing solo level reporting if the number or size of bank subsidiaries were to expand or banking groups become less transparent. The assessors also note that the Basel capital framework applies at every tier within a banking group on a fully consolidated basis.</p>
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank’s management or, where appropriate, the bank’s Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank’s Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and	Generally, the FBAs identify problems or deficiencies at a bank or holding company during

findings re EC1	<p>on-site examinations. Most problems or deficiencies are resolved informally during the course of the examination, when the bank or holding company immediately takes steps to correct or commits to promptly correct the problems or deficiencies and address the regulatory concerns. At the conclusion of the examination of a bank, supervisors send a written "Report of Examination" (ROE) to the bank for review by all directors and senior officers. The ROE assesses the condition of the bank's capital, asset quality, management, earnings, liquidity and sensitivity to market risk (CAMELS); identifies violations of law; assesses compliance with the BSA; and addresses compliance with consumer laws and regulations, information technology, and the CRA. The narrative of the ROE also calls attention to "concerns" or matters that need attention (MRAs and MRAs/MRBAs). For further discussion on MRAs, see CPs 8 and 9. (Example of an agency's policy of communicating examination findings: The Federal Reserve's 2013 supervisory letter "Supervisory Considerations for the Communication of Supervisory Findings"). Similar reports are issued after the inspection of holding companies.</p> <p>Some problems or deficiencies may not be satisfactorily addressed through the informal means mentioned above, especially if problems or deficiencies are serious, pervasive, or repeated. In such cases the supervisors may take supervisory actions (further described in ECs 2, 3 and 4 below). Generally, supervisory actions require a bank or holding company to take certain affirmative actions and make periodic (monthly or quarterly) written reports to the relevant agency (-ies) on the progress that the bank or holding company has made to address the deficiencies identified. Detailed policies and action plans with target dates may be requested from a bank or holding company, and supervisors will review the plan for sufficiency and examine progress against key milestone dates.</p>
EC2	<p>The supervisor has available⁴⁴ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.</p>
Description and findings re EC2	<p>The FBAs have a wide range of supervisory options when a bank or holding company is not complying with the laws, regulations or supervisory orders, or is engaged in an unsafe or unsound practice. The agencies may take prompt remedial action and impose penalties, including a divestiture of activities or control of an entity. The range of tools is applied in accordance with the gravity of a situation.</p> <p>Such action may include requiring the bank's or holding company's board of directors to adopt a resolution to cure the deficiencies, sign a commitment letter, develop and implement a safety and soundness plan, conform to institution-specific minimum capital ratios established by the agencies (applicable only to banks), or execute a memorandum of understanding with the supervisor.</p> <p>In the event that the problems are pervasive, repeated, unresolved by management, or otherwise of serious concern, the agencies may exercise their statutory enforcement authority by taking formal enforcement action. Such actions include (i) Formal or Written Agreements; (ii) Cease and Desist Orders; (iii) Safety and Soundness Orders; (iv) Capital Directives; (v) PCA Directives; (vi) Civil Money Penalty Assessments. FBAs may also take temporary injunctive action using a temporary C&D order under certain conditions. The federal enforcement statutes associated with such actions are the same for all of the</p>

⁴⁴ Please refer to Principle 1.

	<p>agencies.</p> <p>In determining whether a formal enforcement action, as mandated by 12 U.S.C. 1818, is appropriate, the agency staffs consider all relevant factors, including the nature, severity and duration of the problem, the risks presented at the bank or holding company, the anticipated resources and actions necessary to resolve the problem, and the responsiveness of the directors and management, Under certain circumstance, the federal enforcement statutes require formal enforcement action, rather than giving the agency discretion to pursue a formal action. Formal enforcement actions are legally enforceable, remain in effect until modified or terminated, and must be publicly disclosed by the appropriate agency.</p> <p>All informal supervisory actions are entered into with the consent of the bank or holding company. Formal enforcement actions are generally issued with the consent of the bank or holding company. Should the bank or holding company decline to consent to a formal enforcement action, the agency may initiate a contested judicial proceeding to impose the formal action upon the institution. In cases where there is (i) an immediate threat to the viability of the bank or holding company or ongoing unsafe and unsound practices or (ii) the institution’s books and records are so incomplete or inaccurate that the agency is unable to determine the financial conditions of the institution, an agency may immediately issue a temporary order to cease and desist (notwithstanding the ongoing contested proceeding).</p>
EC3	<p>The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.</p>
Description and findings re EC3	<p>A PCA regime (the PCA statute at 12 U.S.C. § 1831 o.) applies to those instances in which a bank’s capital ratios fall below the stipulated minima. The regime encourages intervention at an early stage, also before the thresholds have been violated, to resolve issues and prevent further deterioration. For instance, any bank which is less than adequately capitalized cannot pay dividends and must submit a capital restoration plan that is acceptable to the supervisor. (See the description of the PCA in CP 16, EC1)</p> <p>The supervisor also have powers to act if a bank or holding company violates other regulatory threshold requirements, for instance on large exposures.</p> <p>Supervisors may also act if banks fall below the regulatory minima for liquidity. See CP 24.</p>
EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>Possible remedial measures include restricting the current activities and operations of the bank or holding company; withholding or conditioning approval of new activities or acquisitions; restricting or suspending payments to shareholders or share repurchases;</p>

	<p>restricting asset transfers; barring individuals from banking; replacing or restricting the powers of managers, directors, or controlling owners; facilitating a takeover or merger; providing for the interim management of the bank or holding company ; revoking or recommending the revocation of the banking license; revoking membership in the Federal Reserve; and terminating deposit insurance.</p> <p>The FBAs may also restrict a bank or holding company’s growth; or require it to dispose of any loan or asset involved in the violation or unsafe or unsound practice; require it to employ qualified officers and employees; and take any other action that the agency deems appropriate. The provisions of formal enforcement actions may require the bank or holding company to stop certain action or to take affirmative action. It may be required to submit specific plans, policies or procedures. Common provisions require it to cure specified violations, correct risk management or board of directors’ oversight weaknesses, submit a plan to increase or maintain sufficient capital, provide for an adequate allowance for loan and lease losses, and restrict the payment of dividends.</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	<p>Remedial penalties and sanctions may be applied to the institution and, when appropriate to management, board members, employees, and other individuals who participate in the institution’s affairs (Institution-Affiliated Parties or IAPs).</p> <p>The supervisors may set provisions to limit the individual’s activities at the institution, or to take affirmative actions, or to make restitution or reimbursement to the institution. An agency may suspend or remove an IAP from the institution for violations of law or other misconduct and prohibit an IAP from further participation in the banking industry. An agency may assess civil monetary penalties against an IAP under the same circumstances as a civil monetary penalty against a bank.</p>
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	The FBAs have the authority to impose conditions on the relationships between banks and any other entity, including a holding company, subsidiary, parallel owned banking organization, or other related company in order to prevent or address a threat to the safety and soundness of the bank. The agencies have broad powers to order remedial actions that can protect a bank from adverse actions by its holding company or affiliates. For example, remedial actions may limit or prohibit payments from the bank to its holding company or affiliates. Provisions of such enforcement actions may include restrictions on inter-corporate transactions, prohibitions on the holding company accepting payments from the bank, and requirements for the holding company to provide management and financial support to the bank (known as the Source of Strength doctrine as codified at 12 U.S.C. §1831o-1.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	When a problem bank does not have the ability or resources to solve its deficiencies, the FBAs have authority to appoint a conservator or a receiver. The conservator takes full control of the bank and assumes the powers of shareholders and board of directors. The conservator may repudiate contracts and temporarily limit customer withdrawals and payments to

	<p>creditors. If the bank returns to a safe and sound condition, the conservator may return control to the shareholders or prepare for a sale of the bank.</p> <p>In the case of a resolution the relevant supervisory agency (ies) of a bank would cooperate with the resolution agency, the FDIC, to ensure a smooth process. For instance, it would inform the FDIC at an early stage about impending problems that might lead to a bank's failure. It would also provide the FDIC with supervisory information needed for the resolution. It could also, on behalf of the FDIC, conduct investigations on the bank post-resolution.</p>
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	<p>The PCA statute and regulations require early intervention by supervisors to address capital shortfalls of banks. The capital levels triggering supervisory action are clear and objective, and many of the associated remedial measures are mandatory.</p> <p>Aside from the PCA, there are generally no specific statutory requirements that establish timetable for taking supervisory action. However, formal enforcement actions generally are implemented within a reasonable time frame. Moreover, formal enforcement actions and most other supervisory measures, such as MRAs and MRAs, establish timeframes for each of the actionable articles in the enforcement action. Each FBA has instituted tracking of matters that a bank needs to address, whether as a result of MRAs, etc., set forth in exam reports or deadlines set in enforcement actions. For instance, the Federal Reserve has established a Performance Measurement Program that tracks the type of MRA/MRIA found in examinations on a quarterly basis and measures the response time for correction of such deficiencies.</p> <p>The agencies maintain a time limit of 45 days between the end of a supervisory full-scope examination and the sending of the Supervisory Letter to the bank, but this limit may be prolonged for various reasons in individual cases.</p>
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	<p>The "Policy Statement on Interagency Notification and Coordination of Enforcement Actions" discusses federal banking agency coordination. The U.S. FBAs work together to address supervisory concerns of common interest. Coordination with non-banking regulators on enforcement actions coordinated on a case-by-case basis, in particular when the enforcement action is to be published. The Federal Reserve, as the "umbrella supervisor" of holding companies of holding companies and their subsidiaries, relies on the federal and state supervisors of "functionally regulated" subsidiaries, such as broker dealers and insurance companies, to examine these companies and to take supervisory actions when appropriate. The Federal Reserve coordinates its actions and share information where appropriate with the FBAs and other agencies, foreign supervisors and sectoral regulators.</p> <p>Also, the FSOC could in certain circumstances be a forum for coordination and information-sharing when formal corrective action is being taken against a systemically important institution.</p>
Assessment of	Compliant

principle 11	
Comments	<p>The authorities are recommended to consider implementing rules for promoting early action also for other issues than bank capital and liquidity. The advantages of a prompt correction regime are that it provides transparency to the supervisory process and to the expectations on the supervised institutions, while mitigating against forbearance. However, it is important that there is adequate flexibility in the regime since a too-rigid framework would not be able to deal with different situations.</p> <p>The assessors acknowledge that the U.S. legislation, regulations, and processes for taking supervisory action (informal or formal) are robust and have been further strengthened in recent years. For instance, the assessors noted earlier cases in which the escalation of supervisory measures, when warranted, took longer than appropriate given the severity of the deficiency at hand. However, in recent years there has been a clear reduction in such cases, reflecting the authorities' new and more explicit rules and stricter implementation. The assessors recommend the authorities to continue on this path, for instance by setting even more explicit rules for the ageing of MRAs and MRIAs. The evolving practice of setting timelines for the completion of remedial actions, and requiring regular reporting of progress, is encouraged by the assessors. The assessors also encourage the implementation of planned OCC guidance on supervisory practices relating to MRAs</p> <p>The assessors saw ample evidence of both informal and formal enforcement actions undertaken by the FBAs. Subject to the comments above, the assessors found that the authorities do use the options available to make banks take remedial action and that the follow-up process is adequate.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ⁴⁵
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>The Federal Reserve is the consolidated supervisor for U.S. banking holding companies (BHCs)—including financial holding companies (FHCs)—and for savings and loans holding companies (SLHCs).</p> <p>The Federal Reserve achieves a comprehensive understanding of the overall structure of banking groups through the ongoing supervision process. The statutes require specific prior approval for holding company formation, acquisitions, and commencement of new activities. As a part of the approval process for these transactions, the Federal Reserve evaluates a banking group's structure, material activities, and risk management programs. The Federal Reserve also relies on the relevant primary supervisors, functional regulators, and foreign supervisors for information and analysis about other entities within a holding company</p>

⁴⁵ Please refer to footnote 19 under Principle 1.

	<p>structure.</p> <p>Section 604 of the DFA makes it easier for the Federal Reserve to obtain information directly from BHC subsidiaries, including functionally regulated subsidiaries. The provision also grants the Federal Reserve examination authority over BHC subsidiaries, including functionally regulated subsidiaries, to inform itself of (1) the nature of the operations and financial condition of the BHC and the subsidiaries; (2) the financial, operational and other risks within the BHC system that may pose a threat to the safety and soundness of the BHC or any of its depository subsidiaries or the stability of the financial system of the U.S., and (3) the systems of the BHC for monitoring and controlling the foregoing risks. In exercising this authority, the Federal Reserve must rely to the fullest extent possible on examination reports prepared by a functional regulator and notify the functional regulator before conducting an examination of the functionally regulated subsidiary. Section 604 of the DFA repealed a provision of the GLB Act that barred the Federal Reserve from exercising enforcement or rulemaking authority over functionally regulated subsidiaries except in extraordinary circumstances.</p> <p>In conjunction with state bank supervisors, the U.S. FBAs have a number of formal and informal mechanisms to facilitate consolidated supervision. These mechanisms cover, among other things, the coordination of examinations, communication protocols for emergency situations, and information sharing related to electronic databases containing examination reports, financial records, and other supervisory information. In addition, functional regulators, such as the SEC, the CFTC, and state insurance supervisors exchange information with the FBAs related to securities and insurance companies in a holding company or a financial conglomerate that includes a bank. Normally, the FBAs would rely on information provided by the functional regulators before making their own requests. U.S. law authorizes the U.S. FBAs to exchange financial records, examination reports, and other information regarding banks and holding companies.</p> <p>In addition, structural changes have by themselves implied improved consolidated supervision. An increasing number of insurance companies have acquired thrifts, which means that the holding companies will be supervised by the Federal Reserve on a consolidated basis.</p> <p>Also, the scope of supervision of the largest groups has been broadened and examination teams now include, for instance, macroeconomic experts, IT experts and legal experts in addition to prudential supervisors.</p> <p>The stress-testing requirements for all holding companies having assets in excess of \$50 bn, laid down in the DFA, apply on a consolidated basis and will increase supervisors' understanding of the group's risk profile. The Capital Plan requirements (2011) require large banks to submit for supervisors' review a yearly capital plan on a consolidated basis, taking all material risks into account,</p> <p>The requirement in the Section 165 DFA that FBOs generally, with some exceptions, must form a holding company for their U.S. affiliates, has also strengthened consolidated supervision.</p>
EC2	<p>The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure.</p>
Description and	<p>The Federal Reserve has established prudential standards to address a broad range of</p>

findings re EC2	<p>supervisory issues and concerns. These include, but are not limited to, standards to address:</p> <ol style="list-style-type: none"> 1) Resolution and recovery plans for large holding companies 2) Capital adequacy—See responses for Principle 16 for detail. 3) Liquidity—See responses for Principle 24 for detail. 4) Large exposures and lending limits—See responses for Principle 19 for detail. 5) Exposures to related parties—See responses for Principle 20 for detail. 6) Group structure—See responses for Principle 4, Principle 6, and Principle 7 for detail. <p>The Federal Reserve imposes the prudential standards on capital adequacy, risk management, and risk-specific measures, the internal audit and controls measures, and the accounting and disclosures standards on a consolidated, group-wide basis. The Federal Reserve requires regular financial and organizational structure reporting by all holding companies. Holding companies having over \$500 million in assets report financial data on a consolidated basis, while smaller holding companies provide parent-only financial statements which, when combined with bank financial reports, provide an approximate consolidated view. Organizational structure information is updated on an ongoing basis. Reported information is analyzed by the Federal Reserve in conjunction with regular supervisory activities and as part of formal off-site monitoring programs.</p>
EC3	<p>The supervisor reviews whether the oversight of a bank’s foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks’ policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>The Federal Reserve’s processes for understanding and assessing firm-wide legal and compliance risk management encompass both domestic and international operations. Under the Federal Reserve’s Regulation K (12 CFR part 211) (See also CP 15, EC 1), foreign branches and subsidiaries of U.S. banking groups must be managed to ensure their operations conform to high standards of banking and financial prudence and must make available to Federal Reserve examiners all information deemed necessary to determine compliance with U.S. banking laws.</p> <p>As part of the authorization process for foreign operations of U.S. banking groups, the applicant must describe any potential obstacles to providing necessary information to regulators and its parent and discuss how it will mitigate any such impediments. The U.S. FBAs assess the quality of supervision conducted in the countries in which its banks and holding companies seek to establish material operations. Once material operations are established, the FBAs informally evaluate host country supervisors through ongoing communication with host supervisors and evaluation and inspection of the cross-border establishments.</p> <p>The FBAs have implemented an enterprise-wide supervisory approach that cuts across legal entities. In carrying out this approach, the agencies evaluate the effectiveness of the bank’s and holding company’s policies, procedures, controls, management information systems</p>

	<p>(MIS) and risk management processes across the organization. This includes audit programs, internal monitoring reports, and review processes that provide the organization with input on the performance of local managers. An assessment of cross-border operations is incorporated into the evaluation of key corporate governance functions and primary firm-wide risk management and internal control functions, including legal and regulatory risk management.</p> <p>There are often issues unique to a bank's or holding company's international operations. For example, some host country legal and regulatory structures and supervisory approaches are fundamentally different from those in the U.S., which often requires the organization to devote additional resources to maintain expertise in local legal and regulatory requirements. In some instances, privacy concerns have led to limits on information that can be shared by a foreign office with its parent holding company. This can limit the parent holding company's ability to exercise consolidated risk management on a global basis. In these cases, strong internal controls and audit processes are particularly important and hence enforced by the supervisors.</p> <p>For a holding company with international operations or risks, an assessment of cross-border operations is incorporated into the processes for developing an understanding and assessment of key corporate governance functions and primary firm-wide risk management and internal control functions. Any limits to the Federal Reserve's ability to access information on host country operations or to engage in on-site activities is considered when assessing the appropriate extent of the organization's activities in that jurisdiction.</p> <p>The U.S. FBAs review materials prepared by host country supervisors, including examination reports and assessments, and conduct ongoing communications with involved foreign and domestic supervisors regarding trends and assessment of cross-border operations. These continuous monitoring activities are supplemented, as appropriate, by examination activities to understand and assess the bank's or holding company's cross border strategy, activities, risks, trends, and legal entity structure and related governance, risk management, and internal controls. For example, in the case of large, complex banking organizations with foreign operations, OCC supervisors perform on-site inspections of high-risk foreign operations and analyze the macroeconomic and market risks in countries in which U.S. banks operate.</p>
<p>EC4</p>	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
<p>Description and findings re EC4</p>	<p>Statutory provisions expressly authorize examinations of and the submission of reports by regulated banks and their affiliates, including foreign offices and subsidiaries. A provision of the International Banking Act provides for communication and cooperation with foreign bank supervisors (see 12 U.S.C. §3109).</p> <p>As noted in EC 3, for holding companies with international operations or risks, the FBAs assess cross-border operations as part of their evaluation of key corporate governance functions and primary firm-wide risk management and internal control functions. Also, the U.S. FBAs' formal strategies for the supervision of individual banks and holding companies revolve around assessments of risk, and control processes, including those of foreign operations. On-site work is performed where risks are greatest. When foreign offices are inspected, supervisors meet with host supervisors. Agencies have the ability to use a wide</p>

	<p>variety of approaches to supervise and have, for example, required special reports and audits of foreign offices. Additionally, the U.S. FBAs have worked for many years with counterparts from various countries to strengthen communication and cooperation as it relates to the supervision of banks and holding companies that operate across borders. These efforts have intensified in recent years and now take place in a variety of settings.</p> <p>In accordance with principles promulgated by the Financial Stability Board, the Federal Reserve participates with other U.S. and international supervisors in CMG meetings to enhance preparedness for the cross-border management and resolution of a failed global systemically important financial institution. The U.S. FBAs also participate in supervisory colleges with international supervisors.</p> <p>As discussed in Principle 13, the U.S. FBAs have formal information sharing arrangements with many supervisors. These arrangements set out essential elements in the areas of on-site inspections, ongoing coordination, and protection of information, and facilitate timely information sharing. Periodic visits are used to develop working relationships with many foreign supervisors. During these visits there are banking industry discussions and strategy sessions focusing on specific supervisory issues and initiatives.</p>
EC5	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>The U.S. FBAs have implemented a comprehensive supervisory framework that evaluates the risks that non-banking activities conducted by banks and holding companies may pose to the consolidated organization. The authority for this derives from the overarching duty of the agencies to protect the safety and soundness of banks (12 U.S.C. § 1831p-1), including through the imposition of prudential safeguards. Under the FDI Act, the FDIC is also responsible for developing an independent risk assessment of affiliates of the insured depository institution and to ensure that appropriate correct actions are taken to reduce unreasonable risk.</p> <p>The Federal Reserve has the authority and responsibility to understand and assess the risks that the parent holding company and its nonbank subsidiaries may pose to the whole organization, its depository institution subsidiaries, and to the U.S. financial system.</p> <p>However, there is no regulated framework on capital rules for corporate and insurance company SLHCs. Further, no regulatory and supervisory rules, guidance, and a formal rating system for SLHCs have been adopted, which hinders assessment of impact of the broader group on safety and soundness.</p> <p>Supervisory activities: For all significant nonbanking subsidiaries and nonbanking activities of the parent holding company, the Federal Reserve uses two mechanisms: continuous monitoring and periodic examination activities. These mechanisms are utilized to: (i) maintain an understanding of the unit's operations, financial condition, inherent risks, and risk management practices, and (ii) assess the adequacy of risk management and internal controls, including those relating to compliance risk.</p> <p>Periodic testing examination activities may also be used to ensure that key risk management and internal control practices conform to legal requirements and internal policies. The examination activities are also used to understand and assess operations presenting a moderate or greater likelihood of significant negative impact to a subsidiary bank or the consolidated organization. Periodic examination testing will focus on controls for identifying, monitoring, and controlling these risks.</p>

<p>EC6</p>	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <ul style="list-style-type: none"> (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or; (c) the exercise of effective supervision on a consolidated basis is hindered.
<p>Description and findings re EC6</p>	<p>The U.S. FBAs have the power, at authorization or as a remedial measure, to limit the range of activities a bank or holding company may conduct and the locations in which activities may be conducted. In practice, the FBAs use this power to ensure that the consolidated organization's activities are properly supervised and that the safety and soundness of the bank and holding company are not compromised. The assessors saw evidence on actions relating to item (a) but not to (b) or (c). According to the authorities there had been no need for such formal actions (in specific cases, informal measures were used to achieve adequate consolidated supervision. For example, supervisory information on the overseas entity was gathered through the parent company itself rather than from the foreign supervisor and the internal audit function of the banking group was given broader responsibilities vis-à-vis the affiliates by the supervisor).</p>
<p>EC7</p>	<p>In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.⁴⁶</p>
<p>Description and findings re EC7</p>	<p>Statutes authorize the relevant FBAs to examine and require reports from individual banks in the group. The U.S. FBAs have strong cooperative relationships with each other and with functional and foreign regulators. These relationships respect the statutory authorities and responsibilities of the respective supervisors and provide for appropriate information flows and coordination to enable each responsible bank supervisor to understand the bank's relationship to the banking group.</p> <p>An important element of effective consolidated supervision is the supervision of individual banks within a banking organization. The FBAs each have specific bank supervision responsibilities that are carried out to ensure the safety and soundness of individual institutions and contribute to the understanding of a banking organization's condition on a consolidated basis.</p> <p>Information sharing among domestic and international supervisors, consistent with applicable law and the jurisdiction of each supervisor, is essential to ensure that a bank's and holding company's global activities are well understood. These concepts underlie the provisions of the DFA and the GLB Act that govern the interaction between the Federal Reserve as consolidated supervisor, and the other primary federal banking supervisors.</p> <p>The U.S. FBAs assist each other by sharing pertinent information to the extent permissible. This includes information regarding the financial condition, risk management policies, and operations of a bank and holding company that may have a material impact on the bank subsidiaries. The U.S. FBAs also consider transactions or relationships between the bank and</p>

⁴⁶ Please refer to Principle 16, Additional Criterion 2.

	its affiliates.
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	<p>Only companies that are regulated BHCs may hold controlling interests in banks, and their managerial resources and integrity must be taken into account in the authorization and approval process (12 U.S.C. § 1842(c)(5)). Management also is evaluated in ongoing supervision. Companies that are not BHCs may hold non-controlling interests in banks. For this ownership structure, the approval process includes an investigation of the competence, experience, integrity, and financial ability of each person or entity who will have an ownership stake (12 U.S.C. § 1817(j); 12 CFR 225.43(f) and (g)). The U.S. FBAs have authority to remove or prohibit participation in the affairs of a bank if the statutory requirements in the Federal Deposit Insurance Act are met (see 12 U.S.C. §§1813(u) and 1818(e)).</p> <p>Rulemaking and supervisory guidance/procedures are under development to provide additional detail around the supervision of commercial SLHCs. These organizations are principally engaged in either commercial activities (such as manufacturing or merchandising) or activities not specifically permissible for FHCs (such as real estate development). See SR letter 11-11.</p> <p>Refer also to the lack of regulations and supervisory powers on SHLCs mentioned in EC 5 above.</p>
Assessment of Principle 12	Largely compliant
Comments	<p>A lack of full compliance with this principle is based on the absence of a capital rule for corporate and insurance company SLHCs, and on the fact that regulatory and supervisory rules, guidance, and a formal rating system for SLHCs have not been adopted. Capital standards are not required at the diversified financial group level under the Basel capital framework (which are to be calculated at the banking holding group level and banking group level), however the lack of an established supervisory assessment framework will likely hamper the supervisors in reviewing and taking action at the holding company (SHLC) level.</p> <p>As noted in CP 10, the FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries). The assessors are satisfied; however, that in practice this omission has no prudential significance under the current circumstances as U.S. bank subsidiaries tend to be small relative to the parent bank and can only undertake activities that the bank itself could undertake in its own name.</p>
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of

	<p>its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.</p>
<p>Description and findings re EC1</p>	<p>The U.S. FBAs have established supervisory colleges for U.S. banking groups that have material cross-border operations. The U.S. FBAs have policies and guidelines in place for determining the appropriate members of supervisory colleges, and those policies and guidelines take into account the size of the operations in the foreign jurisdiction, their significance to the group as a whole and to the host market, and the needs of the supervisors.</p> <p>The Federal Reserve and OCC co-chair supervisory colleges for several U.S. banking groups with significant foreign operations. The colleges hold meetings at least annually, with conference calls between meetings to supplement communications. Where the size and scope of the bank’s operations warrant it, the U.S. convenes both core and general college meetings. Those participants with whom the Federal Reserve and OCC do not have standing information-sharing arrangements participate on the basis of ad hoc confidentiality undertakings.</p> <p>A college meeting will generally include the following elements: meetings with the bank officials in which host supervisors can raise questions and concerns, sessions in which Federal Reserve/OCC present to host supervisors a high-level supervisory assessment of the bank’s risk profile and its risk management and internal audit functions, and sessions in which host supervisors present information about developments in their jurisdictions.</p> <p>The assessors saw evidence of general documentation about FBAs participation in supervisory colleges.</p>
<p>EC2</p>	<p>Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group⁴⁷ and on the supervisors’ assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.</p>
<p>Description and findings re EC2</p>	<p>The U.S. FBAs share information bilaterally with home and host supervisors, understanding arrangements, such as memoranda of understanding (MoUs) and statements of cooperation (SOCs) (There are no legal differences between MOUs and SOCs), and in response to requests on a case-by-case basis. As noted in EC 1, the U.S. FBAs also share information in supervisory colleges. On a case-by-case basis, the U.S. FBAs share information with foreign supervisors that have a legitimate supervisory need for the information and agree to keep it confidential.</p> <p>U.S. FBAs provide adequate and timely data and information relevant to host country supervisors about U.S. banks and holding companies, including any significant issues of a supervisory nature, to enable the host authority to supervise the overseas operations of the U.S. banks effectively and appropriately. The U.S. FBAs have ongoing contact with supervisors in other countries in which U.S. banks have material operations.</p>

⁴⁷ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

Information sharing by the U.S. FBAs as both home and host supervisors involves sharing significant supervisory concerns and supervisory documents; providing information to assist with the authorization process and with investigations; discussing and coordinating supervisory plans and strategies; managing and participating in bilateral and multilateral meetings in the U.S. and overseas; developing joint enforcement actions when warranted; and participating in supervisory colleges to focus on a specific bank, holding company or supervisory issue. Additionally, U.S. FBAs periodically visit foreign supervisory authorities to discuss supervisory issues.

The U.S. FBAs provide relevant information on U.S. banks and holding companies to host supervisors in response to specific requests regarding their supervision and provide information on significant problems that might have a material effect on the subsidiaries or branches in the host country. Information sharing on a home to host basis is also provided for in MoUs and similar arrangements. These arrangements provide for cooperation during the licensing process, in the supervision of ongoing activities, and in the handling of problem banks. U.S. FBAs endeavor to inform host country supervisors in a timely manner about events that could endanger the stability of cross-border establishments in the host country. The U.S. FBAs also inform host country supervisors when administrative penalties have been imposed or any other formal enforcement action has been taken against a U.S. bank or holding company if the agencies believe such information will be important to the host country supervisor as it may relate to the cross-border operations in that country.

As host country supervisors, the U.S. FBAs cooperate with the home country supervisors of foreign banking organizations (FBOs) with U.S. banking operations in order to facilitate the consolidated supervision activities of those supervisors.

Under the FBO Supervision Program, the Federal Reserve and the OCC routinely provide copies of essential supervisory products to home country supervisors. This includes an annual assessment of the combined U.S. operations of the FBO, which contains a supervisory rating, summary examination and supervisory findings along with details of areas requiring management attention, and notice of any proposed or pending formal or informal supervisory action as well as a copy of the notification to the head office of the FBO's Strength-of-Support Assessment (SOSA) ranking). The SOSA is an assessment by the U.S. supervisor of the foreign parent/head office's ability to support its U.S. operations. Where specifically requested by the home country supervisor, copies of examination reports of the U.S. operations of the FBOs may be provided to the home country supervisor.

Similarly, the U.S. FBAs communicate with home country supervisors on subsidiaries of foreign banks and banking organizations. The U.S. FBAs will apprise home supervisors of significant concerns and impending supervisory actions.

International cooperation would be further strengthened if state supervisory agencies consulted fully, in all cases, with the FBAs and foreign supervisors on impending enforcement actions. The assessors were made aware of circumstances where this was not the case.

Information sharing through MoUs, SOCs or similar arrangements has become increasingly common. Today, U.S. FBAs have joint (and, in certain cases, individual) information sharing arrangements in place with banking supervisors in many foreign jurisdictions. These arrangements, while not legally binding, broadly govern information access and information sharing between supervisors acting in a home and host capacity. These arrangements generally cover those elements set forth in the Basel Committee's paper "Essential elements of a statement of cooperation between banking supervisors" (May, 2001).

	<p>U.S. FBAs are authorized to share relevant supervisory information with foreign banking supervisors even in the absence of a formal arrangement such as a MoU. In practice the U.S. FBAs share significant information with foreign supervisors whether the U.S. FBAs act in a home or host capacity. All sharing is subject to certain statutory requirements including those relating to the ability of the foreign bank supervisor to maintain the confidentiality of information provided to it. In appropriate cases the U.S. FBAs also have the authority to share information with financial supervisors other than bank supervisors (see 12 U.S.C. 1817(a)(2)(C)(iii)). Information sharing on risk management practices and supervisory concerns varies across different home regulators. This can result in incomplete cooperation or release of key regulatory documents such as annual assessment letters of foreign banking organizations conducted by home country regulators. In such cases, the supervisors may require the banks to restrict their activities in the concerned country.</p>
EC3	<p>Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.</p>
Description and findings re EC3	<p>Under the statutory authority that allows sharing confidential supervisory information with foreign bank regulators (see EC 1), the U.S. FBAs coordinate supervisory activities with host and home supervisors to improve the effectiveness and efficiency of supervision.</p> <p>As noted in the response to EC 2, the U.S. FBAs regularly share significant supervisory concerns and related supervisory documents; discuss and coordinate supervisory plans and strategies with foreign supervisors; and manage and participate in bilateral and multilateral meetings in the U.S. and overseas, such as supervisory colleges and CMGs. Additionally, U.S. FBAs periodically visit foreign supervisory authorities to discuss supervisory issues.</p> <p>As host country supervisors, the U.S. FBAs cooperate with the home country supervisors of FBOs with U.S. banking operations in order to facilitate the consolidated supervision activities of those supervisors. This might include a home country supervisor conducting a review at the U.S. operations of an FBO or the participation of a home country supervisor in examination activities conducted by the U.S. supervisors at an FBO's U.S. operations. Similarly, as home country supervisors, the U.S. FBAs regularly conduct examinations of the foreign operations of banks and BHCs in coordination with host country supervisors.</p> <p>The U.S. FBAs communicate with home country supervisors on subsidiaries of foreign banks and banking organizations. The U.S. FBAs will apprise home supervisors of significant concerns and impending supervisory actions, and will provide reports of examination upon request.</p>
EC4	<p>The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.</p>
Description and findings re EC4	<p>In addition to the MoUs and SOCs described above, the U.S. FBAs have established ongoing information sharing mechanisms and regularly scheduled meetings and conference calls as part of their communication strategies for banking groups for which such enhanced cooperation is appropriate.</p> <p>The U.S. FBAs communicate with foreign supervisors through formal processes (i.e., MOUs, SOCs, supervisory colleges) and informal processes (e.g., ad hoc conference calls, email). Ongoing communication between home and host supervisors and with supervised banking</p>

	organizations is a fundamental aspect of the supervisory process. For example, the U.S. supervisors hold periodic meetings with host supervisors to share information as applicable on home country risk management practices and models that may be employed in host country entities of the globally supervised banks and holding companies.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	With reference to cross-border cooperation for crisis preparation, CMGs have been established for the largest, most systemic U.S. banking groups and the U.S. FBAs are in the process of completing cooperation agreements (COAGs) that will govern the activities and information sharing in each CMG. The U.S. FBAs participate as home and host authorities of firms designated as global systemically important financial institutions by the Financial Stability Board in numerous firm-specific CMGs for the purposes of developing crisis management strategies and resolution plans for such firms.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	The U.S. FBAs participate as home and host authorities of firms designated as global systemically important financial institutions by the Financial Stability Board in numerous firm-specific CMGs for the purposes of developing crisis management strategies and resolution plans for such firms. The U.S. FBAs also participate as home and host authorities in supervisory colleges established for numerous banking institutions at which recovery and resolution plans created by those institutions are reviewed.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	The U.S. operations of foreign banks are subject to prudential, inspection, and regulatory reporting requirements similar to those applicable to domestic banks. In general, these requirements can be found in the statutes and regulations applicable to domestic banks and in the International Banking Act (IBA), 12 U.S.C. § 3101 et seq, and its implementing regulations, see 12 CFR part 211, subpart B and 12 CFR part 28, subpart B. The IBA establishes a framework under which "national treatment" is afforded to foreign banks doing a banking business in the U.S., which means that foreign banks are generally accorded parity of treatment with U.S. banking organizations. Apart from branches and agencies, foreign banks may choose to establish banking subsidiaries under either a federal or state license. In addition, foreign banks are subject to the BHC Act, in the same way as a U.S. banking organization. U.S. savings associations owned or controlled by foreign banks are subject to the same requirements and treatment as U.S. savings associations owned by U.S. SLHCs. In February 2014 the Federal Reserve introduced enhanced prudential standards for FBOs (see 12 CFR part 252) as required in Section 165 of DFA. For a foreign banking organization

	<p>with total consolidated assets of \$50 billion or more, the final rule implements enhanced risk-based and leverage capital requirements, liquidity requirements, risk-management requirements, stress testing requirements, and the debt-to-equity limit for those companies that the FSOC has determined pose a potentially grave threat to the financial stability of the U.S.. In addition, it requires foreign banking organizations with U.S. non-branch assets of \$50 billion or more to form a U.S. intermediate holding company and imposes enhanced risk-based and leverage capital requirements, liquidity requirements, risk-management requirements, and stress-testing requirements on the U.S. intermediate holding company. The final rule also establishes a risk-committee requirement for publicly traded foreign banking organizations with total consolidated assets of \$10 billion or more and implements stress-testing requirements for foreign banking organizations and foreign savings and loan holding companies with total consolidated assets of more than \$10 billion. Foreign banking organizations with U.S. non-branch assets of \$50 billion or more are large, complex, and interconnected institutions, and generally have a U.S. risk profile similar to U.S. bank holding companies of total consolidated assets of \$50 billion or more. The U.S. intermediate holding company requirement provides for consistent application of capital, liquidity, and other prudential requirements across the U.S. non-branch operations of the foreign banking organization and a single nexus for risk management of those U.S. non-branch operations, facilitating application of the mandatory enhanced prudential standards, increasing the safety and soundness of and providing for consolidated supervision of these operations.</p> <p>As noted, the IBA establishes a framework under which “national treatment” is afforded to foreign banks doing business in the U.S. However, a number of regulations do not apply to foreign banking organizations that do not have retail banking operations. The Federal Reserve’s CA letter 04-3 and the OCC’s Federal Branches and Agencies Supervision Handbook provide guidance for assessing whether a consumer compliance or CRA examination of an FBO is necessary (see 12 CFR 228.11(c)(3)). These assessments are conducted according to the frequencies mandated in the OCC’s Bank Supervision Process Handbook and the Federal Reserve’s CA letter 03-12.</p> <p>Where foreign banking organizations own and/or control subsidiary U.S. savings associations, those savings associations are subject to the same requirements and treatment as domestically held savings associations.</p> <p>Liquidity rules for branches to foreign banks apply a 15-day run-off criterion, versus the 30-day period for U.S. banks. Also, some States apply an asset maintenance rule for foreign branches, i.e. the branch must hold a certain portion of its assets in qualified U.S. assets.</p>
EC8	<p>The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group’s safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.</p>
Description and findings re EC8	<p>Foreign home supervisors may conduct examinations of U.S. operations of their banks and will generally have access to all relevant information, including information necessary to assess safety and soundness and compliance with customer due diligence requirements. Before conducting on-site examinations in the U.S., foreign supervisors should contact the relevant U.S. FBAs and the state banking authority if the operations to be examined are state-chartered or state-licensed. With prior arrangement, foreign supervisors typically may conduct their on-site examinations without being accompanied by representatives of the U.S. FBAs. Note, however, there may be state laws (e.g. FLA.STAT. 655.059 (2007)) that limit access to certain types of information at state-licensed entities.</p> <p>In general, the U.S. FBAs expect to be permitted on-site access to foreign offices and</p>

	<p>subsidiaries of a U.S. bank and holding company's foreign operations in order to facilitate their assessment of the bank and holding company's safety and soundness and compliance with KYC requirements. The U.S. FBAs inform host supervisors in advance of intended visits to foreign offices and subsidiaries. MOUs and SOCs generally contain provisions regarding on-site examinations.</p>
EC9	<p>The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.</p>
Description and findings re EC9	<p>Shell banks are not permitted under U.S. law, nor may U.S. banks establish correspondent accounts for foreign shell banks. In addition, foreign banks may not use their U.S. branches or agencies to manage types of activities through offshore offices that could not be managed by a U.S. bank at its foreign branches or subsidiaries.</p> <p>Banks also must take reasonable steps to ensure that any correspondent account established, maintained, administered, or managed in the U.S. for a foreign bank is not being used by that foreign bank to provide banking services indirectly to foreign shell banks, i.e., that the U.S. correspondent bank of the foreign bank does not in turn give a foreign shell bank the ability to access the U.S. correspondent account through its account. A bank is required to terminate immediately any account that it knows to be the account of a foreign shell bank or that it knows is being used indirectly by a foreign shell bank. Recent amendments to the Bank Secrecy Act (BSA) prohibit U.S. banks from establishing, maintaining, administering or managing a correspondent account in the U.S. for any foreign shell bank other than a regulated affiliate of a U.S. or foreign bank. See 31 CFR 103.177</p> <p>As host supervisors the FBAs supervise booking offices in a manner consistent with internationally agreed standards.</p>
EC10	<p>A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.</p>
Description and findings re EC10	<p>As a general matter, the U.S. FBAs do not take action on the basis of information received from another supervisor without independently confirming the information and consulting with the providing supervisor, to the extent possible, before taking action.</p> <p>Effective cross-border supervision relies on clear, open communication between home and host supervisors. This is particularly the case where a banking supervisor contacts a supervisor in another country about significant or serious (including criminal) supervisory issues requiring attention. By the very nature of U.S. federal (and state) banking supervision, the relevant agencies work within a communication web that demands continuous coordination and consideration. The same methodology applies with cross-border information exchanges and requests for action or opinions. In such cases, the U.S. FBAs confer at the appropriate level and to the appropriate extent with the foreign supervisor before taking any action. See Federal Reserve AD letter 03-27/SR letter 01-21/AD letter 01-3; and OCC's PPM 5500-1 (Rev).</p> <p>Notwithstanding the above, the FBAs will, and have the powers to, take action without prior consultation if the situation is deemed urgent.</p>
Assessment of Principle 13	Compliant
Comments	<p>Reflecting the large cross-border activities of U.S. banks abroad, and of foreign banking groups in the U.S., there exist a comprehensive framework of policies and processes for co-</p>

	<p>operation and exchange of information between the FBAs and foreign supervisory authorities. This is currently being strengthened by the work in supervisory colleges and in CMGs.</p> <p>The assessors encourage the authorities to establish agreements with their foreign counterparts on a framework of communication strategies, especially for crisis situations</p> <p>International cooperation would be further strengthened if state supervisory agencies consulted fully, in all cases, with the FBAs and foreign supervisors on impending enforcement actions. The assessors were made aware of circumstances where this was not the case. Although this is a clear deficiency in cooperation arrangements, the assessors did not judge it as sufficient to lower the “Compliant” rating for CP 13, but improvements in such consultations should be a high priority.</p> <p>There remain some instances in which specific rules apply to foreign institutions, such as the shorter run-off period for foreign branches in the liquidity, asset maintenance requirements for branches and requirements on large FBOs to set up intermediate U.S. holding companies. The mandate of the BCP assessment is limited to ensure that prudential rules and supervision are applied to ensure a minimum level of safety and soundness of banks. The assessors find that these rules are aimed to obtain such effect. The BCP mandate and assessment and do not include a judgment of level playing field issues.</p>
<p>B. Prudential Regulations and Requirements</p>	
<p>Principle 14</p>	<p>Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks’ Boards and senior management,⁴⁸ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.</p>
<p>Essential criteria</p>	
<p>EC1</p>	<p>Laws, regulations or the supervisor establish the responsibilities of a bank’s Board and senior management with respect to corporate governance to ensure there is effective control over the bank’s entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.</p>
<p>Description and findings re EC1</p>	<p>Comprehensive corporate governance rules that establish the responsibility of the bank’s board of directors and senior management primarily arise from state corporate law as well as federal regulations for publicly held companies, relating to financial disclosure, the auditing process, incentive compensation, ethical conduct, conflict of interest standards, internal controls over financial reporting, board composition, and board committees. (NYSE listing requirements, NASDAQ listing requirements (including Sections 303A.00, 303A.02, 303A.05, and 303A.07 of the NASDAQ Listing Rules), the Sarbanes-Oxley Act of 2002 (SOX), 12 U.S.C. § 1831i, 12 U.S.C. § 1831m, 15 U.S.C. § 78j-1, 15 U.S.C. § 7262(b), 15 U.S.C. § 7265, and 12 CFR 208 Appendix D-1.</p> <p>The Federal Reserve, the OCC, and the FDIC also have various regulations governing the composition and activities of the boards of directors and senior management, such as requirements related to audit functions, capital, resolution planning, financial disclosure, conflicts of interest, and insider activities. These regulations require specific actions or</p>

⁴⁸ Please refer to footnote 27 under Principle 5.

avoidance of certain activities by the firm and require the board of directors and/or senior management to manage, approve, and provide oversight. Also, these regulations may prohibit or require certain actions by the board of directors or senior management.

Guidance established by the Federal Reserve regarding the responsibilities of the board of directors and senior management of bank holding companies (BHCs) and state member banks is discussed in the BHC Supervision Manual, Commercial Bank Examination Manual, and specific supervisory letters, among them SR 12-17.

Guidance established by the OCC regarding the responsibilities of the board of directors and senior management of national banks, savings associations, and insured federal branches, as well as corporate governance generally, is discussed in the Comptroller's Handbook, including booklets on Duties and Responsibilities of Directors, Management and Board Processes, Insider Activities, and Management Information Systems.

SR Letter 12-17, referenced above, states that in order for a firm to be sustainable under a broad range of economic, operational, legal or other stresses, its board of directors (or equivalent for the U.S. operations of FBOs) should provide effective corporate governance with the support of senior management. The board is expected to establish and maintain the firm's culture, incentives, structure, and processes that promote its compliance with laws, regulations, and supervisory guidance. Each firm's board of directors and committees, with support from senior management, should:

- Maintain a clearly articulated corporate strategy and institutional risk appetite. The board should set direction and oversight for revenue and profit generation, risk management and control functions, and other areas essential to sustaining the consolidated organization;
- Ensure that the firm's senior management has the expertise and level of involvement required to manage the firm's core business lines, critical operations, banking offices, and other material entities. These areas should receive sufficient operational support to remain in a safe and sound condition under a broad range of stressed conditions;
- Maintain a corporate culture that emphasizes the importance of compliance with laws and regulations and consumer protection, as well as the avoidance of conflicts of interest and the management of reputational and legal risks;
- Ensure the organization's internal audit, corporate compliance, and risk management and internal control functions are effective and independent, with demonstrated influence over business-line decision making that is not marginalized by a focus on short-term revenue generation over longer-term sustainability;
- Assign senior managers with the responsibility for ensuring that investments across business lines and operations align with corporate strategies, and that compensation arrangements and other incentives are consistent with the corporate culture and institutional risk appetite; and
- Ensure that management information systems (MIS) support the responsibilities of the board of directors to oversee the firm's core business lines, critical operations, and other core areas of supervisory focus.

Federal Reserve and OCC guidance specifically references the board of directors and their responsibility to establish a comprehensive and effective compliance function. The board of directors is expected to establish clear policies regarding the management of key risks and ensure that the institution adheres to those policies. Additionally, regulatory guidance requires the board of directors to have general oversight of the corporate governance structure, as well

as specific requirements in the areas of risk management, capital, liquidity, funding, credit, model risk management, and fiduciary activities, to name a few.

Following the recent financial crisis, the OCC developed a set of “Heightened Expectations” to enhance the supervision and strengthen the corporate governance and risk management practices of large national banks. The OCC has also applied aspects of the heightened expectations to midsize banks. In January 2014, the OCC proposed guidelines to formalize these Heightened Expectations by setting forth the minimum standards for the design and implementation of a bank’s risk governance framework and for the board of directors’ oversight of the risk governance framework. The public comment period on the proposed guidelines closed on March 28, 2014, and the adoption of final guidelines took place in September 2014 and will be gradually implemented during a transitional period beginning on November 10, 2014. However, the OCC has for some time applied the prior heightened expectations backed by its powers for ensuring banks’ safety and soundness. The “Heightened Standards” apply to banks supervised by the OCC with average total assets of \$50 billion or greater. The guidelines provide that each member of the board should oversee a bank’s compliance with safe and sound banking practices. Consistent with this, the board should also require management to establish and implement an effective risk governance framework that complies with the guidelines. The board or its risk committee should also approve any significant changes to the framework. The guidelines also provide that the board should actively oversee a bank’s risk-taking activities and hold management accountable for adhering to the framework. The board should also evaluate management’s recommendations and decisions by questioning, challenging, and when necessary, opposing management’s proposed actions that could cause the covered bank’s risk profile to exceed its risk appetite or threaten the institution’s safety and soundness. Additionally, a bank’s board of directors should review and approve a talent management program covering the talent development, recruitment, and succession planning. Further at least two members of a covered bank’s board would need to be independent, i.e., they should not be members of the bank’s or parent company’s management.

The U.S. FBAs guidance discuss that one of the primary areas of focus for consolidated supervision of large complex BHCs and banks are evaluating 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. See Federal Reserve BHC Supervision Manual, Section 1050.3.1, and OCC Comptroller’s Handbook, Safety and

	Soundness booklets.
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	<p>As part of the examination process, examiners review and assess whether the institution's board of directors is providing a clear framework of objectives and policies within which senior management can operate and administer the bank's affairs. Examiners evaluate the adequacy and effectiveness of the board of directors by assessing the frequency and effectiveness of board meetings; the effectiveness of board committees; the directors' role in establishing policy; the adequacy of the policies and major inconsistencies therein; the quality of reports for directors; violations of laws and regulations; the composition of the board; and the board's responsiveness to recommendations from auditors and supervisory authorities. See Commercial Bank Examination Manual, Section 5000.3, and Comptroller's Handbook.</p> <p>The FBAs have developed ratings systems in which a bank or BHC is rated, in part, based upon board and senior management oversight of the organization's entire business including the areas cited above for which directors are held responsible. The ratings system that applies to a bank or BHC is dependent on the bank's charter.</p> <p>With regards to rating BHCs, all of which are supervised by the Federal Reserve, examiners assign ratings for board and senior management oversight which feed into the board and senior management subcomponent of a BHC's Risk Management (R) rating under the RFI/C (D) rating system. See SR Letter 04-18, BHC Rating System.</p> <p>With regards to rating domestically chartered banks (nationally-chartered banks, state-chartered member banks, state-chartered nonmember banks, and savings associations), the FBAs have adopted, and adhere to, uniform guidance for rating board and senior management oversight of the bank through the FFIEC's Uniform Financial Institutions Rating System (UFIRS). This rating system also known as CAMELS explicitly references the level and quality of oversight and support of all institution activities by the board of directors and management within the Management (M) component rating description of the CAMELS.</p> <p>Examiners evaluate the board of directors and management in light of all of the factors necessary to operate the institution in a safe and sound manner and their ability to identify, measure, monitor, and control the risks of the institution's activities. In assigning a (M) rating under CAMELS, examiners consider a variety of factors, including but not limited to the level and quality of oversight and support provided by management and the board; compliance with regulations and statutes; ability to plan for and respond to risks that may arise from changing business conditions or initiation of new products or services, accuracy, timeliness, and effectiveness of management information and risk monitoring systems; adequacy of and compliance with internal policies and controls; adequacy of audit and internal control systems; responsiveness to recommendations from auditors and supervisory authorities; reasonableness of compensation policies and avoidance of self-dealing; demonstrated understanding and willingness to serve the legitimate banking needs of the community; management depth and succession; the extent that management is affected by or susceptible to dominant influence or concentration of authority; and the overall performance of the institution and its risk profile.</p> <p>The U.S. FBAs also complete a series of testing procedures, contained in the agencies' examination manuals, to confirm banks' and holding companies' compliance with prudential regulations and other legal requirements. The agencies assign a numeric rating (on a scale of</p>

	<p>1 to 5, with '1' being the best and '5' being the worst) to financial institutions to indicate how well the board of directors and management identify, measure, monitor and control the risks of the organization's activities and ensure the organization is managed in a safe and sound manner with efficient operations in compliance with applicable laws and regulations (under the Management component rating in the CAMELS rating system). Among the criteria considered are: (1) the level and quality of oversight and support of all institution activities by the board of directors and management; (2) the ability of the board of directors and management, in their respective roles, to plan for and respond to risks that may arise from changing business conditions; (3) the accuracy, timeliness, and effectiveness of management information and risk monitoring systems; and (4) the adequacy of internal controls to promote effective operations and reliable financial and regulatory reporting. In addition to the rating system for banks, the Federal Reserve also assigns numeric ratings (using a "1" to "5" scale comparable to the scale for banks) for Risk Management in the RFI/C (D) rating system for BHCs. This risk management component rating includes, among other things, a Board and Senior Management Oversight subcomponent. See discussion of the CAMELS and RFI/D (C) rating systems in Legal Framework for EC 2 above.</p>
<p>EC3</p>	<p>The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members</p>
<p>Description and findings re EC3</p>	<p>Comprehensive corporate governance rules that establish the responsibility of the bank's board and senior management primarily arise from state corporate laws, banking regulations as well as federal regulations for publicly held companies. This includes the organization's activities related to nominating and appointing board members, establishing board committees such as audit, risk oversight, and remuneration committees, and requiring specific director independence requirements.</p> <p>Publicly traded bank holding companies with total consolidated assets between \$10 and \$50 billion, and bank holding companies with total consolidated assets of \$50 billion or more, are required to maintain a risk committee that periodically approves the risk-management policies and global operations and global risk-management framework. See 12 U.S.C. § 5365; and 12 CFR 252.22 and 225.33. Refer also to CP 15. The BHC's global risk-management framework is required to be commensurate with its structure, risk profile, complexity, activities, and size. The applicable regulations also impose specific corporate governance requirements on the charter, composition, and activities of the risk committee, including requiring having at least one member with experience in identifying, assessing, and managing risk exposures of large, complex firms, being chaired by an independent director pursuant to the listing standards of a national securities exchange, receiving regular reports from the company's chief risk officer, and conducting regular, fully documented meetings. In addition, federal regulations require FBOs with total consolidated assets over \$10 billion to maintain a committee on its global board of directors that is responsible in whole or in part for overseeing the risk management policies of the combined U.S. operations of the organization, with at least one committee member having experience in identifying, assessing, and managing risk exposures of large, complex firms.</p> <p>In addition, in the proposed Appendix D to 12 CFR part 30, the OCC proposes to require at least two directors of each bank supervised by the OCC to be independent (not members of the bank's or the parent company's management). A bank's board of directors would also be</p>

	<p>required to establish and adhere to a formal, ongoing training program for independent directors. OCC examiners would evaluate each director’s knowledge and experience.</p> <p>An audit committee’s duties include reviewing with management and the independent public accountant the basis for all financial reports issued. For banks and holding companies with total assets between \$500 million and \$1 billion, the majority of audit committee members must be outside, non-executive directors, subject to case-by-case exceptions granted by supervisors. For banks and holding companies with total assets of \$1 billion or more, the audit committee must be comprised entirely of outside, non-executive directors. For banks and holding companies with total assets of more than \$3 billion, the audit committee members must (a) have banking or related financial management expertise; (b) have access to the committee’s own outside counsel; and (c) not be a large customer of the bank or holding company. For public companies, SOX requires each member of the audit committee to be independent of the issuer. SOX also requires public companies to disclose in their periodic reports whether there is at least one financial expert on the audit committee and, if not, why not.</p> <p>There is also a 30-day prior-notice requirement for appointing any new directors or senior executive officers of banks and bank holding companies. This notice requirement also applies to any change in the responsibilities of any current senior executive officer that proposes to assume a different position. Section 32 of the FDI Act requires federal banking agency approval for additions to the board of directors or executive management of a troubled Insured Depository Institutions (IDI) or troubled holding company of an IDI within 90 days of the required notice.</p> <p>One of the primary areas of focus for consolidated supervision of large financial institutions is the adequacy of governance provided by the board and senior management. This would include an evaluation of the governance processes for nominating and appointing board members. Supervisors will evaluate the culture, expectations, and incentives established by the highest levels of corporate leadership to ensure they set an appropriate 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.</p>
EC4	Board members are suitably qualified, effective and exercise their “duty of care” and “duty of loyalty”. ⁴⁹
Description and findings re EC 4	As reflected in law and practice, the primary basis for ensuring board members are suitably qualified, effective, and exercise their “duty of care” and “duty of loyalty” arises from the business judgment rule in the U.S.. For a plaintiff to place an action against the corporation’s board of directors in the court of law, the plaintiff would need to prove that one of the directors breached their fiduciary duty and breached their duty of care or duty of loyalty.

⁴⁹ The OECD (OECD glossary of corporate governance-related terms in “Experiences from the Regional Corporate Governance Roundtables”, 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines “duty of care” as “The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a ‘prudent man’ would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule.” The OECD defines “duty of loyalty” as “The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders.”

	<p>Banks in the U.S. are also subject to these requirements. In addition, banking-specific provisions address the duties of bank boards of directors and the directors. See, for example, 12 U.S.C. 73; 12 CFR part 215 (Reg. O); 12 CFR 163.201; and OCC Comptroller’s Handbooks “Insider Activities”, “Duties and Responsibilities of Directors”.</p> <p>The FBAs establish expectations of boards of directors and senior management. The level of technical knowledge required of directors varies depending on the size, complexity, and business practices of the bank and holding company. Specifically, boards of directors and officers of banks and holding companies are obligated to discharge the duties owed to their bank and holding company and to the shareholders and creditors of their organizations, and to comply with federal and state statutes, rules and regulations. These duties include the duties of loyalty and care. Directors have ultimate responsibility for the level of risk taken by their bank or holding company. This means that directors are responsible for selecting, monitoring, and evaluating competent management; establishing business strategies and policies; monitoring and assessing the progress of business operations; establishing and monitoring adherence to policies; and for making business decisions on the basis of fully informed and meaningful deliberation credibly challenging management as appropriate to ensure risks are identified, managed, and controlled consistent with risk appetite and governing policies.</p> <p>Written and oral evidence from the supervisors as well as from the interviewed bank management provided assessors with the clear impression that the requirements on board members’ qualifications and duties were considerably increased during the last few years. This improvement seems to stem both from new legislation/regulation and from within the banking sector itself. The actual competence of bank boards has risen substantially, although to different degrees in different banks. That said, changing boards is a gradual process and there is still a way to go in the advanced banks, and even more in the laggards.</p>
EC5	<p>The supervisor determines that the bank’s Board approves and oversees implementation of the bank’s strategic direction, risk appetite⁵⁰ and strategy, and related policies, establishes and communicates corporate culture and values (e.g. through a code of conduct), and establishes conflicts of interest policies and a strong control environment.</p>
Description and findings re EC5	<p>Regarding ECs 5 to and including EC 8, the supervisors’ determination of the quality of the work of the bank board and of the senior management will be reflected in the component “M” (for Management) in the CAMELS grading system. Hence, there is a comprehensive and clear process for such determination, which is based on onsite visits to the bank as well as banks’ periodic reporting to supervisors and other offsite information-gathering including contacts between supervisors and representatives of the banks. Non-compliance with rules for corporate governance may therefore lead not only to enforcement actions but also to a downgrade.</p> <p>The FBAs establish expectations for, and examine, review and monitor, the role of a bank’s board of directors in setting the bank’s strategic direction, risk appetite, related policies, corporate culture, and establishing appropriate conflicts of interest policies and a strong control environment.</p>

⁵⁰ “Risk appetite” reflects the level of aggregate risk that the bank’s Board is willing to assume and manage in the pursuit of the bank’s business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms “risk appetite” and “risk tolerance” are treated synonymously.

	<p>Because banking is essentially a business of assuming and managing risk, the OCC has adopted a supervisory philosophy that is centered on evaluating risks and risk management systems. The OCC applies this philosophy to all supervisory activities it conducts, including safety and soundness, information technology, compliance, and fiduciary activities. Supervision by risk consists of determining the quantity of risk exposure in a bank and evaluating the quality of risk management systems in place to control risk. Supervision by risk provides consistent definitions of risk, a structure for assessing these risks, and integration of risk assessment in the supervisory processes. Supervision by risk places the responsibility for controlling risks with the board of directors and management.</p> <p>Federal banking agencies review whether the board oversees the banking organization’s strategic direction through the approval of significant strategies and policies. Additionally, the board, with the support of senior management, is expected to maintain a clearly articulated corporate strategy and institutional risk appetite. The board is expected to establish control activities encompassing policy and implement procedures that ensure management’s directives are achieved. Furthermore, the board and senior management are expected to establish and implement an effective risk management framework capable of identifying and controlling both current and emerging risks as well as effective independent control functions that ensure risk-taking is consistent with the organization’s risk tolerance and policies. The board and senior management are expected to promote a continuous dialogue between and across business areas and risk management functions to help align the organization’s established risk appetite and risk controls. The board is also expected to ensure that organization’s internal audit, corporate compliance, risk management, and internal control functions are effective and independent, with demonstrated influence over business-line decision making that is not marginalized by a focus on short-term revenue generation over longer-term sustainability.</p> <p>The board and senior management are expected to establish a “tone from the top” by establishing, communicating, and monitoring institutional risk tolerances and a corporate culture that emphasizes the importance of compliance with laws and regulations and consumer protection. The board and senior management are expected to further demonstrate their development of a strong control environment by establishing and implementing a code of conduct addressing integrity and ensuring the organization has appropriate policies governing the segregation of duties and the avoidance of conflicts of interest.</p> <p>In the event that audit, compliance, or regulatory issues arise, the board and senior management are expected to take corrective actions to ensure timely resolution of these issues.</p>
EC6	<p>The supervisor determines that the bank’s Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management’s execution of Board strategies, including monitoring senior management’s performance against standards established for them.</p>
Description and findings re EC6	<p>The FBAs have identified the expectations against which examiners should assess a banking organization’s board with respect to selecting senior management, maintaining plans for succession, and actively and critically overseeing senior management’s execution of board strategies, including monitoring senior management’s performance against standards established for them. Examiners are expected to assess whether boards of banks and BHCs are 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. The board is expected to ensure that the firm’s senior management</p>

	<p>has the expertise, training, and level of involvement required to manage the firm’s core business lines, critical operations, banking offices, and other material entities. To ensure that senior management can continue to perform its duties in the event that there is turnover amongst its ranks, the board is expected to have a management succession plan in place.</p> <p>The board is expected to actively and critically oversee management’s execution of board strategies, including monitoring senior management’s performance against standards established for them. The board is expected to monitor and enforce established guidelines to minimize management’s ability to override policies and procedures.</p> <p>The FBAs require institutions that are in less-than-satisfactory condition (also including de novo institutions) to provide prior notice before appointing any new directors or senior executive officers. The notice must contain the identity, personal history, business background, and experience of each proposed individual. The agency may disapprove of an individual on the basis of the individual’s competence, experience, character, or integrity that it would not be in the best interests of the depositors or the public to permit the individual to be employed by, or associated with, the bank. See 12 U.S.C. § 1831i, 12 CFR 5.51, Comptroller’s Licensing Manual, Changes in Directors and Senior Executive Officers, 12 CFR 225.71-.72; SR Letter 03-6, Guidance Regarding Restrictions on Institutions in Troubled Condition.</p> <p>In the proposed Appendix D to 12 CFR part 30, the OCC states that the bank’s board of directors has a duty to oversee the bank’s risk-taking activities and hold management accountable for adhering to the risk governance framework. In providing active oversight, the board of directors should question, challenge, and when necessary, oppose recommended decisions made by management that could cause the bank’s risk profile to exceed its risk appetite or jeopardize the safety and soundness of the bank. The board of directors or a board committee should provide oversight over processes for talent development, recruitment, and succession planning to ensure management and employees who are responsible for or influence material risk decisions have the knowledge, skills and abilities to effectively identify, measure, monitor and control relevant risks. When the proposed Appendix D is finalized, it is expected that OCC examiners will formally review (this has so far been conducted on an informal “expectations” basis) and assess whether the bank’s board of directors is meeting the expectations described above.</p>
EC7	<p>The supervisor determines that the bank’s Board actively oversees the design and operation of the bank’s and banking group’s compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.</p>
Description and findings re EC7	<p>The FBAs jointly issued “Guidance on Sound Incentive Compensation Policies” (the Guidance) in June 2010. The Guidance is intended to ensure that a banking organization’s compensation system and related performance standards are designed and implemented in a way that is consistent with the long-term objectives and financial soundness of the banking organization. Incentive compensation arrangements at a banking organization should: provide employees incentives that appropriately balance risk and reward; be compatible with effective controls and risk-management; and be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. Banking organizations are expected to regularly review their incentive compensation arrangements for all executive and non-executive employees who, either individually or as part of a group, have the ability to expose the organization to material amounts of risk, as well as to regularly review the risk-management, control, and corporate governance processes related to these arrangements. Boards of directors at banking organizations are responsible for ensuring that their</p>

	<p>organizations' incentive compensation arrangements are consistent with the principles described in the Guidance and that the arrangements do not encourage employees to expose the organization to imprudent risks. Section 39(c) of the FDI Act (Compensation Standards) requires the FBAs to prohibit excessive compensation to executive officers, employees, directors, and principal shareholders as an unsafe and unsound practice. The definition of excessive compensation, as well as the specific prohibition required by section 39(c), is found in Section III of Appendix A to Part 364, Standards for Safety and Soundness.</p> <p>The FBAs communicate supervisory findings related to incentive compensation through relevant reports of bank examination or inspection as well as continuous monitoring activities. Per the Guidance, a banking organization's appropriate federal supervisor may take an enforcement action against the organization if its incentive compensation arrangements or related risk-management, control, or governance processes pose a risk to the safety and soundness of the organization.</p> <p>Moreover, examiners routinely review the reasonableness of an institution's compensation policies as part of their review of the "Management" component of the CAMELS rating in the examination process.</p> <p>With certain limited exceptions, banks and bank holding companies that are in less-than-satisfactory supervisory condition are also subject to restrictions on making "golden parachute" and indemnification payments to any current or former institution-affiliated party. In those cases, the FDIC, and the OCC or the Federal Reserve, as applicable, is required to review and approve any such payments in advance of such payments being made to an IAP.</p>
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's and its risks, including those arising from the use of structures that impede transparency (e.g. special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>As part of onsite examinations, i.e. by perusing reports from external and internal auditors of banks, or from Board discussions, supervisors determine that board of directors and senior management understanding of the bank's and banking group's operational structure and its risks. Directors and senior management oversight of the enterprise-wide compliance program, including approval of risk-management policies and monitoring of internal processes, is essential to get an understanding of the risks to the bank and the banking group, including those emanating from specific structures. The supervisor will determine that risks are effectively managed, and may order the bank, if warranted, to take steps to mitigate risks, such as through limiting its exposures to other group entities.</p> <p>Refer also to the answer provided to EC 1, CP 12.</p>
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	As part of their remedial powers, the FBAs may limit the powers of institution-affiliated parties (IAPs) (including directors and management) when an unsafe or unsound practice or violation exists. See 12 U.S.C. § 1818(b). The agencies also have the power, under certain well-defined circumstances, to prohibit an IAP from participating in the affairs of a bank or holding company. See 12 U.S.C. § 1818(e). In some instances, this prohibition may extend industry-wide. See 12 U.S.C. § 1818(e)(7). In general, supervisors try to address deficiencies in the composition of the board or management by less formal means, including moral suasion, and as part of a broader effort to resolve prudential concerns. Federal law also prohibits individuals convicted of any criminal offense involving dishonesty or a breach of trust or

	money laundering (or who have agreed to enter into a pretrial diversion or similar program in connection with a prosecution of such offense) from: (a) becoming or continuing as an IAP of any insured depository institution; (b) owning or controlling, directly or indirectly, any insured depository institution; or (c) otherwise participating, directly or indirectly, in the conduct of the affairs of any insured depository institution. This includes removal of the IAPs from their position if they are convicted of such crimes. See 12 U.S.C. § 1829.
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	Certain laws and regulations require the bank and holding company to notify the supervisor when they become aware of material information that may indicate that a board member or member of senior management is unfit for service. For example, suspicious activity reports are required to be filed for any instances of known or suspected illegal or suspicious activity including the actions of board members and senior management. See 31 U.S.C. § 5318(g); 12 CFR 208.62, 12 CFR 211.24(f), and 12 CFR 225.4(f); 12 CFR 353; and 12 CFR 21.11 and 163.180. The FBAs expect that notification would be given of any circumstance involving a board or management member that has the potential to impact the safety or soundness of the bank or holding company.
Assessment of Principle 14	Largely Compliant
Comments	<p>Since the financial crisis of 2008-09 major changes have taken place in supervisors' demands on banks' corporate governance and in the bank's own approaches to these issues. Laws and regulations have gradually raised the requirements, although from a low level. In particular, the expectations have been strengthened in those areas: (i) Board involvement in setting the bank's risk appetite; (ii) the establishment of Risk Management Committees and; (iii) the increased frequency of Board meetings. The BCP assessors saw evidence of this, for instance in the reports from supervisory examinations, including when taking informal supervisory actions or formal enforcement actions for non-compliance. Assessors' discussions with banks also indicate a clearly heightened focus by boards and management on corporate governance issues. One prominent area concerns the role and mandates of banks' boards relative to that of the senior management. Until very recently in the U.S., there was not a clear distinction between the two; for example the assessors saw numerous examples both in regulation and in actual supervision where the standard term "board and senior management" was used in situations where good current international practices would dictate that only one of the two should have the specific role and responsibility. The demands on board involvement and skills have increased substantially and this has also in many instances led to consequential changes in board compositions and calls for wider skill sets of directors. That said, both supervisors and banks agree that further steps need to be taken and implemented in the field of corporate governance. For instance, the stricter requirements and expectations by the supervisors seem to apply primarily to large banks. There seems to be a process of "trickling down", i.e., that strengthened corporate governance practices also reach midsize and smaller banks, but this will probably take some more time before reaching desired levels.</p> <p>The LC rating is based on the fact that some key regulations, such as the SR 12-17 by the FRB and Heightened Standards by the OCC, have only recently come into force and have therefore not yet been fully implemented (and, as mentioned above, they primarily refer to large banks.)</p>

	<p>The new requirements will imply a substantial improvement but, in fact, the new, higher level is no more than standard practice in some other jurisdictions. In addition, there continue to exist areas where the requirements on the roles and responsibilities of bank boards fall short of international standards (See for instance the comments on CP 20 on Lending to related parties).</p> <p>In addition, on AC1, the requirements that bank informs the supervisors promptly about material developments that affect the fitness and propriety of Board directors or senior management are defined only for a narrow scope of events and should be broadened.</p>
Principle 15	<p>Risk management process. The supervisor determines that banks⁵¹ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate⁵² all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.⁵³</p>
Essential criteria	
EC1	<p>The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that:</p> <ul style="list-style-type: none"> (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	<p>As with many aspects of the regime, the approach to risk management is tiered. In the case of risk management this is largely achieved by reference to asset size. See Table 15.1.</p>

⁵¹ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

⁵² To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

⁵³ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	1	2	3	4	5	6
Table 15.1	All US banking organisations	Publicly Traded Bank Holding Companies with at least \$10bn of Assets	Bank Holding Companies with at least \$50bn of Assets	Foreign Banking Organisations with Combined US assets of at least \$50bn	Foreign Banking Organisations with Total Consolidated Assets of \$50bn or more but Combined US assets of less than \$50bn	Publicly Traded Foreign Banking Organisations with Total Consolidated Assets between \$10bn and \$50bn
Risk Management	An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks.	The BHC's risk management framework must be commensurate with its capital structure, risk profile, complexity, activities, and size must include enumerated policies, procedures, processes, and systems.	BHCs are expected to have effective risk identification, measurement, management, and control processes in place to support their internal capital planning. In addition to the assessments of a BHC's stress scenario analysis and stressed loss- and revenue-estimation practices, supervisory assessments of BHCs' internal capital planning will continue to focus on fundamental risk-identification, measurement, and management practices, as well as on internal controls and governance. Specific controls should be in place to (i) ensure that MIS are sufficiently robust to support capital analysis and decision making; (ii) provide for reconciliation and data integrity processes for all key reports; (iii) address the presentation of aggregate, enterprise-wide capital planning results, which should describe any manual adjustments made ensure that reports provided to senior management and the board contain the appropriate level of detail and are accurate and timely.	The risk committee must aggregate, monitor and report risks across all US legal entities.	An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks.	
Risk Committee	No requirement	Required to establish and maintain a risk committee that approves and periodically reviews the risk-management policies of its global operations and oversees the operation of its global risk management framework.	must establish an enterprise-wide risk committee. Same as for Column 2. The responsibilities must also include liquidity risk management the Risk Committee must (i) be an independent committee with risk management oversight as its sole function; (ii) report directly to the BHC's board of directors; and (iii) receive and review regular reports at least quarterly from the bank's chief risk officer	Must establish a US Risk Committee that oversees combined US operation The US risk committee must meet at least quarterly and fully document and maintain records of its proceedings, including risk management decisions.	Must certify on an annual basis that it maintains a US risk committee of its board of directors (or equivalent) that oversees the US risk-management policies of the combined US operations of the company.	
Risk Committee Membership	No requirement	The risk committee must include at least one member with relevant risk management expertise which can be gained from prior experience working for a large, complex bank or for a large, complex nonbanking or nonfinancial firm. The committee must be chaired by an independent director. All committee members must have an understanding of risk management principles and practices relevant to the BHC.		At least one member must be independent	Must certify on an annual basis that it has at least one member of the risk committee with risk management expertise in large, complex firms (which may be nonfinancial or nonbanking firms)	
Chief Risk Officer	No requirement		The chief risk officer must have risk management expertise in a large, complex financial firm. The chief risk officer is responsible for overseeing: (i) the establishment of risk limits and monitoring compliance with those limits; (ii) the implementation and ongoing compliance with appropriate policies and procedures for risk management governance, practices, and controls, including emerging risks; (iii) managing risk exposures and risk controls; (iv) monitoring and testing risk controls; (v) reporting risk management issues and emerging risks; and (vi) ensuring that risk management issues are timely and effectively resolved. The chief risk officer must report directly to both the risk committee and the chief executive officer of the BHC.	The US chief risk officer must operate under dual reporting lines to the US risk committee and the global chief risk officer. The US chief risk officer is responsible for overseeing (i) measurement, aggregation, and monitoring of risks undertaken by the combined US operations; (ii) implementation of and ongoing compliance with the FBO's risk management policies and procedures for its combined US operations, and the development and implementation of processes and systems for implementing and monitoring compliance with the policies and procedures; and (iii) management of risks and risk controls, and monitoring and testing of such risk controls.	No requirement	
Location of Risk Committee	No Requirement		The Risk Committee must (i) be an independent committee; and (ii) report directly to the BHC's board of directors.	The US risk committee may be a committee of the FBO's global board of directors (on a standalone basis or jointly with its enterprise-wide risk committee) or, if the FBO is subject to the IHC requirement, as a committee of the IHC's board of directors. An IHC must have its own risk committee, which may also fulfill the responsibilities of the US risk committee.	The risk committee must be a committee of the global board of directors.	The risk committee must have a formal, written charter that is approved by the BHC's board of directors, and must meet quarterly (and otherwise as needed) and fully document and maintain records of its proceedings.

All Banks

The general supervisory regime that applies to all banks for risk management is derived from guidance against the safety and soundness statutes.

As part of the examination process, supervisors review and rate risk management (strategy and culture) to determine the adequacy of bank processes relative to the size and nature of the bank, and identify weaknesses requiring attention from management. If Supervisors determine that risk management processes (including risk appetite and consideration of uncertainties) are inadequate, they have the power through various means to require a banking group to strengthen them. Supervisors assess risk management as part of the formal rating systems and various other ratings and assessment processes they use (risk management is a part of Management assessment in the CAMELS rating for banks or part of "R" (risk and risk management) in the RFI/C rating system for Bank Holding Companies, Savings and Loan Holding Companies. There are continuous supervision activities, specific on-site reviews, and horizontal supervision reviews. Off-site monitoring looks for indications of metrics that may indicate risk management issues. Risk-focused supervision places specific emphasis on the quality of risk management. Examiners consider findings relating to the following elements of a sound risk management system: active board and senior management collective oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls. Examiners use a risk-focused approach to supervision, and apply flexibility when assessing the appropriateness of a banking organization's risk management processes to address the organization's circumstances and the nature, scope, and complexity of its operations.

For smaller banks engaged predominantly in traditional banking activities and whose senior managers and directors are actively involved in the details of day-to-day operations, risk management systems may be less sophisticated. Even smaller and mid-size banks can have complex parts of their operation needing sophisticated risk monitoring and risk management capabilities. Risk specialists can join supervisory activities for these banks.

Banks and holding companies are required to have in place comprehensive risk management policies and processes to identify, evaluate, monitor and control or mitigate material risks. Interagency safety and soundness guidelines require institutions to establish internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities. High-level requirements are specified in those portions of the interagency safety and soundness guidelines addressing operational and managerial standards. There is detailed guidance and supervisory manuals on various specific risk areas and on consolidated approaches to risk management.

Banking Institutions with at least \$10bn of Assets

Large complex banks and holding companies are expected to have far more sophisticated and formal risk management systems in order to address their broader and typically more complex range of financial activities and to provide the board and senior management with the information needed to monitor and direct day-to-day activities. These risk management systems require frequent monitoring and testing by independent control areas and internal, as well as external, auditors to ensure the integrity of the information used in overseeing compliance with policies and limits. Supervisors will review the adequacy of internal audit work and their capacity to rely on it. Large complex banks and holding companies should have risk management systems or units that are credible, authoritative, and sufficiently independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest. Supervisors review the work of these units, and Basel II supervisory work

has also been used in this regard.

The DFA introduced some risk management and stress testing standards for institutions between \$10bn and \$50bn (such as annual company-run stress tests and the formation of a risk committee).

Banking Institutions with at least \$50bn of Assets

The DFA contained a number of additional requirements relating to risk management primarily targeted at Banking Institutions with at least \$50bn of Assets. The requirements cover establishing a risk-management framework that is commensurate with an institution's structure, risk profile, complexity, activities, and size. That framework should include policies and procedures establishing risk-management governance, risk-management procedures, and risk-control infrastructure for its global operations, as well as processes and systems for implementing and monitoring compliance with such policies and procedures. These processes and systems would cover identifying and reporting risks and risk-management deficiencies, including regarding emerging risks; ensuring effective and timely implementation of actions to address emerging risks and risk-management deficiencies for its global operations; establishing managerial and employee responsibility for risk management; ensuring the independence of the risk-management function; and integrating risk management and associated controls with management goals and its compensation structure for its global operations. Assessments of the quality of risk management at large institutions subject to higher risk management requirements are included as part of the evaluation of the overall organization. The Federal Reserve has established, through its Capital Plan Rule and its annual CCAR, additional requirements for Bank Holding Companies with at least \$50bn in assets to ensure they properly assess their risks (including those arising during adverse conditions) and maintain sufficient capital to support those risks. The Federal Reserve's Capital Plan Rule, along with subsequent capital planning guidance, establishes requirements for firms to have effective processes for ensuring they have sufficient levels of capital in both normal and stressed conditions. The firms are required to have internal processes for assessing their capital adequacy that reflect a full understanding of their risks and ensure that they hold capital corresponding to those risks to maintain overall capital adequacy.

Banking Institutions with at least \$250 billion in total consolidated assets or at least \$10 billion in total on-balance sheet foreign exposure

The agencies' Supervisory Guidance on the Supervisory Review Process of Capital Adequacy (Pillar 2) lays out further requirements related to risk management for core banks mandated to use the advanced capital approaches under Basel II, which they have been putting in place for some time. During the implementation process Supervisors having been using Basel II implementation (and supervisors have been assessing implementation), among other measures to promote enhanced risk management practices. There are also supervisory letters, which lay out additional risk management guidance. Taken together, the amount of guidance on risk management is extensive.

Note

Banking Institutions with at least \$50bn of Assets

The OCC formalized its "heightened expectations" for risk management and governance in its Heightened Standards Guidelines. The guidelines contain minimum standards for the design and implementation of a Risk Governance Framework and for the role of the board of directors in overseeing the framework. These standards apply to large national banks and federal savings associations and are consistent with the principles embedded in the Federal Reserve's expectations for large bank holding companies. The Guidelines will be phased in according to

	<p><i>the bank's size: (i) banks with average total consolidated assets of \$750 billion or more should comply with the Guidelines on 10 November 2014; (ii) banks with average total consolidated assets of \$100 billion or more but less than \$750 billion should comply by 10 May 2015; (iii) banks with average total consolidated assets of \$50 billion or more but less than \$100 billion should comply by 10 May 2016; (iv) banks with average total consolidated assets of less than \$50 billion that are subject to the Guidelines by virtue of being a subsidiary of a parent company that controls another bank subject to the guidelines should comply with the Guidelines on the same date that the affiliated bank should comply; and (v) banks with average total consolidated assets of less than \$50 billion on the effective date (November 10, 2014) that subsequently become subject to the Guidelines should comply within 18 months as of date of the most recent Call Report used to calculate the average.</i></p>
<p>EC2</p>	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ul style="list-style-type: none"> (a) to provide a comprehensive “bank-wide” view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s risk management process.
<p>Description and findings re EC2</p>	<p>All Banks</p> <p>In assessing the adequacy of risk management processes, agencies' processes are designed to ensure that banks and holding companies have effective risk management and internal controls systems with a documented understanding of both. The agencies assess, and ratings reflect, the board's fulfillment of its responsibilities primarily in accordance with the guidance outlined in EC 1 above. On balance the assessors felt that the guidance did not constitute requirements, but the assessors did see considerable evidence of supervisory action in supporting improved levels of risk aggregation. The Firms the assessors interviewed also acknowledged the push from the regulator and that some of the improvements they had made had been down to that pressure.</p> <p>U.S. FBAs are required to assess the management of all institutions under their jurisdiction, regardless of their size, and to assign a rating reflecting the assessment. In assessing management, risk-focused supervision places specific emphasis on the quality of risk management. Examiners consider findings relating to the following elements of a sound risk management system: active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, mitigation, and management information systems; and comprehensive internal controls. An institution's policies, procedures, and limits are expected to provide for the adequate identification, measurement, monitoring, and control of the risks posed by its activities. Policies and procedures are also expected to reflect the changing risk profile of the institution by providing for the review of activities new to the institution to ensure that the infrastructures necessary to identify, monitor, and control risks associated with an activity are in place before the activity is initiated. Principles of sound risk management are expected to apply to the entire spectrum of risks facing a consolidated organization as well as individual institutions. U.S. federal banking examiners use a risk-focused approach to supervision, and apply flexibility when assessing the appropriateness of a banking organization’s risk management processes to address the organization's circumstances and the nature, scope, and complexity of its operations. Large complex banks and holding companies are expected to have more sophisticated and formal</p>

risk management systems in order to address their broader and typically more complex range of financial activities and to provide the board and senior management with the information needed to monitor and direct day-to-day activities.

The agencies use a risk-based process for smaller (community) banks. Assessments of these firms are generally made through both periodic on-site examinations that are supplemented with off-site monitoring (see, for example, SR Letter 97-25, Risk Focused Framework for the Supervision of Community Banks and the OCC's Community Bank Supervision Booklet). As with their supervisory programs for large institutions, the agencies' supervisory programs for smaller organizations assess management's ability to identify, measure, monitor and control risks. The risk management processes of BHCs are assessed in accordance with the guidance set out in SR Letter 95-51, Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies, the BHC Supervision Manual (BHCSM), the Commercial Bank Examination Manual (CBEM), the Trading and Capital-Markets Activities Manual (Trading Manual), and various other guidance documents. Similar to the Federal Reserve, the OCC uses a risk assessment system to evaluate the risk profiles of nationally chartered banks across eight categories of risks. These assessments consider the bank's quantity of risk, quality of risk management and direction of the bank's risk exposures. The OCC expects that regardless of a bank's size and complexity, sound risk management systems should (i) *Identify risk*—To properly identify risks, a bank must recognize and understand existing risks and risks that may arise from new business initiatives, including risks that originate in nonbank subsidiaries and affiliates, and those that arise from external market forces, or regulatory or statutory changes. Risk identification should be a continuing process and should occur at both the transaction and portfolio levels; (ii) *Measure risk*—Accurate and timely measurement of risks is essential to effective risk management systems. A bank that does not have a risk measurement system has limited ability to control or monitor risk levels. Further, more sophisticated measurement tools are needed as the complexity of the risk increases. A bank should periodically test to make sure that the measurement tools it uses are accurate. Sound risk measurement systems assess the risks of both individual transactions and portfolios; (iii) *Monitor risk*—Banks should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be timely, accurate, and informative and should be distributed to appropriate individuals to ensure action, when needed. For a large, complex company, monitoring is essential to ensure that management's decisions are implemented for all geographies, products, and related entities; and (iv) *Control (mitigate) risk*—Banks should establish and communicate risk limits through policies, standards, and procedures that define responsibility and authority. These limits should serve as a means to control exposures to the various risks associated with the bank's activities. The limits should be tools that management can adjust when conditions or risk tolerances change. Banks should also have a process to authorize and document exceptions or changes to risk limits when warranted. The board must establish the bank's strategic direction and risk tolerances. In carrying out these responsibilities, the board should approve policies that set operational standards and risk limits. Well-designed monitoring systems will allow the board to hold management accountable for operating within established tolerances. (See OCC's Bank Supervision Process Handbook). A bank's or holding company's failure to establish a management structure that adequately identifies, measures, monitors, and controls the risks involved in its various products and lines of business is considered unsafe and unsound conduct, for which the U.S. FBAs may initiate formal or informal supervisory action requiring the immediate implementation of necessary corrective measures, as explained in the enforcement actions section of the banking agencies' web sites and in BCP 11.

Publicly Traded Banking Institutions with at least \$10bn of Assets

Banks are required to maintain a risk committee that approves and periodically approves the risk-management policies and global operations and global risk-management framework (see 12 U.S.C. § 5365; and 12 CFR 252.22 and 252.33). The Bank Holding Companies global risk-management framework is required to be commensurate with its structure, risk profile, complexity, activities, and size. The applicable regulations also impose specific corporate governance requirements on the charter, composition, and activities of the risk committee, including requiring having at least one member with experience in identifying, assessing, and managing risk exposures of large, complex firms, being chaired by an independent director pursuant to the listing standards of a national securities exchange, receiving regular reports from the company's chief risk officer, and conducting regular, fully documented meetings. The Federal Reserve, OCC, and FDIC also require annual company-run stress tests, under which firms must estimate the impact of a range of economic and financial scenarios on their capital levels. The agencies maintain teams of examiners dedicated to each of the large complex banks, and these banks are subject to a continuous risk-focused supervision program. These teams include examiners with specialized expertise in areas such as capital markets, retail and commercial lending, operations, and information technology, and they conduct on-going, risk-focused supervision based upon agency guidance.

Banking Institutions with at least \$50bn of Assets

Firm-wide views of all material risks and risk profile (and controls) are critical elements to the CCAR process and the overall supervisory evaluation of the firm, built through examinations and on-going supervision throughout the year. The supervisory evaluations are built on regulation and guidance, along with a broader view of safety and soundness. The risks from the macroeconomic environment are assessed in CCAR-related stress testing along with broader stress testing regimes that may occur across the organization or within individual businesses or portfolios. In CCAR, the Federal Reserve utilizes their teams dedicated to individual large banks, horizontal teams for specialty areas, and independent stress testing to determine the adequacy of capital levels and the management of capital at the firms and across the portfolio. Each firm's capital adequacy process is assessed in relation to seven key principles: (1) Sound foundational risk management—identification, measurement, assessment, and control (2) Effective loss estimation methodologies (3) Solid resource estimation methodologies (estimating capital resources) (4) Sufficient capital adequacy impact assessment (5) Comprehensive capital policy and capital planning (6) Robust internal controls and (7) Effective governance. Within this framework, risk identification, measurement, assessment, and control are examined, along with governance over those risks. The process includes the assessment during the CCAR examination and assessments developed through other supervisory processes.

The OCC applies a similar set of practices for large national banks and as a management initiative they have launched the “Strive for Strong” approach whereby supervisors judge the gap from the current risk management standard of the bank and a strong rating. They then devise a supervisory strategy to bridge that gap. The assessors were shown data that suggested that this strategy was yielding further improvements. The Federal Reserve issued supervisory guidance in 2012 (see SR 12-17, Consolidated Supervision Framework for Large Financial Institutions) to describe the enhanced supervisory approach for institutions with at least \$50 billion in assets, given their systemic importance.

Note

Banking Institutions with at least \$50bn of Assets

The OCC formalized its "heightened expectations" for risk management and governance in its Heightened Standards Guidelines. The guidelines provide that the bank should have a

	<p><i>comprehensive written statement that articulates the bank's risk appetite and serves as a basis for the risk governance framework (i.e., risk appetite statement). The term risk appetite refers to the aggregate level and types of risk that the board and management are willing to assume to achieve a covered bank's strategic objectives and business plan, consistent with applicable capital, liquidity, and other regulatory requirements. The risk appetite statement should include both qualitative components and quantitative limits. The qualitative components of the risk appetite statement should describe a safe and sound risk culture and how a covered bank will assess and accept risks, including those that are difficult to quantify, on a consistent basis throughout the institution. Quantitative limits should incorporate sound stress testing processes, as appropriate, and should address a covered bank's earnings, capital, and liquidity positions. Additionally, the guidelines provide that each member of the board should oversee a covered bank's compliance with safe and sound banking practices. Consistent with this, the board should also require management to establish and implement an effective risk governance framework that complies with the guidelines. The board or its risk committee should approve any significant changes to the framework.</i></p>
<p>EC3</p>	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.</p>
<p>Description and findings re EC3</p>	<p>All Banks</p> <p>In assessing the adequacy of risk management processes, agencies ensure that risk management strategies, policies, processes, and limits are properly documented, reviewed and updated, and communicated within the bank and banking group. In addition, examiners determine that exceptions to established policies, processes and limits receive the prompt attention of and authorization by the appropriate level of management and the board where necessary. The agencies generally conduct examinations of the documentation supporting the risk management process and adherence to internal policies, processes, and limits in conjunction with targeted examinations of specific business activities.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>These institutions are subject to enhanced standards of risk management. Bank Holding Companies are expected to have effective risk identification, -measurement, -management, and -control processes in place to support their internal capital planning.</p> <p><i>Note</i></p> <p>Banking Institutions with at least \$50bn of Assets</p> <p><i>The OCC formalized its "heightened expectations" for risk management and governance in its Heightened Standards Guidelines. The guidelines provide that a bank should establish and adhere to a formal, written risk governance framework that is designed by independent risk management and approved by the board of directors or the board's risk committee. The framework should be reviewed and updated at least annually, and as often as needed to address improvements in industry risk management practices and changes in the bank's risk profile caused by emerging risks, its strategic plans, or other internal or external factors. Also, the</i></p>

	<i>guidelines provide that the framework should include processes whereby initial communication and on-going reinforcement of the bank's risk appetite statement occurs throughout the bank in a manner that causes all employees to align their risk-taking decisions with applicable aspects of the risk appetite statement.</i>
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	<p>All Banks</p> <p>Supervisors review whether senior management and the board understand the nature and level of risk being taken by the institution and how this risk relates to adequate capital levels. Examiners also determine that senior management ensures that the risk management policies and processes are appropriate in the light of the institution's risk profile and business plan and that they are implemented effectively. Senior management is expected to review regularly and understand the implications (and limitations) of the risk management information that it receives. The same requirement applies to the board in relation to risk management information presented to it in a format suitable for board oversight. The agencies assess, and ratings reflect, whether senior management and the board of directors understand the nature and level of risk being taken by the organization primarily in accordance with guidance outlined in EC 1.</p>
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	<p>Capital</p> <p>All Banks</p> <p>Supervisors expect banks and bank holding companies to develop internal capital and strategic plans that exceed minimum regulatory capital requirements to ensure that the capital they are holding and forecast to need is adequate given their risk profile and appetite including as they are manifested through various stress scenarios. All organizations are expected to understand their underlying risks and hold capital commensurate with those risks "at levels above regulatory minimum" to ensure capital adequacy.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>DFA capital stress tests and the Federal Reserve's annual CCAR exercise also enhance the supervisory approach to ensuring that the largest firms have sufficient capital to support their risks. Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013, which set out that Bank Holding Companies are expected to have effective risk identification, —measurement,— management, and—control processes in place to support their internal capital planning.</p> <p>Liquidity</p> <p>All Banks</p> <p>Similarly, various rules and interagency guidelines require banking organizations to establish and maintain robust liquidity risk management practices and process for determining the</p>

	<p>adequacy of their liquidity resources, including through various stress scenarios. This involves requiring a company's board of directors to approve the company's liquidity risk tolerance at least annually, receive and review information from senior management at least semi-annually to determine whether the organization is operating in accordance with its established liquidity risk tolerance, and to approve and periodically review the liquidity risk management strategies, policies, and procedures established by senior management.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve undertakes a Comprehensive Liquidity Analysis and Review (CLAR) program to assess liquidity in normal and stressed scenarios and aspects of liquidity risk management for individual firms.</p>
<p>EC6</p>	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
<p>Description and findings re EC6</p>	<p>All Banks</p> <p>Banks and holding companies generally are expected to ensure that risk management models and systems are independently validated and tested with an appropriate frequency. Supervisory guidance directs that key assumptions, data sources, and procedures used in measuring (including any model output uncertainties) and monitoring risk be appropriate and adequately documented and tested for reliability on an on-going basis. Models should be independently validated and tested by risk management staff or by internal or outside auditors. Guidance that more specifically addresses model requirements for various types of models is found in the related sections of the agencies' manuals. Although the comprehensiveness and specificity of supervisory guidance relating to the role of the Board varied, the assessors found evidence that supervisors did pursue issues in relation the role of the Board.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>Rules on DFA stress tests also include requirements for institutions to validate their stress testing models.</p> <p>The assessors saw examples of supervisors raising limitations on models.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013, which set out that Bank Holding Companies are expected to have an effective independent review and validation of all models used in internal capital planning.</p>
<p>EC7</p>	<p>The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the</p>

	bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	Supervisory safety and soundness guidelines require banks and holding companies to have information systems that are appropriate to the size of the institutions and the nature, scope and risks of their activities and that provide access to timely and accurate financial, operational, and regulatory reports. Supervisors assess, and their supervisory ratings reflect, the adequacy of firm-wide risk management information at both the holding company and institution level. Risk monitoring activities must be supported by information systems that provide senior managers and directors with timely reports clearly indicating positions and risk exposures, as well as with regular and sufficiently detailed reports for line managers engaged in the day-to-day management of the organization's activities. Examiners analyze reports flowing to executive management, board committees, and the board of directors for clarity, consistency, timeliness, quality, and coverage of crucial areas of the organization. Examiners ascertain that reporting is sufficiently comprehensive for sound decision-making, and that reports relate risks relative to the bank's earnings and capital.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ⁵⁴ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an on-going basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	Supervisors verify that banks and Bank Holding Companies have policies and processes in place to ensure that management identifies and reviews all risks associated with new activities or products, and that the infrastructure and internal controls necessary to manage the related risks are in place. Supervisors expect that risk management process reflect the size and the complexity of the product or service offered. Although the comprehensiveness and specificity of supervisory guidance relating to the approval of new products and major risk management initiatives varies (including in relation to the role of the Board), the assessors found evidence that supervisors do pursue issues in relation to product development and activities.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	All Banks Supervisors have an expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks.

⁵⁴ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	<p>Supervisors expect the Independent Risk Management function to identify and assess the bank’s material aggregate risks; determine if actions are needed to strengthen risk management or reduce risk given changes in the bank’s profile or other conditions; establish and adhere to enterprise policies that include concentration limits; and identify and communicate to the CEO and the board of directors material risks and significant instances where independent risk management’s assessment of risk differs from that of a front line unit and significant instances where a front line unit is not adhering to the risk governance framework.</p> <p>Supervisors ensure that the composition of the risk management function must comprise a well-qualified and trained group of individuals with a wide variety of skill sets. Initiatives should be in place to ensure education and training coincides with changes in the risk landscape.</p> <p>The assessors found conflicting evidence on the issue of whether the risk management function should be in the ‘control universe’ subject to review by Internal Audit. The inter-agency guidance of 2003 (e.g. SR03-5) describes the general role as assessing risk management and governance, but not the function. The Federal Reserve supplementary guidance (SR13-1) does however make it clear that Internal Audit should include the function.</p> <p>In practice the position of risk management is a key part of the examination process and the assessors saw substantial evidence of supervisory action in this respect.</p> <p>Publicly Traded Bank Holding Companies with at least \$10bn of Assets</p> <p>A BHC's risk management framework must be commensurate with its capital structure, risk profile, complexity, activities, and size must include enumerated policies, procedures, processes, and systems.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Bank Holding Companies are expected to have effective risk identification, measurement, management, and control processes in place to support their internal capital planning. In addition to the assessments of a BHC's stress scenario analysis and stressed loss- and revenue-estimation practices, supervisory assessments of Bank Holding Companies' internal capital planning will continue to focus on fundamental risk-identification, -measurement, and -management practices, as well as on internal controls and governance.</p> <p>Specific controls should be in place to (i) ensure that management information systems are sufficiently robust to support capital analysis and decision making; (ii) provide for reconciliation and data integrity processes for all key reports; (iii) address the presentation of aggregate, enterprise-wide capital planning results, which should describe any manual adjustments made ensure that reports provided to senior management and the board contain the appropriate level of detail and are accurate and timely.</p> <p>Supervisors require Bank Holding Companies and individual banks to have risk evaluation, monitoring, and control or mitigation functions with duties clearly segregated from risk-taking functions and which report on risk exposures directly to senior management and the board or board committee. While organizations are generally given flexibility in how they accomplish this objective, most large, complex banks and Bank Holding Companies have established dedicated units to manage risk at the group level.</p>
<p>EC10</p>	<p>The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the</p>

	reasons for such removal with its supervisor.
Description and findings re EC10	<p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve's requirements for establishment of a CRO position at all Bank Holding Companies with at least \$50bn in assets stem from the idea that the complexity and size of the operations of a BHC of this size warrant Bank Holding Companies having a designated executive in charge of implementing and maintaining the risk management framework and practices approved by the risk committee. The chief risk officer must have risk management expertise in a large, complex financial firm. The chief risk officer is responsible for overseeing: (i) the establishment of risk limits and monitoring compliance with those limits; (ii) the implementation and on-going compliance with appropriate policies and procedures for risk management governance, practices, and controls, including emerging risks; (iii) managing risk exposures and risk controls; (iv) monitoring and testing risk controls; (v) reporting risk management issues and emerging risks; and (vi) ensuring that risk management issues are timely and effectively resolved. The chief risk officer must report directly to both the risk committee and the chief executive officer of the BHC. The CRO may execute his or her responsibilities by working with, or through, others in the organization.</p> <p>The CRO is required to report directly to the risk committee and the BHC's CEO, as this dual reporting helps the board of directors to oversee the risk-management function and may help disseminate information relevant to risk management throughout the organization. Finally, the compensation of a BHC's CRO must be structured to provide for an objective assessment of the risks taken by the company. Current guidance is silent whether if a CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.</p> <p><i>Note</i></p> <p>Banking Institutions with at least \$50bn of Assets</p> <p><i>The OCC formalized its "heightened expectations" for risk management and governance in its Heightened Standards Guidelines. The guidelines provide that the board or its risk committee approves all decisions regarding the appointment or removal of the Chief Risk Executive and approves the annual compensation and salary adjustment of the Chief Risk Executive.</i></p>
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	U.S. FBAs have issued standards related to credit, market, liquidity, interest rate risk in the banking book, and operational risk in the form of supervisory guidance and through the issuance of examination procedures and handbooks. Ratings reflect the results of the assessment of compliance with expectations appearing in these documents.
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.

<p>Description and findings re EC12</p>	<p>All Banks</p> <p>Supervisors have an expectation under guidance (under the Safety and Soundness provisions) that all banks and holding companies have in place contingency plans, but there are no requirements.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve has taken a number of steps to improve its supervisory program for large financial institutions. These steps include the development of an overall “Consolidated Supervision Framework for Large Financial Institutions” that focuses on enhancing the resiliency of a firm through, among other things, recovery planning, and on reducing the impact of a firm’s failure through, among other things, resolution planning. In addition, the Federal Reserve has issued guidelines regarding its heightened supervisory expectations for recovery and resolution preparedness for the largest Bank Holding Companies and outlines the capabilities that an institution should have in connection with its recovery and resolution preparedness. These capabilities that a BHC should have include, but are not limited to:</p> <ul style="list-style-type: none"> • Effective processes for managing, identifying, and valuing collateral it receives from and posts to external parties and affiliates; • A comprehensive understanding of obligations and exposures associated with payment, clearing, and settlement activities; • The ability to analyze funding sources, uses, and risks of each material entity and critical operation, including how these entities and operations may be affected under stress; • Demonstrated management information systems capabilities for producing certain key data on a legal entity basis that is readily retrievable and controls in place to ensure data integrity and reliability; and • Robust arrangements in place for the continued provision of shared or outsourced services needed to maintain critical operations that are documented and supported by legal and operational frameworks. <p>The Federal Reserve, in conjunction with the FDIC, have also issued regulations requiring Bank Holding Companies and regulated nonbank financial companies, to develop resolution plans or “living wills” for how the companies would be resolved in a rapid and orderly manner under the Bankruptcy Code (or other applicable insolvency regime) in the event of material financial distress or failure. The FDIC also has promulgated rules that require banks with \$50 billion or more in total assets to provide a living will plan to the FDIC. Federal Reserve and FDIC’s resolution plan regulations contain mechanisms through which the agencies can address weaknesses and inadequacies within any resolution plan, including requiring changes to the plan that would remediate such weaknesses.</p>
<p>EC13</p>	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank’s stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor’s assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control, on a bank-wide basis

	<p>(b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks;</p> <p>(c) benefits from the active involvement of the Board and senior management; and</p> <p>(d) is appropriately documented and regularly maintained and updated.</p> <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process</p>
<p>Description and findings re EC13</p>	<p>Banking Institutions with at less than \$10bn of Assets</p> <p>There are no requirements for banks below \$10bn of Assets.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>The agencies issued supervisory guidance on stress testing for all banking organizations with at least \$10 billion in total assets. That guidance laid out principles and standards for a satisfactory stress-testing framework, including for capital and liquidity stress testing. It noted that stress testing should involve the board and senior management and be an integral part of the bank's governance and capital planning. This includes establishing stress testing objectives, defining scenarios, review and discussion of stress test results, assessing potential actions and decision-making. An organization should continuously review scenarios and develop new ones, examine new products to identify potential risks, improve the identification risks and how they interact, and evaluate appropriate time horizons and feedback effects.</p>
<p>EC14</p>	<p>The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.</p>
<p>Description and findings re EC14</p>	<p>All Banks</p> <p>Guidance lays out principles for sound compensation practices including the principle that incentive compensation arrangements should balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risks. An incentive compensation arrangement is balanced when the amounts paid to an employee appropriately take into account the risks (including compliance risks), as well as the financial benefits, from the employee's activities and the impact of those activities on the organization's safety and soundness.</p> <p>Supervisors also monitor incentive compensation systems to ensure that appropriate personnel, including risk-management personnel, have input into the organization's processes for designing incentive compensation arrangements and assessing their effectiveness in restraining imprudent risk taking.</p> <p>Banking Institutions with at least \$1bn of Assets</p> <p>The DFA requires the appropriate federal regulators, including the FBAs, to issue a joint rulemaking or guidance to prohibit incentive-based compensation arrangements at institutions with \$1 billion or more in assets (covered financial institutions) that encourage inappropriate risks by providing excessive compensation, or potentially leading to material financial loss. The agencies, along with other federal agencies, have issued guidance and proposed rules to implement this requirement.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>Supervisors assess the incorporation of risks into pricing, performance measurement, and the</p>

	<p>new product process. One approach (used in stress testing, review of incentive compensation, new approval and performance scorecards) is to look at internal pricing (e.g., funds transfer pricing, capital allocation), performance measurement (e.g., incentive compensation, returns on allocated risk based capital,) and new product approvals as an overall process across all of the business lines and control functions that they touch.</p> <p>An alternative approach is a bottom- up method. Where in reviews of business lines there is often examine or test how pricing, capital allocation, new product approval and incentive compensation are implemented at the business lines, and how risks are incorporated at the more micro-level for these processes.</p>
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	<p>All Banks</p> <p>Agencies approaches differ as to whether or not they consider reputational and strategic risks as separately identifiable risks. Each agency requires its organizations and institutions to have in place appropriate policies and processes for assessing <i>all</i> material risks, including those not directly addressed in the subsequent Principles, such as reputational and strategic risk. The agencies consistently expect reputational risk to be factored into the formulation of business strategy, and a part of the approval process for new activities and products. Agencies also hold the board of directors responsible for overseeing that strategic plans are implemented in a safe and sound manner. The agencies issue specific guidance when necessary to address unique reputational and/or strategic risks associated with a particular activity for which existing guidance may not adequately address supervisory expectations.</p> <p>Banking Institutions with at least \$250 billion in total consolidated assets or at least \$10 billion in total on-balance sheet foreign exposure</p> <p>For those institutions subject to the advanced approaches of Basel II-based capital adequacy guidelines, the agencies have issued supervisory guidance related to the supervisory review process of capital adequacy, which addresses the need for banks to consider all material risks in their internal assessments of capital adequacy, including, reputational and strategic risks.</p>
Assessment of Principle 15	Largely Compliant
Comments	<p>The assessors were able to see substantial improvement in the risk management process, but it also has to be acknowledged from a low starting point. It was noted on several occasions by the assessors that some milestones heralded by the banks, which the assessors interviewed, as significant improvements would only be considered as standard practice in some jurisdictions. For example:</p> <ul style="list-style-type: none"> • Increased frequency of board meetings; • Existence of independent risk committees; and • Board members with expertise relevant to the business of the bank <p>There has been a key focus on risk aggregation and the material that is used in the risk oversight process and the assessors saw some good material on supervisory actions reinforcing those points.</p>

However, most have acknowledged that this remains very much work in progress—much of the guidance for the larger banks is new or yet to be implemented and the task of implementation at the firms is a substantial one—often coming with substantial data projects that can take years to complete.

The assessors also noted that for Banking Institutions with less than \$10bn of Assets, many aspects of the essential criteria were not met. In general, supervisory expectations are tailored to be less strict for smaller, non-systemic banks. This means that there is a shortfall from the criteria, but the assessors judged that this was not sufficiently material to alter their overall conclusions. The assessors welcome that supervisors are encouraging medium and small banks with higher risk activities to adopt better practices in corporate governance and risk management that are appropriate for the risk profile of these firms, moving them closer to the criteria and some of the principles outlined in the requirements for the larger banks.

On the whole, however, the assessors found that both in the guidance and from the supervisory files the assessors reviewed there was less weight placed on the role of the Board. On some occasions it seemed clear that the messages were failing to delineate the role of Board and management (the phrase “Board and Senior Management” was very common). What distinction existed was often at the most basic level—for example that it is the role of the Board to appoint management. The assessors noted that in the most recent material (both supervisory reviews and guidance), the role of the Board was gaining more attention and this was welcomed. More clearly needed to be done in this area.

Policy was also in its infancy in relation to the Chief Risk Officer. It was also unclear what arrangements existed should a CRO be removed. The assessors would recommend that this be clarified.

The level of commitment to stress testing is substantial and the assessors found significant consensus that the outputs and outcomes of that process were significant. The assessors noted that both supervisors and firms were becoming more efficient with each iteration and also that the standards required were also increasing. There is perhaps still some way to go before the Supervisory led stress tests achieve an optimum state of data granularity. The assessors would also make two further observations:

- Firms’ own stress-testing—it was striking that a number of firms to which the assessors spoke gave us cause for concern as to how they approached the stress test. In essence they described a “Dutch Auction” process where a firm’s own test was felt to be generating insufficient losses. As a response to this management would add increasingly more extreme scenarios in order to increase the amount of loss. This would consequently detach the overall stress scenario from what the Board and management would consider a plausible business outcome. This would eventually render the stress more as a compliance issue rather than as one that improves the risk management conversation. There are probably two things going wrong here: (i) that the supervisors could offer more guidance on severity and (ii) that the base scenarios that firms run should be more severe and thus remove the need for the more extreme scenarios.
- Disaggregation—supervisors could useful engage with firms more on the components of the stress test—i.e. which areas make up the larger losses in the regulatory run stress tests. This would foster a useful discussion on what the vulnerabilities are in the firms’ portfolios.

Principle 16	Capital adequacy. ⁵⁵ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>Laws and regulations require banks and bank holding companies to calculate and maintain minimum capital ratios. Federal statutes authorize the FBAs to establish minimum capital requirements for banks and require the FBAs to impose two types of capital adequacy requirements on banks—a risk-based capital requirement and a leverage ratio requirement. The FBAs also have the authority to establish minimum capital requirements for certain affiliates of banks, including bank holding companies and savings and loan holding companies. Under those authorities, the FBAs adopted capital adequacy rules (“former capital standards”) for banks and certain top-tier bank and SLHCs. The risk-based capital requirement was based on Basel I and a generally applicable minimum leverage ratio, defined in terms of a banking organization’s tier 1 capital to total on-balance sheet assets, was set at 4 percent.</p> <p>In July 2013, the FBAs adopted a new capital rule implementing global capital reforms and certain changes required by the DFA. The new rule implements Basel III revisions related to minimum capital requirements, the definition of capital and additional capital “buffer” standards, and incorporates aspects of the Basel II standardized approach and applicable Basel III changes to the advanced approaches. See <i>12 CFR part 3</i> (national banks and federal savings associations), <i>12 CFR part 217</i> (state member banks, bank holding companies, and savings and loan holding companies) and <i>12 CFR part 324</i> (state nonmember banks and state savings associations). The new capital rule supersedes the general risk-based capital rules and restructures the FBAs’ regulatory capital rules into a harmonized, codified regulatory capital framework. Aspects of the former capital standards remain in effect as the new rule transitions to full effectiveness.</p> <p>The new capital rule has three forms of capital: common equity tier 1 capital, additional tier 1 capital, and tier 2 capital. The rule also sets out a list of criteria that an instrument must meet to be included in each category of regulatory capital, which are largely consistent with Basel III and focus on the permanence of capital and the availability of capital to absorb losses on a going concern basis. See <i>12 CFR part 3, subpart C</i> (OCC); <i>12 CFR part 217, subpart C</i> (Federal Reserve), <i>12 CFR part 324, subpart C</i> (FDIC).</p> <p>Under the new capital rule, individual banking organizations are subject to minimum risk-based capital requirements on a consolidated basis. These requirements are 4.5 per cent</p>

⁵⁵ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

common equity tier 1 capital, 6 per cent tier 1 capital and 8 per cent total capital. The new rule also incorporates a capital conservation buffer of 2.5 per cent and, for banking organizations using the advanced approaches risk-based capital rule, a countercyclical capital buffer of up to 2.5 per cent; both buffers are composed of common equity tier 1 capital.

The new capital regulatory framework continues the longstanding minimum 4 per cent leverage ratio requirement (tier 1 capital to total on- balance-sheet assets) for banking organizations. In addition, "core" banking organizations (those with total consolidated assets of at least \$250 billion or total consolidated on-balance sheet foreign exposures of at least \$10 billion) that are required to use the advanced approaches risk-based capital rule, and other banking organizations that elect to do so, are also required to meet a minimum "supplementary leverage ratio" of 3 per cent, consistent with the Basel III leverage ratio. The supplementary leverage ratio is defined in terms of tier 1 capital to total on- and off-balance sheet assets. See *12 CFR 3.10* (OCC); *12 CFR 217.10* (Federal Reserve); *12 CFR 324.10* (FDIC). Most banking organizations operate with capital levels well above these minimum requirements. In April 2014, the FBAs adopted an enhanced supplementary leverage ratio final rule for top-tier bank holding companies and their insured depository institution subsidiaries. (See EC4).

The new capital rule requires compliance by different types of organizations at different times, commencing on 1 January 2014, and incorporates transition provisions consistent with Basel III.

Bank holding companies with \$500 million or less in total consolidated assets are exempt from the new rule and are instead subject to the standards in the Federal Reserve's Small BHC Policy (see *12 CFR part 225, Appendix C*). Savings and loan holding companies were not subject to the former capital standards, but most are or will be subject to the new capital rule. Certain savings and loan holding companies with substantial commercial or insurance operations are currently excluded from the new capital rule (see *12 CFR part 217, subpart A*); however, consistent with legal requirements, the Federal Reserve anticipates applying capital requirements to these excluded holding companies in the future. (See *12 U.S.C. § 5371*.)

The FBAs review the quality and regulatory capital eligibility of more complex instruments as necessary on a case-by-case basis. A banking organization must request approval from its primary FBA before including a capital element in regulatory capital, unless certain conditions are satisfied. The FBAs consult with each other when determining whether a new element should be included in common equity tier 1, additional tier 1 or tier 2 capital, and such decisions are made publicly available, including a brief description of the capital element and the rationale for the conclusion. The banking agencies therefore retain flexibility to consider new instruments on a case-by-case basis as they are developed over time to satisfy different market needs. See *12 CFR part 3, subpart C* (OCC); *12 CFR part 217, subpart C* (Federal Reserve); *12 CFR part 324, subpart C* (FDIC).

The Prompt Corrective Action (PCA) requirements provide the FBAs with a framework to take necessary measures should a bank become less-than-well capitalized. A bank's common equity tier 1, tier 1 and total risk-based capital ratios, and leverage ratios, including the supplementary leverage ratio if applicable, must be at or above the regulatory minimum requirements to be considered adequately capitalized. In practice, banks typically have a strong preference to remain well capitalized, as falling below this threshold results in certain restrictions on activities (e.g., inability to accept or roll over brokered deposits). The minimum ratio requirements for each level of capitalization under the PCA requirements may be found in *12 CFR part 6* (OCC); *12 CFR part 208, subpart D* (Federal Reserve); *12 CFR part 324, subpart H*, *12 CFR part 325, subpart B*, and *12 CFR part 390, subpart Y* (FDIC). The PCA framework is not

applicable to bank holding companies.

The new capital rule and its relation to the PCA framework is summarized in the following table:

	"Well Capitalized"	"Adequately Capitalized"	"Undercapitalized"	"Significantly Undercapitalized"	"Critically Undercapitalized"
	A bank is "well capitalized" if it significantly exceeds the required minimum levels of capital (risk-based and leverage).	A bank is "adequately capitalized" if it meets the required minimum levels of capital.	A bank is "undercapitalized" if it fails to meet any required minimum level of capital	A bank is "significantly undercapitalized" if it is significantly below any required minimum level of capital.	A bank is "critically undercapitalized" if it fails to meet the "critical capital" level to be determined by the regulators
Total Capital	≥10%	≥8%	<8%	<6%	Tangible Equity (defined as Tier 1 capital plus non Tier 1 perpetual stock) to Total Assets ≤2%
Tier 1 Capital	≥8%	≥6%	<6%	<4%	
Common Equity Tier 1	≥6.5%	≥4.5%	<4.5%	<3%	
Leverage Ratio	≥5%	≥4%	<4%	<3%	
Supplementary LR	Not Applicable	≥3%	<3%	Not Applicable	Not Applicable
Capital Distributions	Permitted if afterwards the bank is not classified as under capitalized		Not permitted		

	<p>Restrictions</p>	<p>None. Well-capitalized banks actually benefit. They may accept brokered deposits and the regulators may examine them less frequently.</p>	<p>None. Adequately capitalized banks are subject to some restrictions.</p> <p>Significantly, although they may accept brokered deposits, they can do so only with an FDIC waiver. Even with a waiver, the bank cannot pay a rate that "significantly" exceeds (75 bps) rates in the normal market area or the national rate on deposits outside such area. FHLB restrictions begin to apply. Risk-based deposit premiums will also increase.</p>	<p>The appropriate regulator must closely monitor the condition of, require a "capital restoration plan" from, limit growth by and limit access to the Federal Reserve's discount window by an undercapitalized bank. The appropriate regulator's approval is required for acquisitions, branching or entering new lines of business.</p>	<p>Executive bonuses or raises without regulatory approval are prohibited. The regulators must prohibit the payment of subordinated debt and must require the bank to undertake one or more of the following:</p> <ul style="list-style-type: none"> -sale of securities, -securities to be sold be voting stock, -eliminate the sister bank exemption to Section 23A, -further restrict transactions with affiliates, -limit interest rates paid, -require the bank to limit or terminate "excessively" risky activities, -improve management by: <ul style="list-style-type: none"> -requiring a new board to be elected, - dismissing any director or executive officer who has served at least 180 days, or - requiring the bank to hire executive officers, -prohibit deposits from correspondent banks, - require divestitures: <ul style="list-style-type: none"> . by the bank of any subsidiary, . by the bank's parent of any non depository affiliate, or .by the bank's parent of the bank itself, -require any other actions 	<p>A critically undercapitalized bank must be placed in conservatorship or receivership within 90 days of such a determination unless FDIC and appropriate regulators determine that other action would protect the deposit fund. Redetermination is required every 90 days. If bank is, on average, critically undercapitalized for 270 days, then a receiver must be appointed unless the bank:</p> <ul style="list-style-type: none"> • has positive net worth, • is in substantial compliance with an approved capital restoration plan, • is profitable, • is reducing its ratio of nonperforming loans to total loans, and • the FDIC chairperson and the appropriate regulator certify that the bank is both viable and not expected to fail. The FDIC must by regulation or order prohibit a critically undercapitalized bank, without approval, from: <ul style="list-style-type: none"> • entering into any material transaction not in the ordinary course of business, • extending credit for any highly leveraged transactions, • amending its Articles or bylaws,
<p>EC2</p>	<p>At least for internationally active banks,⁵⁶ the definitions of capital, risk coverage, method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.</p>					

⁵⁶ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully

(continued)

Description and findings re EC2	<p>For internationally active banks (defined by the agencies for these purposes as the advanced approaches banking organizations), the new capital rule provides for definitions of capital and risk coverage that are largely consistent with the applicable Basel standards. However, the FBAs highlighted that there are differences in methods of calculation and in prescribed requirements between the U.S. advanced approaches and the advanced Basel II approaches, related in particular to:</p> <ul style="list-style-type: none"> • the U.S. securitization framework, as the use of external ratings are prohibited by the DFA; and • the detailed minimum requirements of the advanced IRB approach. <p>These differences have been explored in the recent Regulatory Consistency Assessment Programme (RCAP) review of the adoption of the Basel risk-based capital standards (Basel II, 2.5 and III) by the U.S.⁵⁷</p> <p>Banking organizations that are subject to the advanced approaches under the new rule are also subject to a supplementary leverage ratio that is consistent with the Basel III leverage ratio.</p> <p>All banks and most bank holding companies are currently subject to the general risk-based capital framework that is broadly consistent with Basel I and, starting on January 1, 2015, will become subject to the corresponding rules under the new capital rule (standardized approach). The U.S. standardized approach is based on the Basel II standardized approach but has a number of differences. The FBAs highlighted that the U.S. approach:</p> <ul style="list-style-type: none"> • excludes a capital charge for operational risk and for Credit Value Adjustment (CVA) risk; and • specifies risk-weights for a range of assets instead of basing those risk-weights on external credit assessments, as per the Basel II approach (due to DFA requirements). <p>The BCP assessors were not in a position to quantify the materiality of these differences. However, in the absence of an explicit capital charge for operational risk and for the CVA, it is difficult for the assessors to satisfy themselves that the requirements of the new U.S. standardized approach are not lower than the applicable Basel standards.</p> <p>Under the new capital rule, a banking organization using the advanced approaches must use as its minimum capital ratio the lower of its ratios as calculated under the standardized approach or the advanced approaches. This creates a “floor” for the risk-based capital of such</p>
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consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

⁵⁷ At the time of the assessment, the RCAP report had not been published and therefore was not used as a source by assessors. Assessors had access to the preliminary RCAP report based on draft U.S. rules, as published by the Basel Committee on Banking Supervision (BCBS) in October 2012. The final RCAP report for the U.S. was published on 5 December 2014. The report concluded that the U.S. risk-based capital requirements for internationally active banks are “largely compliant” with the applicable Basel framework. The RCAP took into account a number of proposed amendments to the final capital rule announced by the U.S. authorities on 18 November 2014, after the preliminary RCAP assessment was completed. For the benefit of the reader, some references to the RCAP report finalized after this BCP assessment have been included in footnotes.

	<p>organizations and thereby provides that organizations that are using internal-ratings-based models, and those that are not, are subject to generally applicable capital requirements.⁵⁸</p> <p>Banking organizations, including those using the advanced approaches, with significant trading activity are also subject to the market risk rule. Covered savings and loan holding companies will be subject to the market risk rule in the new capital rule in the same manner as bank holding companies. (See 12 CFR 3.201(b); 12 CFR 217.201(b); 12 CFR 324.201(b)). The FBAs stated that the market risk requirements in the new capital rule are broadly consistent with the Basel market risk framework, including the 2011 revisions, but differ in the treatment of securitizations—in particular, the maintenance of a transitional rule for non-modeled securitization positions.⁵⁹</p>
EC3	<p>The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g. securitization transactions)⁶⁰ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.</p>
Description and findings re EC3	<p>The former capital standards require banks and bank holding companies to hold capital commensurate with the level and nature of all risks to which they are exposed. The new capital rule continues this requirement and also applies it to most savings and loan holding companies. The FBAs have broad statutory authority to establish minimum capital levels for a bank or holding company (see 12 U.S.C. §§ 3907(a)(2), 3909) and to impose specific capital charges on one or more exposures if the charge under the rules is not appropriate for the exposures. The Federal Reserve has also published guidance on how certain risk transfer transactions affect analysis of capital adequacy (SR 13-23, Risk Transfer Considerations When Assessing Capital Adequacy; SR 11-1, Impact of High-Cost Credit Protection Transactions on the Assessment of Capital Adequacy). However, the rules do not give the FBAs the power to directly limit material risk exposures, as mentioned in this EC. The FBAs can achieve the same result through their discretionary authority to alter capital requirements on a bank and through their general formal or informal enforcement actions in the case of threats to safety and soundness. The assessors saw ample evidence of this approach in the supervisory material reviewed, including setting specific minimum capital requirements for a bank or requiring a bank board to develop a capital plan to raise capital to a level commensurate with its risk profile.</p> <p>The FBAs consider risk-mitigating activities and off-balance sheet items directly in the regulations and in general when considering imposing higher requirements. The new capital rule expressly incorporates various risk-mitigating activities and off-balance sheet items such as guarantees, credit protection and collateral, in a manner consistent with the Basel capital framework.</p> <p>Under the FBAs' Uniform Financial Institutions Rating System (UFIRS), supervisors assess a</p>

⁵⁸ For information, the RCAP report broadly accepted that this “floor” would likely be at least as conservative as the Basel I floor for a typical U.S. bank.

⁵⁹ For information, taking this difference into account, the RCAP report concluded that the U.S. implementation of the market risk framework was “materially non-compliant”. Unlike the RCAP, the BCP assessment considers materiality but does not attempt to quantify it.

⁶⁰ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	<p>bank's capital adequacy during every full-scope examination. This assessment is reflected in the Capital component of the CAMELS rating and is an important component of the overall CAMELS composite rating, which also factors into the PCA requirements for banks that are not adequately capitalized. The Federal Reserve's RFI/C (D) rating system measures the overall performance and condition of bank holding companies. The "F" component rates the financial condition of the company, which includes an assessment of the adequacy of its capital. The RFI/C (D) is also used on an indicative basis for savings and loan holding companies.</p> <p>In assessing capital adequacy, the FBAs take into account, among other things: the level and severity of problem and classified assets; exposure to economic declines in capital as a result of interest rate, liquidity, funding, and market risks; the quality and level of earnings; investment, loan portfolio and other concentrations of credit; certain risks arising from nontraditional activities; the quality of loans and investments; the effectiveness of loan and investment policies; and management's overall ability to monitor and control financial and operating risks, including the risks presented by concentrations of credit and nontraditional activities.</p> <p>Supervisory material reviewed by the assessors confirmed the detail and thoroughness of assessments of capital adequacy across banks of varying sizes.</p>
EC4	<p>The prescribed capital requirements reflect the risk profile and systemic importance of banks⁶¹ in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.</p>
Description and findings re EC4	<p>The former capital standards and new capital rule for banks and holding companies reflect the risk profile of individual banks and holding companies and capture both on-balance-sheet and off-balance-sheet risks. However, the FBAs acknowledge that the rules do not explicitly address all material risks that banks and holding companies may face, particularly in the most sophisticated and competitive financial markets. Both the former capital standards and new capital rule acknowledge that risk profiles are dynamic and, accordingly, the FBAs expect banks and holding companies to have forward-looking capital plans. They also expect that banks and holding companies will operate at all times at capital levels commensurate with the risks to which they are exposed, including those not explicitly addressed by the capital guidelines. An FBA can impose higher capital levels if, in the supervisor's judgment, existing levels are not commensurate with the risks faced.</p> <p>In addition to the risk-based capital requirements, the FBAs also review a bank's or holding company's tier 1 leverage ratio when assessing its capital adequacy. Under the new capital rule, as noted above, banking organizations using the advanced approaches are also subject to a "supplementary leverage ratio". Further, bank holding companies with \$700 billion in total consolidated assets or more that \$10 trillion in assets under custody are subject to an enhanced leverage buffer greater than 2 percentage points (above the minimum 3 percent supplementary leverage ratio). That is, they must meet a total leverage ratio (tier 1 capital to</p>

⁶¹ In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>total on- and off-balance sheet assets) of at least 5 percent to avoid restrictions on capital distributions and discretionary bonus payments to executive officers. In addition, the insured depository institution subsidiaries of those bank holding companies must maintain a supplementary leverage ratio of at least 6 per cent to be considered “well-capitalized” under each agency’s PCA framework.</p> <p>FBA supervisors generally expect and require banks and bank holding companies to operate at capital levels well above the required minimums. PCA requirements for banks generally result in higher de facto risk-based and leverage capital requirements because there are disincentives for banks to fall below the “well-capitalized” category. In addition, bank holding companies that have elected to be financial holding companies (FHCs) have the incentive to ensure their bank subsidiaries or affiliates remain well capitalized so they can retain their FHC status in order to establish and retain certain non-banking financial subsidiaries and merchant banking investments. FHCs and bank and savings and loan holding companies themselves do not have a PCA requirement.</p> <p>Under section 165 of the DFA, the Federal Reserve is required to impose enhanced prudential standards on large bank holding companies, including large foreign-based bank holding companies, and nonbank financial companies designated by the FSOC for supervision by the Federal Reserve. The enhanced prudential standards must include standards related to capital and to stress testing. The Act directs the Federal Reserve to increase the stringency of the standards in line with the systemic footprint of the company. For foreign-based bank holding companies specifically, the Federal Reserve is to take into account comparability of home country standards, national treatment and equality of competitive opportunity. (See 12 U.S.C. § 5365). In applying these enhanced standards, the Federal Reserve is required to consider the systemic importance of the covered companies.</p> <p>In February 2014, the Federal Reserve approved a final rule pursuant to section 165 that establishes enhanced prudential standards for bank holding companies with more than \$50 billion in total consolidated assets. See 79 FR 17239. The rule is designed to enhance financial stability by addressing certain weaknesses in the U.S. regulatory framework that were revealed during the financial crisis and its aftermath. The capital plan rule (see EC 6), the stress-testing rule (see EC 6) and the enhanced supplementary leverage ratio rule represent the Federal Reserve’s capital-related enhanced prudential standards. A foreign-based BHC with a significant U.S. presence is required to establish an intermediate holding company over its U.S. subsidiaries, which will generally be subject to the same capital requirements as a U.S.-based BHC; this is intended to facilitate consistent supervision and regulation of the U.S. operations of the foreign bank.</p>
EC5	<p>The use of banks’ internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank’s processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank’s internal assessment process in order to determine that the relevant qualifying standards are met and that the bank’s internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor

	<p>considers it prudent to do so; and</p> <p>(e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.</p>
<p>Description and findings re EC5</p>	<p>Under the advanced approaches framework in the former capital standards and the new capital rule, subject banks and holding companies are required to use internally generated assessments of credit and operational risk as the basis for their regulatory capital requirements. The FBAs oversee the internal models created by subject banks and holding companies and, if the models are judged to be flawed, a bank or holding company can be required to change its models.</p> <p>Use of the advanced approaches framework is subject to rigorous qualifying criteria, described in the capital rules, which must be met on an initial and ongoing basis. Before moving to the advanced approaches, a banking organization must complete a parallel run of at least four consecutive calendar quarters, and during which the banking organization's primary FBA supervisor deems compliance with the qualification requirements to be satisfactory. During the parallel run, a banking organization is subject to the general risk-based capital rules or the standardized approach (subject to transitions arrangements) for all applicable regulatory and supervisory purposes, but it must also calculate its capital ratios using the advanced approaches and report pertinent information to its primary FBA supervisor. If the FBA supervisor determines that a banking organization that has been approved to use the advanced approaches subsequently fails to comply with the qualification requirements, the banking organization will be notified and must submit a plan satisfactory to the FBA to return to compliance. Failure to do so could result in revocation of the approval to use the advanced approaches, in which case a bank would be required to revert to the standardized approaches.</p> <p>A bank or holding company is required to notify its primary FBA supervisor when it makes any change to a system that would result in a material change to the risk-weighted asset amount of an exposure type, or when the bank or holding company makes any significant change to its modeling assumptions.</p> <p>If the primary FBA supervisor determines that a banking organization's risk-based capital requirements are not commensurate with credit, market, operational or other risks, the supervisor may require the banking organization to calculate its risk-based requirements under the advanced approaches with any modifications established by the supervisor or under the general risk-based capital rule until January 1, 2015, and then the new capital rule after that date. In addition, a banking organization applying the market risk rule must obtain prior approval from its primary FBA supervisor before using an internal model to calculate market risk-weighted assets and must continue to satisfy specific requirements to continue using the internal model. These specific requirements include that the model's sophistication be commensurate with the complexity and amount of covered positions, that the model properly measures all material risks and that the model conservatively assesses risks arising from less liquid positions.</p> <p>The general risk-based capital rules under the former capital standards generally do not allow use of internal estimates. A banking organization that meets strict requirements may use an internal risk-rating approach for certain exposures to asset-backed commercial paper programs. Similarly, the standardized approach under the new capital rule generally does not allow use of internal estimates; however, there are limited exceptions, which generally require supervisory approval prior to use.</p>
<p>EC6</p>	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital</p>

	<p>management (including the conduct of appropriate stress testing).⁶² The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	<p>All banking organizations must hold capital commensurate with a forward-looking view of their risk profile. The FBAs have the power to require corrective action if, in their judgment, a bank's current or prospective capital plans are inadequate and cause it to be in an unsafe or unsound condition.</p> <p>The Federal Reserve has established capital planning and stress testing requirements for bank holding companies with total consolidated assets greater than \$50 billion. See <i>12 CFR part 252; 12 U.S.C. 5365(i)</i>. The stress test requirements establish a framework for the Federal Reserve to conduct annual supervisory stress tests to evaluate whether these institutions have the capital necessary to absorb losses as a result of adverse economic conditions using scenarios provided by the FRB; these companies are also required to conduct semi-annual company-run stress tests. Additionally, in October 2012, the FBAs individually published final rules implementing section 165(i)(2) of the DFA, which requires financial companies with more than \$10 billion in assets to conduct annual stress tests themselves ("annual company-run stress tests") using scenarios provided by the FBAs. The FBAs have issued final guidance describing supervisory expectations for stress tests conducted by these companies. The scenarios for the supervisory and annual company-run stress tests are the sets of conditions that affect the U.S. economy or the financial condition of a covered company that the relevant FBA annually determines are appropriate including, but not limited to, baseline, adverse and severely adverse scenarios.</p> <p>In addition, bank holding companies with assets greater than \$50 billion are subject to specific, annual capital planning requirements. See 12 CFR 225.8. Each company is required to submit an annual capital plan to the FRB that contains estimates of its minimum regulatory capital ratios and its tier 1 common ratio under expected conditions and a range of stressed scenarios over a nine-quarter planning horizon. A capital plan also must include a discussion of how the company will, under expected conditions and stressed scenarios, maintain regulatory capital ratios and a pro forma tier 1 common ratio above 5 per cent and maintain sufficient capital to continue its operations by maintaining ready access to funding, meeting its obligations to creditors and other counterparties, and continuing to serve as a credit intermediary.</p> <p>The Federal Reserve's annual Comprehensive Capital Analysis and Review (CCAR) is an intensive assessment of the capital adequacy of bank holding companies with assets greater than \$50 billion and of the practices these companies use to manage their capital. The Federal Reserve expects each company to incorporate, as part of its capital-planning process, analysis of the potential for significant and rapid changes in the risks it faces, including risks generated by a marked deterioration in the economic and financial environment, as well as pressures that may stem from firm-specific events. Through CCAR, a BHC's capital adequacy is</p>

⁶² "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverse stress testing.

	<p>evaluated on a forward-looking, post-stress basis; the companies are required to demonstrate in their capital plans and in a supervisory post-stress capital analysis (stress test) how they will maintain, throughout a very stressful period, capital above a tier 1 common ratio of 5 per cent and above minimum regulatory capital requirements. Additionally, in CCAR the Federal Reserve expands upon its firm-specific supervisory practices by undertaking a simultaneous, horizontal assessment of capital adequacy and capital planning practices at the largest bank holding companies. The Federal Reserve has significantly heightened supervisory expectations for the largest and most complex bank holding companies and expects them to have the most sophisticated, comprehensive and robust capital planning practices. After qualitative and quantitative assessment, the Federal Reserve either objects to, or provides a non-objection to, each company's capital plan; these decisions and the supporting assessment are released publicly. In the case of an objection, the company may not make any capital distribution unless the Federal Reserve indicates that it does not object to the distribution.</p> <p>For banking organizations not subject to CCAR, the FBAs collect data on the organization's quantitative projections of balance sheet assets and liabilities, income, losses and capital across a range of macroeconomic scenarios. They also review qualitative supporting information on the methodologies used to develop internal projections of capital across stressed economic scenarios. The results of the annual company-run stress tests are subject to onsite supervisory examination and inspection. These stress test results provide the FBAs with forward-looking information that assists in assessing an organization's risk profile and whether it has sufficient capital to continue operations throughout times of economic and financial stress.</p> <p>A key component of the annual stress test is the stress test scenarios. Each scenario includes the values of the variables specified for each quarter over a nine-quarter stress test horizon. The variables generally address economic activity, asset prices and other measures of financial market conditions for the U.S. and key foreign countries. The FBAs consult with each other annually to determine scenarios that are appropriate for use for each annual stress test.</p>
Additional criteria	
AC1	<p>For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.</p>
Description and findings re AC1	<p>As noted in EC2 above, all banks and most bank and savings and loan holding companies will become subject to the new capital rule (standardized approach), from January 1, 2015. The U.S. standardized approach provides for definitions of capital that are largely consistent with Basel III. However, the FBAs have highlighted that there are differences in risk coverage and method of calculation between the two approaches. The U.S. approach:</p> <ul style="list-style-type: none"> • excludes a capital charge for operational risk and for CVA risk; and • specifies risk-weights for a range of assets instead of basing those risk-weights on external credit assessments as per the Basel II approach. <p>The assessors were not in a position to quantify the materiality of these differences. However, in the absence of an explicit capital charge for operational risk and for the CVA, it is difficult for the assessors to satisfy themselves that the requirements of the new U.S. standardized approach are not lower than the applicable Basel standards.</p> <p>Section 171 of the DFA requires the FBAs to establish, on a consolidated basis, minimum risk-</p>

	based and leverage capital requirements for bank holding companies, savings and loan holding companies, and nonbank financial companies that “shall not be less than” the generally applicable capital requirements for insured depository institutions. Further, the minimum capital requirements cannot be “quantitatively lower than” the generally applicable capital requirements for insured depository institutions that were in effect in July 2010.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁶³
Description and findings re AC2	<p>The FBAs apply minimum capital requirements at both the bank (including its subsidiaries) and holding company levels. Other prudential supervisors of holding company subsidiaries may set minimum capital requirements for those subsidiaries.</p> <p>The FBAs expect the distribution of capital among entities within a banking group to reflect the risks presented by those entities. Other subsidiaries also are expected to maintain appropriate levels of capital that are, if applicable, consistent with the expectations of supervisors with oversight responsibilities. If an FBA believes a bank or holding company is operating in an unsafe or unsound manner, including after taking into account affiliate capital adequacy, the FBA can require it to hold more capital. By statute, bank holding companies and savings and loan holding companies are required to serve as sources of financial strength for any subsidiaries that are depository institutions. See 12 U.S.C. § 1831o-1. However, the Federal Reserve is limited by statute in its ability to require that regulated broker-dealers or insurance companies within a holding company structure provide funds or other assets to an affiliated depository institution. See 12 U.S.C. § 1844(g).</p> <p>Bank holding companies with consolidated assets of less than \$500 million are generally exempt from the calculation and analysis of risk-based capital ratios on a consolidated holding company basis, subject to certain terms and restrictions. However, the Federal Reserve may apply the risk-based capital rules at its discretion to any BHC, regardless of asset size, if such action is warranted for supervisory purposes.</p>
Assessment of Principle 16	Largely Compliant
Comments	The FBAs have a robust and comprehensive approach to setting prudent and adequate capital adequacy requirements for banks and most holding companies, and this approach has been strengthened since the financial crisis in response to the Basel and DFA reform initiatives. In the process, a number of concerns raised in the 2010 DAR have been addressed. The broad adoption of the Basel III definition of capital, when fully implemented, will improve the quality of bank capital by limiting the extent to which certain intangibles, which had previously counted for a high proportion of bank capital, can be included in regulatory capital. The introduction of risk-based capital rules based on Basel standards for most savings and loan holding companies removes an anomaly created by the previous case-by-case determination of capital requirements for such companies. However, savings and loan holding companies with substantial insurance or commercial activities are excluded from the new regulatory capital rules. Although such companies have a relatively small market share, their exclusion could over time create safety and soundness, and competitive neutrality, issues and the assessors would encourage the Federal Reserve to complete the task of establishing a comprehensive capital framework for holding companies.

⁶³ Please refer to Principle 12, Essential Criterion 7.

	<p>Stress testing has now become an essential element of capital adequacy assessments for banking organizations with more than \$10 billion of assets. As it is evolving, the stress-testing regime is entrenching a forward-looking approach to capital needs and engaging boards and senior management more fully in the capital planning process. These are positive developments. At the same time, the regime is very data-and-resource-intensive, for both firms and supervisory agencies. Looking ahead, the assessors believe that the credibility of the stress-testing regime would be further enhanced if the regime were able to avoid excessive granularity and secure the continued engagement of boards by the use of scenarios that readily meet the “severe but plausible” test.</p> <p>Compliance with this CP requires the assessors to satisfy themselves that the capital adequacy regime for internationally active banks is “not lower” than the relevant Basel standards (EC 2) and that for non-internationally active banks is “broadly consistent” with the standards (AC1). The U.S. regulatory capital framework is in a state of transition. The FBAs have implemented major elements of the Basel II advanced approaches from 1 January, 2014 and the U.S. standardized approach based on Basel II will begin to come into effect from 1 January, 2015. Until that point, most banking organizations remain subject to the former capital standards, but the assessors saw little sense in assessing former standards against Core Principle 16 at this late stage.</p> <p>The assessors acknowledge that U.S. banking organizations generally have risk-based capital ratios above, and in many cases well above, relevant Basel minimum capital requirements. However, EC 2 and AC 1 refer not just to thresholds but also to definitions of capital, the risk coverage and the method of calculation. In those areas, the FBAs have indicated that there are a number of differences between the new capital rule and the relevant Basel framework. Some aspects of these differences have weighed particularly on the assessors’ judgment that a rating of “Largely Compliant” is warranted at this time. Firstly, the risk-based capital requirements for internationally active banks under the advanced approaches are different in a number of respects to the Basel framework, as detailed above. In addition, the U.S. standardized approach, which provides the “floor” for the advanced approach banking organizations and applies to all other banking organizations, does not impose a capital charge for operational risk or for CVA risk (and there are also some divergences regarding the standardized approach to market risk). This is a significant omission in risk coverage, and it distinguishes the U.S. capital regime from other major jurisdictions. While the leverage ratio requirements provide an important backstop against operational and other risks, a leverage ratio framework was never intended to replace the Basel risk-based framework, which requires that significant identifiable risks to banking organizations be explicitly incorporated in minimum capital requirements. In addition, the absence of capital charges for operational risk and CVA makes the “standardized” floor less binding than it may appear.⁶⁴</p>
<p>Principle 17</p>	<p>Credit risk.⁶⁵ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic</p>

⁶⁴ The conclusions of this assessment are independent from the RCAP findings. Nevertheless, the RCAP report published after this assessment corroborates the assessors’ understanding. The report considered the risk-based capital requirements for internationally active banks under the advanced approaches “largely compliant” with the applicable Basel framework. The report also concluded that the U.S. implementation of the market risk framework was “materially non-compliant” with the Basel framework.

⁶⁵ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

	conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁶⁶ (including counterparty credit risk) ⁶⁷ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank’s loan and investment portfolios.												
Essential criteria													
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.												
Description and findings re EC1	<p>All Banks</p> <p>Banks and holding companies are subject to extensive credit-risk management requirements which provide a comprehensive bank-wide view of credit exposures. . The U.S. federal banking regulations are set out in Table 17.1.</p> <table border="1" data-bbox="479 777 1344 1201"> <thead> <tr> <th>Table 17.1 Requirement</th> <th>Federal Reserve</th> <th>OCC</th> </tr> </thead> <tbody> <tr> <td>Loan documentation and credit underwriting</td> <td>12 CFR part 208, appendix D-1, part II(C), (D)</td> <td>12 CFR part 30, appendix A, part II (C), (D)</td> </tr> <tr> <td>Capital adequacy guidelines</td> <td>12 CFR part 225, appendix G</td> <td>12 CFR part 3, appendix C</td> </tr> <tr> <td>Real estate lending standards and setting requirements for lending policies</td> <td>12 CFR part 208, subpart E</td> <td>12 CFR part 34, subpart D</td> </tr> </tbody> </table> <p>These references are further developed in extensive supervisory guidance and related materials. For example, on sub-prime (SR08-2), non-traditional mortgage guidance (SR06-15) and prudent commercial real estate loan workouts (SR09-7). Together, these sources require that banks and holding companies establish, review, update (as appropriate), and implement credit-risk management strategies, policies, and procedures for identifying, measuring, controlling, and reporting on credit risk (including counterparty risk). Also, the U. S. FBAs support the BCBS’s releases of Principles for the Management of Credit Risk (September 2000) and Sound credit risk assessment and valuation for loans (June 2006).</p> <p>Supervisors adhere to the Uniform Financial Institutions Ratings System (UFIRS) and evaluate every bank against UFIRS guidelines during on-site examinations. UFIRS has a specific component to rate asset quality (A), which directly couples supervisory assessments of each bank’s assets and the credit-risk management of those assets. These assessments incorporate</p>	Table 17.1 Requirement	Federal Reserve	OCC	Loan documentation and credit underwriting	12 CFR part 208, appendix D-1, part II(C), (D)	12 CFR part 30, appendix A, part II (C), (D)	Capital adequacy guidelines	12 CFR part 225, appendix G	12 CFR part 3, appendix C	Real estate lending standards and setting requirements for lending policies	12 CFR part 208, subpart E	12 CFR part 34, subpart D
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⁶⁶ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁶⁷ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	quantitative measurements of delinquent, troubled, and classified assets, as well as qualitative evaluations of the adequacy of board of directors (board) and senior management oversight, credit policies, procedures and limits, risk-management practices, internal control mechanisms, and management information systems. The relative importance of the qualitative considerations depends on the risk characteristics and circumstances particular to the bank. Further, peer practice comparisons and data analyses are also integral parts of the evaluation process and, when available and relevant, may be used in assigning a rating.
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, ⁶⁸ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	Supervisors assess whether the board understands (1) the credit risk involved in the activities; (2) communicates its risk appetite to management; and (3) delegates the development of comprehensive policies, procedures, and controls. Supervisors review the quality of aggregated management information provided to the board to test whether these reports are comprehensive and timely and accurately reflect the level and nature of credit risk. To assess board involvement in credit-risk oversight, supervisors will review minutes of board meetings and meetings of board committees, management committees, and other records, as needed. Furthermore, supervisors determine whether the board approves and regularly reviews the adequacy of significant policies and procedures for credit underwriting and for identifying, measuring, monitoring, and controlling credit-risk activities. Supervisors review compliance with supervisory guidance on credit-risk management (which is taken to be identification, measurement, monitoring and mitigation), as well as compliance with internal credit-risk management strategies and risk-management policies, by conducting interviews, reviewing internal policies and procedures, and performing transaction testing.
EC3	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: <ul style="list-style-type: none"> (a) a well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification

⁶⁸ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<p>system;</p> <p>(d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an on-going basis;</p> <p>(e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff;</p> <p>(f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and</p> <p>(g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.</p>
Description and findings re EC3	<p>Supervisors have issued guidance on sound risk-management practices for credit-risk and loan portfolio management. They have published examination manuals that they supplement with specific topical guidance.</p> <p>During the course of examinations, supervisors review banks' and holding companies' compliance with the guidance including evaluating whether banks and holding companies have established effective risk management systems for identifying, measuring, monitoring, and controlling credit risk in their banking activities. When evaluating the adequacy and effectiveness of credit-risk management practices, supervisors generally consider, as applicable based on the size, complexity, and risk profile of the bank or holding company, whether:</p> <ul style="list-style-type: none"> ○ Credit-risk policies are comprehensive and well documented, and whether they accurately reflect existing credit-risk strategies and objectives. Policies and procedures must provide for adequate identification, measurement, monitoring, and control of the credit risks posed by the lending, investing, trading, trust, fiduciary, and other significant activities. ○ Since the last BCP Assessment the Federal Reserve, for example, have issued new credit risk-related guidance <ul style="list-style-type: none"> ● Loan Coverage Requirements in Community State Member Banks (SR 14-7) ● Interagency Guidance on Home Equity Lines of Credit Nearing Their End-of-Draw Periods (SR 14-5) ● Supervisory Approaches for Qualified and Non-Qualified Mortgage Loans (SR 13-23) ● Guidance on Managing Outsourcing Risk (SR 13-19) ● Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions (SR 13-18) ● Supervisory Guidance on Troubled Debt Restructurings (SR 13-17) ● Interagency Guidance on Leveraged Lending (SR 13-3) ● Guidance on a Lender's Decision to Discontinue Foreclosure Proceedings (SR 12-11) ● Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned (OREO) (SR 12-10) ● Policy Statement on Rental of Residential Other Real Estate Owned (OREO) Properties (SR 12-5)

	<ul style="list-style-type: none"> • Interagency Guidance on Allowance Estimation Practices for Junior Lien Loans and Lines of Credit (SR 12-3) • Agricultural Credit Risk Management (SR 11-14) • Disposal of Problem Assets Through Exchanges (SR 11-15) • Counterparty Credit Risk Management (SR 11-10) • Guidance on Model Risk (SR 11-7) • Underwriting Standards for Small Business Loans Originated under the Small Business Lending Fund Program (SR 10-17) • Interagency Appraisal and Evaluation Guidelines (SR 10-16) <ul style="list-style-type: none"> ○ Proposed and current credit activities are consistent with the overall business strategy, stated goals and objectives, and established risk tolerances, as well as the overall financial strength. ○ Policies and procedures require the review and approval by key risk and control personnel of all new credit products and that the policies ensure that the bank or holding company establishes the necessary risk and control infrastructures to identify, monitor, and control the varied risks associated with new credit activities before these activities are initiated. ○ Credit administration practices include initial and on-going borrower and counterparty analyses; comprehensive legal documentation; credit covenant and collateral documentation; transaction due diligence; credit-underwriting criteria; pricing decision tools; borrower and portfolio limit and concentration monitoring; payment and collections procedures; workout and restructuring processes; and loan loss reserving. ○ The bank or holding company maintains documentation supporting its analysis of a customer’s ability and willingness to repay a loan or other exposure at the time it is extended, renewed, or restructured. Supervisors also consider whether the bank or holding company maintains (i) information relating to the borrower’s financial condition, collateral, and its valuation and (ii) other pertinent documents, such as guarantor information, loan agreements, proof of security interest in collateral, and adherence to loan covenants. ○ The bank or holding company employs risk rating/grading systems that accurately assess the absolute and relative credit risk across the bank’s or holding company’s credit portfolios. Supervisors also consider whether the risk-rating system accurately defines and delineates borrower/counterparty credit quality, allows measurement of credit migration, and drives management decision-making. ○ Stress testing processes are effective in identifying the impact of (i) portfolio-level stress events on asset quality, earnings, and capital; (ii) business-level stress on credit concentrations; and (iii) downside scenarios on individual credit exposures. ○ The bank or holding company management information systems are effective for reporting, managing, and monitoring portfolio-level and business-level credit risk exposures. Supervisors also consider whether the bank or holding company: <ul style="list-style-type: none"> • Has management information systems that are structured to monitor current and potential exposures against established limits and strategic goals and objectives; and • Submits reports to management that are timely and contain sufficient information for decision makers to evaluate the level and trend of credit risk faced by the bank or holding company, including reports that make the following information readily
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	<p>available and routinely reviewable: total credit exposure, including loans and commitments; loans in excess of existing credit limits; new extensions of credit, credit renewals, and restructured credits; a listing of all delinquent and/or nonaccrual loans; credits adversely graded or requiring special attention; credits to insiders and their related interests; credits not in compliance with internal policies, laws, or regulations; and specific lending activity aspects, "outsized" credit exposures, and analyses of credit exposure by type, geographic areas, and collateral.</p> <ul style="list-style-type: none"> ○ The bank or holding company has developed governance and control mechanisms for all aspects of model risk management, including the development, implementation, use, and validation procedures. Supervisors will also confirm that model risk management encompasses policies and procedures, as well as board and senior management oversight. ○ The bank or holding company has policies and procedures governing problem loan management including delinquency and charge-off practices. Supervisors determine whether (i) policies, procedures, and processes are in place for the timely identification of problem loans and (ii) there are criteria for providing a full awareness of the risk position, informing management and directors of that position, taking steps to mitigate risk, and properly assessing the adequacy of the allowance for credit losses and capital. ○ The loan review process discharges its duties appropriately. This may include verifying loan grading processes, assessing portfolio-management processes, evaluating credit-risk management, and confirming credit administration procedures, depending on the size and risk. ○ Management promptly and accurately identifies loans or portfolios with potential or well-defined credit weaknesses and ensures the development and implementation of an appropriate action plan, including restructuring and workout processes, to minimize credit losses. ○ Policies and procedures for the Allowance for Loan and Lease Losses comply with both accounting and supervisory guidance. ○ The bank or holding company has implemented a system that clearly identifies portfolio business risks, as well as transaction and portfolio risk limits, and includes processes to (i) confirm compliance with these limits, (ii) require review and approval of limits, and (iii) detect, address, and report exceptions to the limits. Supervisors also determine if risk limits are established to address borrower/counterparty, industry, and geographic concentration risks, as well as unique risk factors such as commodity-reliant industries or complex structured securitizations. If an exception to a limit is made, supervisors validate that the process ensures that specific credit oversight and approval procedures are required. ○ The bank or holding company has adequate risk-management practices for approving, monitoring, and controlling third-party (<i>i.e.</i>, indirect) originations. Supervisors determine whether banks and holding companies perform comprehensive due diligence on third-party originators prior to entering a relationship. In addition, supervisors determine whether adequate audit procedures and controls verify that third parties are not generating credit exposure outside of the established underwriting criteria. Supervisors determine whether third-party audit procedures (i) include monitoring the quality of loans by origination source and (ii) enable management to identify problems, such as early payment defaults and incomplete packages, and take appropriate action, as needed. ○ The bank or holding company has comprehensive, formal strategies for managing risks in
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	<p>secondary market activities. Supervisors determine whether contingency planning includes how the bank or holding company will respond to reduced demand in the secondary market.</p> <p>The expectations for each of these components will vary based on the size and complexity of the institution, but there are no hard and fast rules. Smaller, less complex banks and holding companies will generally not require every element in the above list but are required to have effective policies and procedures to identify, measure, monitor, and control their credit-risk exposures.</p>
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	<p>Supervisors recognize the importance of requiring an institution to assess a borrower’s global (total) indebtedness (including any unhedged foreign exchange risk), especially in times of economic stress. This principle was set out in the Interagency Policy Statement on the Review and Classification of CRE Loans (November 1991 guidance). More recently, in October 2009, the U.S agencies issued guidance to banks or holding companies on the importance of evaluating and monitoring a borrower’s ability to repay all debt obligations (that is, the total indebtedness or global debt of the borrowing entity) in credit and workout decisions. The October 30, 2009, Interagency Policy Statement on Prudent CRE Loan Workouts addresses this supervisory expectation by noting that a regulated institution is expected to analyze repayment capacity of the borrower by evaluating “the nature and degree of protection provided by the cash flow from business operations or the collateral on a global basis that considers the borrower’s total debt obligations.” Further, the guidance notes that an analysis of the borrower’s global debt service reflects a realistic projection of the borrower’s and guarantor’s expenses. The guidance explains that “global debt represents the aggregate of a borrower’s or guarantors financial obligations, including contingent obligations” and provides an example to explain that this analysis is important in determining accrual status of a particular loan.</p> <p>The assessors also saw a number of examples of supervisors requiring banks to consolidate debt positions for customers, where the bank had been treating them separately.</p>
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm’s length basis.
Description and findings re EC5	<p>Supervisors require banks and holding companies to develop policies that (i) define and address real and potential conflicts of interest and (ii) acknowledge that credit decisions are to be given an independent and complete credit evaluation and, in certain situations, require board approval. They require banks and holding companies to establish a functionally independent credit-approval function to maintain consistency with credit-origination criteria, review the credit analysis, and check adherence to credit limits. Supervisors also expect that the risk-management function and the process of measuring, monitoring, and controlling risks are sufficiently independent from those individuals who have the authority to initiate transactions. The practices implementing these expectations vary, however, depending on the size and complexity of the supervised bank or holding company.</p> <p>Supervisors will determine whether banks and holding companies have developed policies and risk-management practices to prevent conflicts of interest from influencing credit-underwriting decisions. Supervisors will review credit-approval policies, credit analysis and approval procedures, credit files and approval records, credit committee minutes, loan/credit review, and internal audit procedures to ensure that conflicts of interest are appropriately</p>

	<p>identified and properly controlled.</p> <p>During the course of examinations, supervisors review credit files and other information to ensure that loans are underwritten and approved on an arm’s length basis. Supervisors may review extensions of credit issued to employees, officers, directors, principle shareholders, or related interests of such persons. Such loans are reviewed to determine whether they (i) were made on substantially the same terms as those prevailing at the time for comparable arm’s length transactions, (ii) involve greater-than-normal risk of repayment or default, or (iii) have other unfavorable features, such as not being supported by adequate credit information or being in violation of lending limitations. Regulation O specifically addresses procedures for extensions of credit to executive officers, directors, principal shareholders and their related interests.</p> <p>Furthermore, supervisors review approved credit decisions to ensure that policies and procedures were followed and that assessments of a borrower’s ability to repay the credit were appropriately conducted and documented. Similar procedures apply to wholesale and consumer credit, trading, investment, and available for sale approvals, all of which should be independently reviewed as part of a bank’s internal credit review or internal loan review function.</p>
EC6	<p>The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank’s capital are to be decided by the bank’s Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank’s activities.</p>
Description and findings re EC6	<p>Supervisors review policies and procedures to ensure that banks establish limits on their credit exposures and that such limits and approval authorities are clearly defined. Supervisors ensure that credit policies describe the manner in which exposures will be approved and ultimately reported to the board. However Supervisors would have to make a determination that the absence of clear limits for escalation to the Board or senior management would be an unsafe and an unsound practice in order to make this a requirement.</p> <p>Supervisors review the approved credit authorities to ensure that the levels of authority are granted to appropriate, experienced staff. Supervisors ensure that policies require that concentrations that involve excessive or undue risks receive close scrutiny by the bank and holding company, and may test credit transactions to ensure that credit approvals comply with policy requirements. For example, the agencies’ Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices directs banks and holding companies with commercial real estate concentrations to (i) evaluate the correlation between related real estate sectors, (ii) establish internal lending guidelines and concentration limits, and (iii) maintain adequate capital for those exposures. The board, or a committee thereof, is to periodically review and approve those risk-exposure limits. The Guidance also sets out exposure thresholds that are expressed as a percentage of a bank’s or holding company’s capital that may signify potential significant exposures that may warrant increased supervisory scrutiny.</p> <p>Supervisors also review policies, procedures, and controls to ensure they address adherence to regulatory mandated limits. For example, all member banks of the Federal Reserve System are subject to limits on extensions of credit to insiders and transactions with affiliates and loans and extensions of credit made by national banks and savings associations are subject to additional lending limits. State-chartered banks have limits imposed by each state regulator, but such limits are generally consistent with those established by the OCC.</p> <p>Real estate lending regulations include supervisory loan-to-value limits for certain categories</p>

	<p>of real estate loans and capital limitations on the aggregate amount of loans that exceed those limits. They also require that the aggregate amount of those exceptions must be reported at least quarterly to the board and that supervisors also review compliance with regulatory restrictions on granting credit for the purpose of purchasing stock or other securities.</p> <p>Supervisors have issued guidance on risk-management practices for specific product types, and they review practices during on-site examinations to ensure consistent and appropriate application.</p>
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	<p>Under the U.S. FBAs' statutory examination authority, supervisors may review all books and records maintained by a bank (and its affiliates) subject to the agencies' supervision, as well as employees involved in a matter under review and bank service companies and independent servicers subject to the Bank Service Company Act. Supervisors also evaluate significant third-party service providers and require that banks and holding companies, in their contracts with third-party service providers, include agency access to the books, records, and operations of these entities.</p> <p>Supervisory guidance also specifies the credit management information that banks and holding companies are expected to maintain, including details on credit and investment portfolios. In addition, supervisors are allowed and generally given full access during examinations to this information and to employees, who assume, manage, control, and report on credit risk.</p>
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	<p>Banking Institutions with less than \$10bn of Assets</p> <p>There is no stress testing requirement.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>The DFA introduced some risk management and stress testing standards for institutions between \$10bn and \$50bn (such as annual company-run stress tests). These cover all credit risks.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve has established, through its Capital Plan Rule and its annual CCAR, additional requirements for Bank Holding Companies with at least \$50bn in assets to ensure they properly assess their risks (including those arising during adverse conditions) and maintain sufficient capital to support those risks. The Federal Reserve's Capital Plan Rule, along with subsequent capital planning guidance, establishes requirements for firms to have effective processes for ensuring they have sufficient levels of capital in both normal and stressed conditions. The firms are required to have internal processes for assessing their capital adequacy that reflect a full understanding of their risks and ensure that they hold capital corresponding to those risks to maintain overall capital adequacy. These cover all credit risks.</p> <p>Agencies will assess an institution's stress testing framework in accordance with the above regulations and guidance that advise a banking organization to establish a stress testing framework that encompasses five principles:</p>

	<ul style="list-style-type: none"> • A stress-testing framework should include activities and exercises that are tailored to and sufficiently capture the banking organization’s exposures, activities, and risks. This principle specifically states that credit risk exposure may be included in the overall stress-testing framework. • An effective stress-testing framework employs multiple conceptually sound stress testing activities and approaches. • An effective stress-testing framework is forward-looking and flexible. • Stress test results should be clear, actionable, well supported, and inform decision-making. • An organization’s stress testing framework should include strong governance and effective internal controls.
Assessment of Principle 17	Compliant
Comment	<p>The U.S. Approach to Credit Risk is exceptionally codified in both regulation and guidance and reflects the emphasis placed on this risk by all of the Supervisors. Indeed the assessors did see examples of firms where even though the supervisor had evaluated that the major risks of an institution were not credit, say they were operational risk, there was still substantial material on credit in regular reports that they were compiling. There is a risk that the bias towards credit assessment (understandable though that is) could drown out adequate consideration of other risks in banks.</p> <p>The assessors judged that one of the Essential Criteria (6) was not met given there are no specific requirements to that effect. However the assessors found evidence that such limits were in place in the banks themselves and also in no doubt that if they were absent the agencies would determine such practice as unsafe and unsound and as such would have authority to require such limits and escalation criteria in individual cases. Our concerns on general Board involvement are expressed in CP 14.</p> <p>The absence of specific limits runs three risks as far as the assessors can determine: (i) a policy limit would provide a signal as to what authorities regard as acceptable, as such it can have a powerful preventative effect; (ii) the time gap between breaking a threshold and action is short and not as now where supervisors tend to first ask for a plan of rectification; (iii) a limit provides a useful reference point for offsite and continuous monitoring and can indicate when a bank might need to be reviewed by supervisory management. The assessors recognize that potentially this would restrict supervisory discretion. The assessors would however, still recommend that in forthcoming guidance, limits are codified.</p>
Principle 18	Problem assets, provisions and reserves. ⁶⁹ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁷⁰
Essential criteria	

⁶⁹ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁷⁰ Reserves for the purposes of this Principle are “below the line” non-distributable appropriations of profit required by a supervisor in addition to provisions (“above the line” charges to profit).

EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>The safety-and-soundness provision of the FDI Act (<i>12 U.S.C. §1831p-i(b)</i>) requires the FBAs to establish standards related to asset quality. The interagency safety-and-soundness guidelines implementing this provision require a bank to establish and maintain a system to identify problem assets and prevent deterioration in those assets. The system should be commensurate with the bank's size and the nature and scope of its operations. In addition, the bank is expected to (a) conduct periodic asset quality reviews to identify problem assets; (b) estimate the inherent losses in those assets and establish allowances/reserves that are sufficient to absorb estimated losses; (c) compare problem asset totals to capital; (d) take appropriate corrective action to resolve problem assets; (e) consider the size and potential risks of material asset concentration; and (f) provide periodic asset reports with adequate information for management and the board to assess the level of asset risk.</p> <p>U.S. federal law provides that the accounting principles applicable to reports or statements required to be filed with FBAs generally must be uniform and consistent with U.S. GAAP. U.S. GAAP includes guidance on accounting for impairment in a loan portfolio and other credit exposures. In certain situations, the FBAs can prescribe alternative accounting principles, provided the alternate principles are "no less stringent" than U.S. GAAP. However, such prescriptions are rare.</p> <p>The FBAs have issued and, as warranted, periodically updated the December 2006 "Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL)", addressing the supervisory expectations about the application of and documentation supporting a bank's ALLL. This policy statement elaborates on the asset quality obligations set out in the interagency safety-and-soundness guidelines. The 2006 statement includes, among other matters, (a) the responsibilities of boards, management and supervisors of banks regarding the ALLL; (b) factors to be considered in the estimation of the ALLL; and (c) the objectives and elements of an effective loan review system, including a sound credit-grading system. The statement emphasizes that each bank is responsible for developing, maintaining and documenting a comprehensive, systematic and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses.</p> <p>To fulfill this responsibility, each bank is expected to ensure that controls are in place to consistently determine the ALLL in accordance with U.S. GAAP, stated policies and procedures, management's well-reasoned, supported and documented judgment, and relevant supervisory guidance. The 2006 statement requires banks to identify incurred losses estimated in accordance with U.S. GAAP, including credit losses in off-balance-sheet credit exposures, resulting from commitments and explicit and implicit recourse. Separate interagency guidance addresses the appropriate accounting and reporting treatment for certain loans that are sold directly from the loan portfolio or transferred to a held-for-sale account. The Federal Reserve expects holding companies to follow interagency policy statements and reviews this during examinations.</p> <p>The FBAs also expect banks and holding companies to perform reasonable stress tests based on adverse scenarios and assumptions that could have serious effects in the future. The FBAs expect banks and holding companies to consider the impact of contingent exposures arising from loan commitments, securitization programs, counterparty credit and other transactions.</p> <p>In December 2012, the Financial Accounting Standards Board (FASB) issued an exposure draft</p>

	of the proposed new accounting standard for credit losses on certain financial instruments. The FASB's proposal would replace the current allowance method, under which credit loss recognition is delayed until a credit loss has been incurred, with a Current Expected Loss Model (CELM), under which an institution would be required to estimate all expected shortfalls in contractually required cash flows by considering past events, current conditions and reasonable and supportable forecasts. This proposal is still being finalized.
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes
Description and findings re EC2	<p>The FBAs confirm the adequacy of a bank's loan classification, loss-provisioning process and overall capital adequacy during each supervisory cycle. External experts are generally not used to support the supervisor's opinion (although see EC11 of CP10). Under the agencies' Uniform Financial Institutions Rating system (UFIRS), supervisors assess and assign a composite rating based on an evaluation and rating of six essential components of a bank's financial condition and operations. One of these component factors addresses the quality of assets. In assigning this component rating, supervisors consider the adequacy of the bank's ALLL and other asset valuation reserves as well as the adequacy of its credit administration processes. Supervisors review the policies, procedures and internal controls for classification of, and provisioning for, credit risk as well as compliance with laws and regulations.</p> <p>To support this assessment, supervisors generally conduct transaction testing to assess the effectiveness of internal control processes. Supervisors also review the internal and external audit reports, internal management reports, models and model validation processes to determine that classifications and provisioning provide boards and senior management an accurate and timely picture of the bank's or holding company's credit risks. For example, supervisors evaluate and test each bank's credit-risk-rating policy and procedures, and review and, if appropriate, adjust the classification or grading of the bank's loan portfolio.</p> <p>The assessors reviewed a number of supervisory reports and confirmed that this assessment process is working effectively.</p> <p>Additionally, through the agencies' Shared National Credit Program, interagency teams conduct an annual review of the classification of large syndicated loans held by multiple banks and holding companies. These reviews are conducted on-site at agent/lead banks and holding companies with assigned classifications applicable to all participating institutions.</p>
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁷¹
Description and findings re EC3	Pursuant to the FDI Act (12 U.S.C. §1831n(a)(3)(c)), all assets and liabilities, including contingent assets and liabilities, of banks and holding companies must be reported in, or otherwise taken into account in the preparation of, any balance sheet, financial statement, report of condition or other report required to be filed with an FBA. Supervisory guidance makes clear that systems for classification and provisioning should take into account off-

⁷¹ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	<p>balance-sheet exposures.</p> <p>The 2006 statement on the ALLL requires the recognition of credit losses in off-balance-sheet exposures, including loan commitments, standby letters of credit, guarantees and recourse liabilities on loan transfers. The FBAs assess the structure of off-balance-sheet instruments to understand the explicit and implicit credit risk to the bank.</p>
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>Under long-standing supervisory guidance, banks and holding companies are expected to establish appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations. The FBAs confirm that banks and holding companies evaluate the ALLL reported on the balance sheet as at the end of each quarter, or more frequently if warranted. The determination of the ALLL and the necessary provision are to be based on the bank's current judgments about the credit quality of the loan portfolio, and should consider all known relevant internal and external qualitative factors that affect loan collectability as of the evaluation date. The ALLL estimates are expected to reflect rigorous quantitative analyses supplemented by management judgment. The FBAs review bank policies, processes and practices to ensure that they achieve prompt and timely charge-off of loans when available information confirms the exposure to be uncollectible.</p> <p>From time to time, the FBAs may issue supplementary guidance for particular products or markets emphasizing the importance of realistic repayment and recovery expectations, including examples of what that means in practice for that product or market.</p>
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g. 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g. rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	<p>Under supervisory guidance, banks and holding companies are expected to have appropriate policies and processes, and organizational resources, for the early identification of deteriorating assets, for ongoing oversight of problem assets and for collecting on past-due obligations. The FBAs require banks and holding companies to initiate additional or heightened oversight as the rating for a credit exposure deteriorates and to initiate appropriate corrective action, including potential escalation into the restructuring, foreclosure or collection processes.</p> <p>Based on a combination of on-site examinations and off-site monitoring, the FBAs assess the quality and timeliness of a bank's or holding company's rating system, classification process and credit workout processes to determine if they are appropriate. Supervisors also assess the trend in credit ratings migration and may direct a bank or holding company to re-grade any credit where the rating does not reflect the credit's actual condition. The assessors saw ample evidence of the thoroughness of this assessment process.</p> <p>For retail transactions, supervisors evaluate a bank's account management and collection and foreclosure processes to determine whether bank intervention is appropriately mitigating or reducing potential losses. Under supervisory guidelines, banks and holding companies are expected to classify loans and recognize losses when payments are contractually a minimum</p>

	number of days in arrears; they are also expected to establish explicit standards that control the use of extensions, deferrals, renewals and rewrites. Supervisors may deviate from the minimum classification guidelines if underwriting standards, risk management or account management standards are weak and present unreasonable credit risk. For other types of loans, supervisors consider credit risk factors beyond just arrears.
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	Under the FBAs' statutory examination authority, supervisors may review all books and records maintained by a bank or holding company (and its affiliates) subject to the agencies' supervision. During the course of examinations, supervisors are provided with full access to all records related to credit risk management, and to all employees involved in assuming, managing, controlling and reporting on credit risk. This includes access to individual loan files, risk-management reports, internal and external audit reports and other material (such as board or committee minutes and reports). Banks and holding companies that do not supply requested information or access to premises and personnel are subject to supervisory sanctions and prosecution. Further, the quarterly Call Reports submitted by banks and holding companies include details on categories of credits and assets, delinquencies and provisioning.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g. if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	<p>If provisions are deemed to be inadequate, the FBAs will require corrective measures, such as additional provisions or other remedial measures, and have the authority to do so. (See 12U.S.C. § 1818(b)). If a supervisor concludes that a bank's or holding company's ALLL is inadequate or based on an unreliable loan review system, the bank or holding company will be required to adjust its ALLL reported on its regulatory reports by an amount sufficient to bring the ALLL to an appropriate level as of the evaluation date, and to address process deficiencies. This adjustment should be reflected in the current period provision or through the restatement of prior period provisions, as appropriate. The FBAs can require the addition of capital or an adjustment of capital to reflect insufficient levels of provisions and ALLL. The FBAs may also take enforcement action against a bank or holding company, based on the magnitude of the observed deficiencies in the ALLL process, including the materiality of any error in the reported amount of the ALLL. Material shortfalls in the ALLL or regulatory capital are immediately met with supervisory action. Supervisors monitor the bank's or holding company's corrective actions to ensure that deficiencies have been addressed.</p> <p>A range of supervisory material reviewed by the assessors has confirmed the importance attached by the FBAs to achieving adequate levels of the ALLL. The assessors saw examples of rigorous supervisory examination of individual loan files and loan review systems, as well as requirements by the FBAs to increase the ALLL, by significant amounts in some cases. The assessors also saw examples of the willingness of the FBAs to use enforcement tools as necessary. The FBAs advised that the conversation between banks and examiners over the level of the ALLL has become more constructive and realistic in more recent years. The earlier "state of denial" by banks in many cases was punctured by the crisis; as the U.S. economy continues to improve, however, supervisors are coming under pressure to accept releases</p>

	from the ALLL.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	<p>The FBAs expect banks and holding companies to establish and implement appropriate policies and procedures for periodically assessing the value of risk mitigants, including guarantees and collateral, at net realizable value. For real estate based credits, the agencies have appraisal and real estate lending standards and regulations that govern collateral valuation practices, underwriting standards (e.g., loan-to-value limits), credit administration and portfolio management expectations. These standards require that prevailing market conditions be taken into account.</p> <p>For loans individually evaluated for impairment and determined to be impaired, supervisors confirm that estimates of credit losses reflect consideration of all significant factors that affect the collectability of the loan as of the evaluation date, including risk mitigants. When a loan is identified as being impaired, a bank is to measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that, as a practical expedient, a bank may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. For individually impaired loans solely dependent on the sale or operation of the collateral for repayment, only the fair value of collateral valuation approach is allowed. The collateral valuation approach is based on the definition of "fair value" in U.S. GAAP.</p> <p>For loans evaluated for impairment on a pool basis, estimates of credit losses are expected to follow a systematic and consistently applied approach to select the most appropriate loss measurement methods, with written documentation and support for conclusions and rationales for the use and valuation of risk mitigants and collateral.</p>
EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <ul style="list-style-type: none"> (a) identified as a problem asset (e.g. a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g. a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	<p>Pursuant to the safety-and-soundness provision of the FDI Act, the FBAs have established criteria for identifying an asset as "impaired" and measuring the impairment on these assets using criteria consistent with U.S. GAAP. (See 12 U.S.C. § 1831p-1(b))</p> <p>The criteria for identifying problem assets are based on their degree of risk and likelihood of repayment. Supervisory guidance expects that analysis of the creditworthiness of a borrower will identify the borrower, document the borrower's current and past financial condition, identify the purpose of the loan and sources of repayment, and identify any collateral and its value. Potential problem loans are then classified based on demonstration of a potential weakness or a well-defined weakness that could hinder the borrower's ability to repay the loan. Supervisory guidance also focuses on the early identification of problem loans via an independent internal loan review system that assesses credit quality and renders an independent opinion of loan classifications.</p>

	<p>Banks and holding companies have the discretion to determine which individual loans are considered for evaluation of impairment. Generally, loans exceeding a certain materiality criterion, nonaccrual assets, severely delinquent credits and problem loan or “watch” lists generate the loans evaluated to determine which loans individually are impaired.</p> <p>The amount of impairment for a pool of loans is based on a bank’s or holding company’s ongoing loan review process and analysis of loan performance. One method of estimating loan losses for groups of loans is through the application of loss rates to the groups’ aggregate loan balances. Such loss rates typically reflect the bank’s or holding company’s historical loan loss experience for each group of loans, adjusted for relevant environmental factors (e.g., industry, geographical, economic, and political factors) and current conditions over a defined period of time.</p> <p>The FBAs have also established criteria for determining when an impaired asset may be reclassified as performing. The asset may be reclassified when none of its principal and interest is due and unpaid and the bank expects repayment of the remaining contractual principal and interest (e.g., after six months of sustained repayment performance), or when it otherwise becomes well secured and in the process of collection.</p>
EC10	<p>The supervisor determines that the bank’s Board obtains timely and appropriate information on the condition of the bank’s asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.</p>
Description and findings re EC10	<p>Under the various guidance, banks and holding companies are expected to have policies and procedures in place to ensure that the board receives timely and appropriate information on the condition of the bank’s or holding company’s asset portfolio, including classification of credits, the level of provisioning, and major problem assets.</p> <p>Supervisors determine whether bank management provides clear, concise, and timely information about the loan portfolio and its attendant risks to the board. Supervisors determine that the board has approved strategic objectives and risk limits; supervisors also ensure that risk levels, trends, provisioning levels, significant problem assets, policy exceptions and compliance with laws and regulations are adequately reported to both senior management and the board. Supervisors determine whether the reports’ descriptions of loan portfolio risks are sufficient to enable the board to exercise its supervisory responsibilities. The agencies expect that a unit independent of the lending function will periodically evaluate the accuracy, completeness and timeliness of the information in these reports. If concerns exist about internal testing, supervisors conduct sufficient testing to reach an independent assessment.</p> <p>The assessors reviewed examination reports covering information on asset quality provided to boards. The assessors were advised that the FBAs have stepped up their focus on the quality of board reporting in this area, as part of the general supervisory thrust to improve risk governance frameworks. The OCC’s Heightened Standards for large banking organizations will reinforce this focus.</p>
EC11	<p>The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.</p>
Description and	<p>Pursuant to the 2006 statement on the ALLL, banks are expected to value, classify and allocate</p>

findings re EC11	provisions for large exposures on an individual item basis. Loans determined to be impaired must be individually reviewed for appropriate valuation and provisioning.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Pursuant to the safety-and-soundness provision of the FDI Act, the FBAs have stepped up their monitoring of trends and concentrations in credit risk across the banking sector, including through horizontal reviews of peer groups. The assessors saw a range of detailed reports and analysis of system-wide asset quality, including trends in the aggregate level of provisions and reserves. Based on these horizontal reviews, the agencies provide guidance to institutions and supervisors; in 2013, for example, the FBAs issued "Interagency Guidance on Leveraged Lending", which outlines high-level principles related to safe and sound leveraged lending activities. The guidance forms the basis of supervisory review of banks and holding companies undertaking these activities, including problem credit management. However, the assessors saw no evidence that such guidance, and systemic risk reviews produced within the agencies, have translated into specific advice to supervisors on how to assess the adequacy of provisions and reserves. This assessment remains institution-specific.
Assessment of Principle 18	Compliant
Comments	<p>The FBAs have a long-established and rigorous process for evaluating banks' approaches to problem assets and the maintenance of an adequate ALLL. The FBAs have shown a consistent willingness to challenge unrealistic bank estimates of the ALLL and to secure increases they judge necessary, taking enforcement action if required. This steadfastness in approach is likely to be tested as the U.S. economy improves.</p> <p>Supervisory judgments in this area, however, continue to be constrained by the "incurred loss" requirements of U.S. GAAP for objective evidence of impairment. As one example, a finding from a horizontal review that a bank's ALLL was well below peers would be expected to trigger a supervisory response but the finding, of itself, would not be sufficient under U.S. GAAP to justify an adjustment to that bank's ALLL; supervisors would also need to find objective evidence of credit losses specific to that bank. That said, the FBAs noted that supervisors and external auditors had developed a better understanding of each other's perspectives and obligations, and the assessors saw examples where recommendations to banks to improve their loan classification systems were based on input from both supervisors and external auditors.</p> <p>The introduction of the FASB's proposed Current Expected Loss Model (CELM), which will allow reasonable and supportable forecasts to be taken into account in calculating the ALLL, will permit more forward-looking provisioning. This proposal is still being finalized and methods of implementation have yet to be resolved by practitioners. In principle, however, the CELM should provide greater scope for supervisors to intrude their judgments about the circumstances of an individual bank, as well as system-wide assessments of risk (as per EC12), in assessing the adequacy of the bank's ALLL. At this point, the FBAs lack a structured process for incorporating system-wide assessments into individual ALLL reviews. However, the assessors did not view this current gap as sufficient reason to downgrade the rating on CP 18, given the general rigor of the FBAs' processes for problem assets. The assessors encourage the FBAs to work closely with accounting and auditing practitioners to ensure that information</p>

	on emerging systemic risks to asset quality can be incorporated into ALLL reviews once the CELM is implemented.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁷²
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁷³ Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	<p>Banks are expected to monitor a range of categories of credit concentrations, including single counterparty, groups of similar counterparties, economic sectors and countries. The FBAs have not set regulatory limits for lending to specific sectors or geographies, but supervisors expect banks to set prudent limits that are subject to supervisory review. Banks with poor internal risk management structures, including for dealing with concentration risk, can be subject to a wide range of supervisory consequences.</p> <p>In the case of commercial real estate lending, the FBAs' "Interagency Guidance on Concentrations in Commercial Real Estate Lending: Sound Risk Management Practices", issued in 2006, directs banks and holding companies with concentrations in such lending to establish internal lending guidelines and concentration limits, to be periodically reviewed and approved by the board, and to hold adequate capital against those exposures. The guidance also sets out exposure thresholds (100 per cent of a bank's or holding company's risk-based capital for construction and land development loans and 300 per cent for commercial real estate (CRE) loans) that may signify potential significant exposures that may warrant increased supervisory scrutiny.</p> <p>The assessors were unclear about the supervisory force of these two exposure thresholds. In some supervisory reports examined, CRE exposures were well over double the thresholds, without supervisory comment or action. These exposures may well have been sound, but the assessors thought that graduated triggers for heightened supervisory attention would be helpful when exposures rose well above the thresholds and/or were rising rapidly. Supervisors interviewed in the "lessons learned" review of failed banks by the Office of Inspector General in the Federal Reserve had also expressed uncertainty about the force of these thresholds.</p> <p>Since the crisis, the FBAs have provided additional guidance on specific aspects of credit risk concentration. In 2010, the FBAs issued "Interagency Guidance on Correspondent Concentration Risks", clarifying that banking organizations should consider developing concentration risk management policies and procedures for correspondent banks. In 2011, the</p>

⁷² Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁷³ This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

FBA's issued "Interagency Counterparty Credit Risk Management Guidance", which sets out sound practices and supervisory expectations for an effective counterparty credit risk (CCR) management framework. The guidance is intended primarily for banking organizations with large derivatives portfolios but is not generally applicable to community banking organizations or banking organizations with insignificant derivatives portfolios. The guidance indicates that banking organizations should consider the full range of credit risks in combination with CCR to manage concentration risk, including risks arising from on- and off-balance sheet activities, contractual and non-contractual risks, contingent and non-contingent risks, underwriting and pipeline risks. It provides that CCR concentration management should identify, quantify and monitor exposures to individual and affiliated entities, sectors, geographic regions and other risk concentrations. The board of directors or a board committee is expected to articulate clearly the banking organization's risk tolerance for CCR by approving relevant policies, including a framework for establishing limits on individual counterparty exposures and concentrations of exposures.

In 2013, the FBA's issued "Interagency Guidance on Leveraged Lending", which sets out sound practices and supervisory expectations for leveraged lending activities. Banking organizations are expected to have a credit limit and concentration framework consistent with the organization's risk appetite, including limits or guidelines for single obligors and transactions, and industry and geographic concentrations. Supervisors review a banking organization's policies and processes for identifying, controlling and remediating concentration risk and large exposures in leveraged lending to ensure consistency with the guidance.

The strong supervisory focus on credit risk concentration is not, at this point, matched by a comparable focus on other aspects of concentration risk, including market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral or currencies, as required by this EC. Recent supervisory guidance, set out immediately below, is high-level and has not been reflected in detailed requirements for policies and processes to cover the full range of concentration risk.

In 2012, the FBA's issued "Supervisory Guidance on Stress Testing for Banking Organizations with More Than \$10 Billion in Total Consolidated Assets", which sets out principles for stress testing as an ongoing risk management practice. The guidance stipulates that banking organizations are expected to maintain a stress-testing framework that covers all material exposures, activities and risks, whether on- or off-balance sheet, and that captures the interplay among different exposures, activities and risks, and their combined effects. Under section 165 of the DFA, all banking organizations with total consolidated assets of more than \$10 billion are required to conduct and publically disclose the results of annual stress tests using scenarios specified by their primary supervisor.

In 2014, the OCC finalized its "Heightened Standards for Large Financial Institutions", which applies to national banks, federal savings associations and federal branches of foreign banks with \$50 billion or more in total consolidated assets. These standards, which are intended to strengthen governance and risk management practices, direct the institutions covered to include concentration risk limits in the risk governance framework that should limit excessive risk-taking and should not exceed the limits established in the institution's risk appetite statement.

EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure ⁷⁴ to single counterparties or groups of connected counterparties.
Description and findings re EC2	<p>The FBAs have directed banks and holding companies to maintain adequate management information systems (MIS) that identify large borrower relationships, and that are appropriate to the size, complexity and global footprint of the banking organization. Supervisors assess the timeliness and quality of MIS reports to ensure that absolute and relative changes in exposure to individual counterparties and groups of connected counterparties are clearly identified in reports to boards and senior management.</p> <p>Under the FBA's 2011 guidance on counterparty credit risk management, banking organizations with large derivatives positions are expected to have MIS with the capacity to measure exposures at various levels of aggregation (e.g. by business line, legal entity or consolidated by industry) and on a timely basis. Aggregation is expected to cover all CCR exposures and all other forms of credit risk to the same counterparty. Management is expected to strive for a single comprehensive CCR exposure measurement platform or, if not possible, to minimize the number of platforms and methodologies, and manual adjustment to exposure calculations.</p> <p>There are no explicit requirements that banks' MIS identify sources of concentration risk other than credit risk/large exposures</p>
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	<p>Under supervisory guidance, boards of banking organizations are expected to be actively involved in the approval, periodic review and oversight of implementation of the risk management framework, including strategies and policies for taking and managing credit risk. In this context, boards are expected to establish prudent concentration control processes, including escalation procedures and approval processes for exceptions to policy limits. Banking organizations are expected to establish internal thresholds for acceptable concentrations of credit and to report all material concentrations to the board for review.</p> <p>The OCC's Heightened Standards (see above) direct the institutions covered to have policies and supporting processes in their risk management framework that effectively identify, measure, monitor and control the concentration of risk, on- and off-balance sheet.</p> <p>Supervisors confirm that management identifies, defines, measures, monitors and controls concentrations of credit risk, generally defined by the agencies as direct or indirect extensions of credit and contingent obligations that in aggregate exceed 25 per cent of tier 1 capital plus the Allowance for Loan and Lease Losses. Supervisors verify that new and existing credit concentrations are reported to the board or appropriate board committee on a regular basis,</p>

⁷⁴ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e. it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	<p>and in sufficient detail to enable an appropriate board response.</p> <p>The assessors reviewed a number of examination reports, which confirmed the strong supervisory attention given to the management of credit concentration risk. However, the assessors did not see detailed requirements or guidance, or supervisory assessments, related to the identification and management of material risk concentrations other than credit risk.</p>
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Supervisors regularly obtain, through regulatory reports and on-site examinations, information that enables review of credit concentrations within a banking organization's portfolio, including sectoral, geographical and currency exposures. Supervisors may follow up on any areas of concern, requesting additional information or directing a banking organization to reduce credit concentrations that present significant risks; more formal action may be taken as necessary. The assessors saw a number of examples of supervisory action in this area. The six largest U.S. bank holding companies also report exposure to top counterparties (individually) across a broad range of categories to the Federal Reserve on a weekly basis. Monitoring of concentrations other than credit risk is still evolving.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	OCC regulations define those individuals and entities whose interests will be attributed to the single borrower for purposes of computing the legal limits, under so-called "combination rules". Under the regulations, a "corporate group" is defined for purposes of the lending limits as including a "person" and all of its subsidiaries (where the person owns or beneficially owns more than 50 per cent of the voting securities/interests of the subsidiaries. The OCC generally has discretion to apply these combination rules in a manner that reflects actual risk exposure. See 12 U.S.C. §84 and 12 CFR 32.5. The OCC has not often needed to exercise this discretion. The Federal Reserve is developing a large exposures regime for large bank holding companies and foreign banking organizations (total consolidated assets above \$50 billion). Under this regime, the Federal Reserve has proposed a simple common ownership test to define when parties under common ownership would be treated as exposure to a single counterparty. Moreover, the definition of a subsidiary for these purposes differs from that in the combination rules in applying a 25 per cent rather than 50 per cent threshold for ownership of voting shares or equity by the parent.
EC6	Laws, regulations or the supervisor set prudent and appropriate ⁷⁵ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis. More generally, supervisors have broad authority to assess the risk posed by a credit risk concentration and consider the adequacy of capital to absorb the risk.

⁷⁵ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

Description and findings re EC6	<p>National banks are subject to a single-counterparty lending limit based on their unimpaired capital and surplus funds. See 12 U.S.C. §84. A bank's total outstanding loans and extensions of credit to one borrower or group of connected borrowers not appropriately secured are limited to 15 per cent of the bank's capital and surplus funds. A further 10 per cent may be extended if the loan is fully secured by readily marketable collateral. That is, there is an aggregate limit of 25 per cent of a bank's capital and surplus funds. The limits cover on- and off-balance sheet extensions of credit and, since introduction of the DFA, counterparty credit risk from derivatives and securities financing transactions.</p> <p>In addition, a bank may not lend more than 50 per cent of its capital and surplus funds to a corporate group. However, the FBAs have explained that this particular limit rarely comes into play. Under the combination rules, the 15 per cent limit applies when the proceeds of a loan to one borrower are used for the direct benefit of another borrower or where a "common enterprise" is deemed to exist between the borrowers. A common enterprise is deemed to exist in any of four circumstances: (i) where borrowers represent a common source of repayment; (ii) where borrowers are related through common control and are substantially financially interdependent; (iii) where separate borrowers are acquiring more than 50 per cent of the voting interests of a company; and (iv) where the OCC (or other appropriate regulator) determines, based on an evaluation of the facts and circumstances of particular transactions, that a common enterprise exists. Only when one of these combination rules is not available would the 50 per cent corporate group limit be relevant. The FBAs see this limit as an additional limit on concentrations where, for example, a bank makes loans to companies that are related through common control but are financially independent. In such situations, the 15 per cent limit would be applied to each member of the group and loans to the corporate group in the aggregate, while not combinable, would nonetheless be limited to 50 per cent. Examiners carefully review the financial condition and interdependencies of the borrowers in a corporate group and, if a common enterprise is deemed to exist, the loans to the members are combined and limited to 15 per cent.</p> <p>The legal limits on credit exposures also apply to all savings associations, with narrow exceptions, and to Federal branches and agencies of foreign banks (based in the latter case on the U.S. dollar equivalent of the foreign bank's capital). The FBAs expect banking organizations to adhere to these limits and to have policies and processes to ensure that the limits are followed; where breaches of the limits are identified, the FBAs may seek restitution and civil money penalties against officers, directors and agents of the bank. See 12 U.S.C. §1818 and 12 U.S.C. §93.</p> <p>In addition to these credit exposure limits, separate limits (10 or 25 per cent) apply on the amount of money market investments and securities issued by any one obligor (other than obligations of or guaranteed by the U.S. Government) that may be held by a banking organization on its own account. These separate limits do not apply to federal savings associations.</p> <p>The Federal Reserve's proposed large exposures regime for large bank holding companies and foreign banking organizations would limit exposures to any unaffiliated company to 25 per cent of capital, or a lower amount as prescribed by the Federal Reserve. A more stringent credit exposure limit would apply between a major covered company and any other major counterparty.</p>
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and	Under supervisory guidance, large banking organizations with significant CCR exposures are

findings re EC7	<p>expected to maintain a comprehensive stress-testing framework, which is integrated into the organization's CCR management. The framework should include measurement of the largest counterparty-level impacts across portfolios and consideration, at least quarterly, of stressed exposures arising from the joint movement of exposures and related counterparty creditworthiness. Senior management should evaluate stress test results for evidence of potentially excessive risk, take appropriate risk reduction strategies, and communicate the results to the board at an appropriate frequency.</p> <p>In addition, the Federal Reserve has implemented a comprehensive stress test framework for bank holding companies and state member banks in its Regulation YY, covering their material risks. Under this framework, the Federal Reserve annually develops scenarios for use in its supervisory stress tests for large bank holding companies, and requires these companies and state member banks to use the same scenarios in their company-run stress tests. In 2014, the Federal Reserve required eight large, interconnected bank holding companies to apply a counterparty default scenario component to their securities lending, repo and derivative exposures.</p> <p>As noted above, the FBAs' 2012 supervisory guidance on stress testing sets out principles for stress testing as an ongoing risk management practice. The guidance stipulates that banking organizations are expected to maintain a stress-testing framework that covers all material exposures, activities and risks, whether on- or off-balance sheet, and that captures the interplay among different exposures, activities and risks, and their combined effects. The FBAs see this guidance, together with the company-run annual stress tests mandated under the DFA, as providing a holistic framework for assessing all material risks, including significant risk concentrations. In practice, however, concentration risk other than credit risk has not to date been imbedded in stress testing.</p> <p>Community banks are not subject to legal or supervisory requirements for enterprise-wide stress testing but are expected to have the capacity to analyze the potential impact of adverse outcomes on their financial condition.</p>
Additional criteria	
AC1	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following:</p> <ul style="list-style-type: none"> (a) 10 percent or more of a bank's capital is defined as a large exposure; and (b) 25 percent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties. <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	See description and findings under EC6. The FBAs do not apply a threshold of 10 per cent of capital to define a large exposure.
Assessment of Principle 19	Largely compliant.
Comments	The FBAs have an effective supervisory framework for dealing with credit concentration risk and the assessors acknowledge the close focus on this risk in credit quality reviews. Guidance has also been issued on a number of specific areas of credit concentration risk and this is followed up in supervisory reviews; however, some reassessment of the supervisory force of

	<p>the thresholds for commercial real estate exposures is warranted. Supervisors are also giving more attention to the treatment of concentration risk in counterparty credit risk management.</p> <p>At this point, however, a detailed supervisory framework and supervisory guidance for market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral or currencies, as specified in EC1, EC 2, EC 3 and EC 4, is not well developed. Assessors were not shown any evidence that the identification and assessment of such risk concentrations is part of supervisory requirements for banks. In principle, the detailed stress-testing regime now in place can provide a comprehensive basis for identifying and assessing the impact of concentration risk, and the assessors would encourage the FBAs to consider scenarios that draw attention to this risk in areas beyond credit concentration. The OCC's "Heightened Standards" will also put the onus on boards to ensure that their banking organizations have a robust risk management framework for concentration risk. However, these Standards only began to come into effect from September 2014.</p> <p>The widening of the definition of large exposures under the DFA to include counterparty credit risk from derivatives and securities financing transactions has brought the large exposure thresholds more into line with the requirements of AC1. However, some anomalies and omissions remain. The separate and additional limits available to banks for money market investments and security holdings continue to leave open the possibility of excessive risk concentrations. The 2010 DAR recommended that these additional exposures be included in the 15 plus 10 limits (as they are for federal savings associations), but this recommendation has not been taken up. The 50 per cent limit on exposures to a corporate group also appears, <i>prima facie</i>, to be out of line with AC1. The assessors acknowledge the view of the FBAs that this is an additional "catch-all" limit on aggregate exposures to group members and one that is rarely approached. Nonetheless, this limit is problematic and could result in excessive risk concentrations if, for example, reputational damage to a corporate group were to undermine the financial independence of individual group members. Moreover, this treatment of corporate groups does not appear consistent with the Federal Reserve's proposed large exposures framework, under which common ownership alone defines whether exposure to a group of counterparties would be treated as exposure to a single counterparty. In its proposals, the Federal Reserve argued that a simpler, more objective approach to combination rules is more consistent with the objectives of a single-counterparty credit limit. The assessors would encourage the FBAs to reconcile these different approaches.</p> <p>Finally, the assessors note that the Federal Reserve is working actively to finalize its large exposures framework, with legal limits, for large bank holding companies and foreign banking organizations, in light of the release of the Basel Committee on Banking Supervision's new large exposures regime for internationally active banks.</p>
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties ⁷⁶ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties ⁷⁷ on an arm's length basis; to monitor these

⁷⁶ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁷⁷ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only

(continued)

	transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of “related parties.” This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>Two major sets of laws define and establish limits on transactions with “related parties”; the laws apply to Federal Reserve member banks (state and national), state nonmember insured banks and all savings associations.</p> <p>First, sections 23A and 23B of the Federal Reserve Act are designed to prevent the misuse of a bank’s resources through preferential transactions with its affiliates. The transactions “covered” include loans and extensions of credit to an affiliate, investments in securities issued by an affiliate, asset purchases from an affiliate, the issuance of a guarantee or letter of credit on behalf of an affiliate, and credit exposures arising from derivative transactions and securities borrowing and lending transactions between a bank and an affiliate. Covered transactions do not include service and construction contracts, or lease agreements. Section 23A imposes quantitative limits and collateral requirements on covered transactions (see EC 5).</p> <p>Second, sections 22(g) and 22(h) of the Federal Reserve Act impose a number of restrictions on extensions of credit between a bank and its insiders and to insiders of its affiliates.</p> <p>Although the regulatory restrictions on transactions with affiliates and insiders apply only to the bank subsidiaries of holding companies, the FBAs encourage all banking organizations to adopt policies to avoid preferential transactions with affiliates or insiders. While related-party transactions that do not involve a supervised bank may be legal, the FBAs may still consider them “unsafe and unsound”. In addition, as consolidated supervisor, the Federal Reserve monitors material intra-group transactions and exposures, and ensures that holding companies have adequate risk management processes in place for the banking organization pertaining to such transactions.</p> <p>The Federal Reserve Act and its implementing regulations (Regulation O) clearly define the individuals and entities to which lending restrictions apply. The definitions are broad and provide some discretion to the supervisor in individual cases to determine whether a particular individual or entity should be subject to the restrictions. The assessors were informed that this discretion has rarely needed to be exercised. The term “affiliate” includes any entity that directly or indirectly controls, or is under common control with, the bank, but does not include the bank’s subsidiaries. The term “insider” includes executive officers, directors, and principal shareholders of a bank or any of its affiliates, as well as their related interests (companies controlled by such insiders), but does not explicitly include family members of insiders other than principal shareholders. Insiders are subject to general “duty of loyalty” obligations not to advance the interests of those with whom they have a personal or business relationship (Comptroller’s Handbook on “Insider Activities”); for insiders of federal savings associations, this duty is set out in 12 CFR 163.200. A transaction between a bank and a third party where the funds are transferred to, or used for the benefit of, an affiliate or insider is considered a</p>

transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	transaction with that affiliate or insider.
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g. in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁷⁸
Description and findings re EC2	<p>Section 23B of the Federal Reserve Act provides that covered transactions between a bank and its affiliates must be on terms and under conditions, including credit standards, that are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with or involving non-affiliated companies. Under section 22(h), extensions of credit to an insider must (a) be made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with non-insiders and (b) not involve more than the normal risk of repayment. Banks are required to maintain records to document compliance with these restrictions.</p> <p>Supervisors review and assess the adequacy of a bank's procedures for ensuring that transactions with affiliates, insiders and related parties are not made on preferential terms and are otherwise consistent with safe and sound banking practices. Violations of these legal requirements can give rise to reimbursement and formal enforcement actions against a bank, and civil money penalties.</p>
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	<p>Regulation O requires that extensions of credit to an insider be reviewed and approved by the board if the aggregate exposure would exceed \$500,000 upon consummation of the new credit facility. A lower review threshold applies to smaller banks. Extensions of credit to insiders above the review threshold require the prior approval of a majority of board directors. The insider must not participate in the preparation of, or discussion and vote on, the credit. More generally, under regulations and supporting guidance, board members with conflicts of interest must recuse themselves from consideration of any matter in which they have an interest.</p> <p>Except for certain securities and asset purchases, there is no regulation requiring prior board approval for transactions between a bank and an affiliate, nor for write-offs of related-party transactions. Under the OCC's "Heightened Standards" for risk governance by large banking organizations, which began to come into effect from September 2014, board oversight of the risk management function should cover compliance risk, which would include risk associated with affiliate transactions.</p>
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	The regulatory requirements mentioned above, supported by supervisory guidance on

⁷⁸ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g. staff receiving credit at favorable rates).

findings re EC4	conflicts of interest, prevent persons benefiting from the transaction or persons related to such individuals from being part of the process of granting and managing the exposure. Banks are expected to have policies and procedures to ensure compliance with these requirements, and these are reviewed by supervisors. As part of the regular examination process, supervisors will review lists of loans to directors and seek confirmation that directors did not involve themselves in any matter in which they have an interest. The assessors saw examples of such reviews.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	<p>The statutes mentioned in EC1 establish quantitative limits on affiliate and insider transactions and collateral requirements on certain affiliate transactions. Section 23A applies a general limit of 10 per cent of the bank's capital and surplus to the aggregate amount of transactions with any one affiliate and a limit of 20 per cent to the aggregate amount of transactions with all affiliates. These limits are generally stricter than those for other counterparties. Moreover, any credit transaction with an affiliate generally must be fully secured and purchases of "low-quality assets" are generally prohibited.</p> <p>Insider transactions are subject to the single-borrower limits set out in 12 U.S.C. §84. That is, loans and extensions of credit to an individual insider, when aggregated with the amount of all other extensions of credit to that person's related interests, generally may not exceed 15 per cent of the bank's capital and surplus. Insiders and their related interests are treated as a single borrower for the purposes of these limits. Aggregate extensions of credit to insiders may not exceed a bank's capital and surplus. For banks with deposits of less than \$100 million, the limit is two times a bank's capital and surplus, subject to certain restrictions (including that the board of directors determines that such a higher limit is consistent with prudent, safe and sound banking practices). Extensions of credit to an executive officer, other than loans with a residential housing or educational purpose, may not exceed \$100,000.</p> <p>Supervisors can address problems with exposures to affiliates or insiders by requiring their deduction from capital when assessing capital adequacy and requiring the posting of additional capital.</p>
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	Banks must identify, through an annual survey, all insiders of the bank and maintain records of all extensions of credit to insiders. All banks that are in holding companies must report their covered transactions with affiliates on a quarterly basis to the Federal Reserve (see EC7). The FBAs require banks to develop policies to ensure that all credit decisions are based on an independent and complete credit evaluation. The FBAs also expect that a bank's MIS identifies and quantifies credits to related parties and that loan management and review routinely review these transactions. However, other than general supervisory expectations that a board exercise proactive oversight over independent risk management and provide prior approvals

	in certain cases, the assessors did not see specific supervisory guidance about the ongoing role of the board (or senior management) in overseeing related party transactions and monitoring exceptions to policies, processes and limits.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	All top-tier bank holding companies and foreign banking organizations that own a U.S. insured depository institution must file the quarterly FR Y-8 report on transactions with affiliates. In Schedule RC-M of the Call Report, banks must report to the OCC the aggregate amount and number of extensions of credit to insiders when they exceed the lesser of \$500,000 or 5 per cent of capital. The assessors were shown examples of Schedule RM-C. In the supervisory review process, supervisors note any transactions with affiliates or insiders that do not appear in regulatory reports.
Assessment of Principle 20	Largely compliant
Comments	<p>The CP requires a higher degree of board involvement and oversight than presently required by U.S. laws and supervisory guidance. There are no formal requirements for prior board approval of transactions with affiliated parties or of the write-off of related party exposures exceeding specified amounts (as per EC3), or for board oversight of related party transactions and exceptions to policies, processes and limits on an ongoing basis (as per EC6). However, the FBAs expect banks to apply a high degree of board oversight and monitoring of affiliate and insider transactions and review this as a matter of practice on offsite and onsite examinations. In addition, significant exposures to insiders – even within the formal limits – could be criticized by supervisors for endangering the safety and soundness of the bank.</p> <p>Statutes impose a set of limits on a bank’s exposures to affiliates and insiders that, with one exception, are at least as strict as those for single counterparties or groups of counterparties. The assessors acknowledge that a robust limit structure acts to constrain exposures in this area, but it does not absolve boards from the need for active and ongoing oversight of all key aspects of related party transactions to reduce the risk of abuse before formal limits are reached.</p> <p>The exception in the limit structure is of concern to the assessors, as it was in the 2010 DAR. This is the aggregate limit for lending to insiders of 100 per cent of a bank’s capital and surplus (and 200 per cent for smaller banks). This limit does not appear consistent with the general intent of this CP; it is higher than prudent practices and creates the risk that a small group of insiders could deplete the own funds of a bank.</p> <p>There are no regulated limits for holding company transactions with their affiliates or insiders, an omission also noted in the 2010 DAR. This omission can create the temptation for a bank to route insider loans through the holding company to avoid the formal bank limits, in turn requiring careful supervisory vigilance. A more formal limit framework for such transactions at the holding company level would facilitate monitoring and is needed for a comprehensive framework for transactions with related parties.</p> <p>The “related party” regime in the U.S. regulatory framework does not appear as broad as required by this CP. The definition of “covered transactions” in section 23 A does not include all elements contemplated by this CP, such as service and construction contracts, and lease agreements. In addition, the definition of affiliates excludes subsidiaries of the bank and the definition of “related interests” of insiders does not explicitly include their family members. Assessors recommend that the “related party” regime be amended to bring it into line with this CP.</p>

Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁷⁹ and transfer risk ⁸⁰ in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank’s policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>The U.S. FBAs are required to evaluate banks’ and holding companies’ foreign country exposure and transfer risk as part of the examination and supervisory process. See 12 U.S.C. § 3903(a). The agencies also must ensure that these risks are taken into account in evaluating a bank’s or holding company’s capital adequacy. Banks and holding companies meeting certain reporting criteria based on cross-border exposure are required to identify and monitor these risks and to provide quarterly reports to supervisors on their foreign country exposure. The quarterly reports detail each bank’s or holding company’s significant claims on foreign entities, specifying, among other things, the types of claims and country in which the borrowers are located. Banks and holding companies must have established policies and procedures for monitoring the risks associated with countries with which they are doing business and monitoring and evaluating their exposures to those countries.</p> <p>As required by statute, the agencies have issued regulations and guidance governing international lending. See e.g., 12 CFR 211, subpart D. However, the provisions of the International Lending Supervision Act, 12 U.S.C. §§ 3901-3911, do not apply to savings associations and SLHCs, which historically have not had large foreign country exposures and transfer risk. For purposes of Principle 21, therefore, the word “bank” does not include a savings association. The Federal Reserve examines large and complex SLHCs for country risk, however, and would require a SLHC to establish an A Allocated Transfer Risk Reserve (ATRR) pursuant to the Interagency Country Exposure Review Committee (ICERC)’s guidelines. Most of the discussion below includes any SLHC with foreign country exposure.</p> <p>Banks and holding companies are required to monitor and evaluate developments in country risk and in transfer risk and, as appropriate, establish an ATRR or take other appropriate countermeasures. See 12 CFR 211.43; 12 CFR 347.303, and 12 CFR 28.52.</p> <p>The FBAs have also implemented enhanced guidance concerning the elements of an effective</p>

⁷⁹ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

⁸⁰ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower’s country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)

	<p>country risk management process for banking organizations. The guidance supplements and strengthens other guidance with regard to country risk and is part of an ongoing effort by the agencies, through their participation in the ICERC, to ensure that banking organizations' management of risks arising from their international activities are appropriately and adequately addressed during the examination process. See Federal Reserve SR 02-05, "Interagency Guidance on Country Risk Management." See also Interagency statement on "Sound Risk Management Practices: Country Risk".</p> <p>Country risk and transfer risk are monitored and measured through two independent supervisory processes: the bank examination process and the work of the ICERC. ICERC was established to provide a forum for U.S. FBAs to coordinate their assessments of cross-border risk and to promote a consistent approach to the supervisory process. The ICERC standards are communicated to the banking industry by supervisors and provide the banking industry with a general expectation for a bank's or holding company's sovereign risk management practices.</p> <p>During examinations, supervisors assess the bank's or holding company's overall identification and management of country and transfer risk. Banks and holding companies are expected to assess the level of their country risk exposure and evaluate the effect of prevailing and future economic, political, and social conditions on a country's ability to sustain external debt service, and reflect the impact of these conditions on the credit risk of individual counterparties located in the country. The agencies expect banks and holding companies to have a comprehensive risk-management system to identify their cross-border exposure by borrower and by country, and to quantify exposure, including cross-border guarantees, derivatives, and reference assets, where appropriate. In order to effectively control country risk, risk-management systems are expected to include, at a minimum, oversight by the bank's or holding company's board of directors, well-defined policies and procedures for managing country risk, an accurate country exposure reporting system, an effective country analysis process, a country risk rating system, established country exposure limits, adequate monitoring of country conditions, effective stress testing and integrated scenario planning, and adequate risk management, internal controls, and audit (FDIC FIL 23-2002).</p> <p>In 2011-2012, the OCC conducted a horizontal examination of banks on their Country Risk Management (CRM) policies and practices. The examination had multiple objectives, including to identify best practices for CRM and to enhance coordinated supervisory practices on CRM monitoring.</p>
<p>EC2</p>	<p>The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.</p>
<p>Description and findings re EC2</p>	<p>The agencies examine for and expect the involvement of a company's board and management in developing and approving strategies, policies and processes for the management of country and transfer risks and the integration into overall risk management. As part of their regular examination process, U.S. federal supervisors determine whether an institution has developed an overall country and transfer risk strategy that is clear, consistent, documented and approved by the institution's board of directors. Supervisors expect that any exception to such policies be justified, documented and approved by the appropriate level of management or/and the board. In the country and transfer risk area, as in all major areas of an institution's business, supervisors expect that the board oversee management with the appropriate level of involvement, to ensure that policies are complied with and processes are followed. Supervisors determine in the course of examinations and as part of their regular monitoring work, that</p>

	country and transfer risk management is appropriately integrated in an institution's enterprise-wide risk management system. The Comptroller's Handbook for Examiners of 2008 provides guidance for assessing Boards' involvement in country risk matters. The horizontal examination mentioned under EC 1 included issues relating to Board involvement and oversight of CRM.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	The agencies hold the banks' or holding company's management responsible for implementing sound, well-defined policies and procedures for managing country risk that establish risk tolerance limits, specify authorized activities, and identify desirable types of business. Supervisors confirm that banks and holding companies have appropriate risk management systems in place to evaluate sovereign risk, including a rating scale and a regular cycle of reviews. Supervisors also review a banking organization's systems to evaluate individual countries' economic, social, and other conditions and developments where the organization is exposed to risk. Supervisors expect a banking organization to establish procedures for dealing with exposures in troubled countries, including contingency plans for reducing risk, and if necessary, exiting the country. The horizontal examination mentioned under EC 1 included issues relating to information, risk management and control systems as well as issues relating to country limits and triggers for actions.
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <ul style="list-style-type: none"> (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	The requirements of the U.S. FBAs for banks' and holding companies' risk practices are embedded in the International Lending Supervision Act (ILSA) passed by the U.S. Congress in 1983. The ILSA requires banks and bank holding companies, when warranted, to set up an allocated reserve for assets subject to more severe transfer risk. The three FBAs have published regulations implementing the ATRR requirement. The regulations require that each affected organization write off or establish and maintain an ATRR for each asset with impaired value due to transfer risk. However, the ATRR requirement does not apply to U.S. branches, agencies, or commercial lending company subsidiaries of foreign banking

	<p>organizations. Nevertheless, each U.S. federal banking agency will determine the need, if any, for other special measures that may be warranted by conditions in the branch or agency, including, for example, increased monitoring of due-from/due-to head office accounts, asset maintenance requirements, and/or specific reserves.</p> <p>U.S. FBAs set country and transfer risk reserve requirements for selected countries. These requirements or ATRRs are determined through the ICERC process, which evaluates transfer risk for the U.S. banking system on an ongoing basis. ICERC evaluates higher-risk regions and countries and mandates ATRRs, where appropriate, for countries in default, by type of exposure and by tenor.</p> <p>The ICERC meets once a year (with ad hoc meetings, as circumstances warrant, at other times during the year) to review conditions in countries that (1) have defaulted by not complying with their external service obligations or are unable to service the existing loan according to its terms, and (2) where U.S. banks and holding companies have large exposures. Based on this review, the ICERC assigns a transfer risk rating to the country and determines whether U.S. banks and holding companies must hold a reserve (an "Allocated Transfer Risk Reserve" or "ATRR") against exposures where the country of residence of the ultimate obligor is a defaulting country. The agencies require banks and holding companies to establish an ATRR for each applicable international asset where the ultimate obligor resides in a defaulted country.</p> <p>In addition to the specific mandated reserves, the agencies expect banks and holding companies to evaluate the risk profile of their foreign exposures (both cross-border and local), appropriately grade countries' and individual obligor exposures, and establish limits that are consistent with the bank's or holding company's strategy, risk profile, and capital. Supervisors evaluate the establishment, appropriateness of, and compliance with such limits during the examination process</p>
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	<p>The agencies, in coordination, have developed rules establishing a framework for conducting annual stress tests for institutions that they supervise. In May, 2012, the agencies issued guidance on Stress Testing for Banking Organizations with Total Consolidated Assets of More Than \$10 Billion. The guidance outlines broad principles for a satisfactory stress testing framework. Risks addressed in a firm's stress testing framework may include country risk. Moreover, banks and bank holding companies are required to have a country risk management framework that monitors and assesses the risks to international activities and exposures, including using appropriate scenario analysis and stress tests of country and transfer risk.</p> <p>Supervisors determine the adequacy of a BHC's and bank's stress testing of its international activities. This includes determining whether scenarios target countries, regions, business lines, and products with material foreign exposures; whether stress testing is commensurate with the complexity of a bank and its level of international activities; whether scenarios are based on the range of risk to which a bank is exposed; whether stress tests typically reveal countries and situations where a bank faces heightened risk; and whether stress testing incorporates contingency and action plans, such as holding more capital, risk mitigation, hedging, reducing lines of credit, and/or adjusting pricing.</p> <p>However, country risk has not been included in the stress tests conducted, so far.</p>
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on

	<p>the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g. in crisis situations).</p>
<p>Description and findings re EC6</p>	<p>Federal banking agencies require banking institutions with foreign country exposure to submit quarterly reports in prescribed format, as required by law (ILSA Section 907 Collection of International Lending Data). Federal banking agencies evaluate the foreign country exposure and transfer risk of banking institutions for use in examinations and supervision, also as required by law (ILSA Section 904 Supervision of International Lending).</p> <p>Banks and BHCs are thus required to report their various asset exposures quarterly on the Country Exposure Report FFIEC 009 and Country Exposure Information Report FFIEC 009a. The agencies maintain a publicly-available quarterly report (FFIEC E.16 Country Exposure Lending Survey) that contains aggregate cross-border and local foreign office exposure by individual country. A restricted version of this data, which contains more detailed information by individual banking organization, is used by supervisors in their foreign exposure monitoring process.</p> <p>The FFIEC 009 reports contain information for on- and off-balance-sheet exposure by type of obligor (public, banks, non-bank financial institutions, corporates, and households). The agencies analyze the quarterly reports for levels, significant variations and trends. Also, agency economists evaluate, on an ongoing basis, political, economic, and social conditions and events for high impact countries. These analyses are supplemented by a more thorough review of country-risk exposure during regular supervisory activities. See the OCC's Country Risk Management Booklet of the Comptroller's Handbook</p> <p>In 2013, the ICERC implemented substantial enhancements to the data requirements for reporting institutions. The enhancements include a more detailed breakdown of exposures by type of obligor (government, corporate, household, non-bank financial institutions); the addition of several memorandum items, including netting of trading items; expanded reporting of credit derivatives; and the addition of the U.S. as a reporting country.</p> <p>The FBAs may use information sharing arrangements to obtain information bilaterally and/or through supervisory colleges and CMGs with foreign supervisors in large banks. Under the U.S. FBAs' statutory examination authority, supervisors may review all books and records maintained by a bank (and its affiliates) subject to the agencies' supervision.</p>
<p>Assessment of Principle 21</p>	<p>Compliant</p>
<p>Comments</p>	<p>A robust framework exists for regulation and assessment of country and transfer risks and for the allocation of loan loss reserves reflecting country and transfer risks.</p> <p>However:</p> <p>The rules do not cover savings associations. (Due to their tradition of having limited international exposures). The assessors would, however, recommend the introduction of a de minimis regime being applied to all categories of banks. Nor are U.S. affiliates of foreign banks covered since they are expected to be under consolidated supervision from the home authorities. The assessors find this acceptable, provided that there is good cooperation and information-sharing between the FBAs and the relevant foreign supervisory authorities on country risk matters as well as consolidated supervision.</p> <p>Country risk has not yet been specifically tested in the stress tests mandated by the FBAs. While it has been covered on a case by case basis by internal stress testing conducted by banks, the assessors recommend that guidance and rules on stress test specifically include</p>

	country risk.																
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.																
Essential criteria																	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.																
Description and findings re EC1	<p>As with many aspects of the supervisory regime, the approach is tiered. In the case of market risk this tiering is generally set by reference to the aggregate trading assets and trading liabilities (as reported in the most recent quarterly Consolidated Reports of Condition and Income (Call Report)).</p> <table border="1"> <thead> <tr> <th>Table 22.1</th> <th>1</th> <th>2</th> <th>3</th> </tr> </thead> <tbody> <tr> <td></td> <td>Below Market Risk Rule Threshold</td> <td>Above Market Risk Rule Threshold</td> <td>Advanced Approach U.S. Banking Organizations with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure</td> </tr> <tr> <td>National Banks</td> <td rowspan="3">An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material market risks.</td> <td>Same as Column 1 plus provisions in 12 CFR part 3 subpart F</td> <td rowspan="3">Same as for Column 2 except banks must use the Supervisory Formula Approach, if applicable, under the standardized measurement method for measuring the specific risk add-on for securitization positions.</td> </tr> <tr> <td>State Member Banks</td> <td>Same as Column 1 plus provisions in 12 CFR part 208 appendix E</td> </tr> <tr> <td>State Non-member Banks</td> <td>Same as Column 1 plus provisions in 12 CFR part 325, appendix C</td> </tr> </tbody> </table>	Table 22.1	1	2	3		Below Market Risk Rule Threshold	Above Market Risk Rule Threshold	Advanced Approach U.S. Banking Organizations with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure	National Banks	An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material market risks.	Same as Column 1 plus provisions in 12 CFR part 3 subpart F	Same as for Column 2 except banks must use the Supervisory Formula Approach, if applicable, under the standardized measurement method for measuring the specific risk add-on for securitization positions.	State Member Banks	Same as Column 1 plus provisions in 12 CFR part 208 appendix E	State Non-member Banks	Same as Column 1 plus provisions in 12 CFR part 325, appendix C
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State Non-member Banks		Same as Column 1 plus provisions in 12 CFR part 325, appendix C															

The provisions listed in Column 2 (Table 22.1) above reflect the agencies' implementation of the market risk amendments to the Basel framework (including the 2011 revisions). The Market Risk Rule threshold is set as banking organizations that have aggregated trading assets and liabilities of at least \$1 billion or 10 percent of total assets. The impact on market risk of different market and macroeconomic conditions and the risk of a significant deterioration in market liquidity are taken into account in the stress testing program (see EC5 and EC6). Guidance does not clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.

Banking Institutions with aggregated trading assets and liabilities less than \$1 billion or 10 percent of total assets

FDIC's independent assessment of risk is conducted in order to make a determination on insurance pricing. Insurance premiums need to be adjusted to compensate for riskier activities.

The Federal Reserve has also issued guidance with respect to market risk.

In addition, each agency supplements these requirements and guidance with procedures and programs that set out more specific supervisory guidance on risk-management expectations.

The U.S. applied a modified version of Basel II Standardized Approach, which takes into account the 2009 "Enhancements to the Basel II Framework". The requirements do not include references to credit ratings, consistent with section 939A of the Dodd Frank Act, but include alternative standards of creditworthiness. Although the regime differs in a number of areas from the Basel II standardized approach, the agencies expressed the view that they are "generally consistent with the goals of the international framework." For example, the Simplified Supervisory Framework Approach (SSFA) has been introduced and is only available to banking organizations for which the Advanced Approach and/or the Market Risk Final Rule do not apply. If the SSFA is not applied, a gross-up approach can be used. If neither approach is used, a risk weight of 1,250 percent is applied, but the chosen securitization approach must be applied consistently across all securitization exposures.

The assessors noted that the U.S. is currently undertaking a Basel Regulatory Capital Assessment Programme (RCAP), which will determine the materiality of deviations.

Banking Institutions with aggregated trading assets and liabilities of at least \$1 billion or 10 percent of total assets

Supervisors expect all material market risks to be captured within the market risk rule.

The Supervisors have set out standards for use of internal models for Value-at-Risk (VAR) calculations and Stressed Vary in market risk capital calculations including treatment of credit spread risk, correlations within and across risk categories, as well as risks arising from the nonlinear price movements. They have also set standards for specific risk capital requirements including use of internal models and the application of specific risk add-on factors.

Banking Institutions with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure (Advanced Approach)

From 1 January 2014, for banking organizations subject to the advanced approaches framework (column 3 – Table 22.1), market risk capital requirements are calculated under subpart F of the agencies' new capital rule that implements the Basel capital framework, as modified by Basel II and Basel III. The market risk requirements in the new rule are substantively the same as those listed in Table 22.1. However, Advanced Approaches organizations will be required to calculate both a general risk-based capital requirement as well as an advanced risk-based capital requirement. Each measure of market risk (general or

	<p>advanced) will need to be multiplied by 12.5 to determine its market risk equivalent assets.</p> <p><i>Note</i></p> <p><i>From 1 January 2015 all other banking organizations subject to the agencies' capital regulations will adopt the approach calculated under subpart F of the agencies' new capital rule.</i></p>
EC2	The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	<p>As described above, supervisors examine banks and holding companies to determine whether they have comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks, including market risk.</p> <p>The Federal Reserve and OCC issued joint guidance on model risk management (SR 11-7 and OCC Bulletin 2011-12). This guidance sets out the overall responsibilities a banking organization's board and senior management collectively are expected to deliver, including the establishment of a strong model risk management framework that fits into the broader risk management of the organization.</p> <p>The OCC issued supplemental guidance (Bulletin 2014-8) specifying examination procedures applicable to any national bank, federal branch or agency, or federal savings association that is an active end-user of derivatives or has significant trading activity. The guidance set out examination requirements on the evaluation of a bank's board of directors' ability to understand and oversee risks related to end-user derivatives and trading activities.</p>
EC3	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ul style="list-style-type: none"> (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	Market risk capital requirements provide that banking organizations subject to the market risk rule requirements (e.g. SR09-1) must establish limits on positions and monitor them daily, and that senior management and qualified personnel must periodically (at least annually) reassess these limits. Banking organizations must also validate their models on an on-going basis in accordance with the various parameters set forth in the agencies' new capital rule. Capital rules also includes oversight and audit requirements with respect to market risk models and requires banking organizations to adequately document all material aspects of the internal models, management and valuation of market risk positions, control, oversight, validation, and review processes and results. The rule also requires banking organizations to have a rigorous process for assessing overall capital adequacy in relation to their market risk; this includes the

	<p>allocation to the trading book.</p> <p>In addition, Federal Reserve and OCC jointly issued guidance (SR 11-7 and OCC Bulletin 2011-12) specify supervisory expectations in relation to EC3 (d).</p> <p>Under the agencies' general supervisory authority, supervisors may assess and monitor a supervised banking organization's policies and procedures to determine whether it is adequately monitoring and controlling its market risk.</p> <p>The OCC's Bulletin 2014-8 requires examiners to evaluate any bank that is an active end-user of derivatives or has significant trading activity. This review should include the market risk management information system and determine whether the reports are appropriate for effective supervision. Examiners must assess whether the information system can generate daily reports on the risk and other parameters at the portfolio level, the line-of-business level, and any other level appropriate for effective management or supervision. Examiners monitor limit breaches and the escalation of any breaches that are unapproved. The OCC requires banks to notify the agency, of models banks use to calculate risk-based capital requirements under the market risk rule, in advance of making any material changes, or extension of a model to a new business or product type.</p>
EC4	<p>The supervisor determines that there are systems and controls to ensure that bank' marked-to-market positions are re-valued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC4	<p>Market risk capital requirements include provisions requiring banking organizations subject to the rule to mark positions to market or model on a daily basis and require banking organizations to have rigorous valuation processes. The market risk capital requirements also provide that banking organizations must have a risk control unit independent from the business trading units and a validation process independent of the model development, implementation, and operation, or otherwise subject to independent review. In addition, a banking organization must have an internal audit function independent of business-line management that assesses the market risk controls. Under the rule, a banking organization must also have a process for valuing its market risk positions that includes policies and procedures on the valuation of positions, marking positions to market or to model, independent price verification, and valuation adjustments or reserves.</p> <p>Federal Reserve and OCC jointly issued guidance (SR 11-7 and OCC Bulletin 2011-12) also contain supervisory expectations related to model validation. All model components are expected to be subject to validation. Validation should be subject to critical review by an independent party. Staff conducting validation work should have explicit authority to challenge developers and users and to elevate their findings, including issues and deficiencies. The individual or unit to whom those staff report should have sufficient influence or stature within the bank to ensure that any issues and deficiencies are appropriately addressed in a timely and substantive manner. There is an expectation of regular, and at least annual, reviews of models. This would include the validation of vendor models. In addition, the guidance sets out the supervisory expectation that an effective validation framework should include three</p>

	<p>core elements:</p> <ul style="list-style-type: none"> • Evaluation of conceptual soundness, including developmental evidence; • On-going monitoring, including process verification and benchmarking; and • Outcomes analysis, including back testing. <p>Supervisors carry out targeted examinations and on-going supervisory monitoring programs to determine that there are systems and controls in place that ensure banks' marked-to-market positions are re-valued daily and are in compliance with regulatory requirements. The targeted examinations review the front office marked-to-market process as well as the financial control policies and procedures for independently verifying the front office valuation. The review also includes whether the bank has established sufficient thresholds for pricing variance and proper procedures for the escalation and resolution of disagreements.</p> <p>FDIC practices are two-fold. As the primary federal regulator for State Non-Member banks, the FDIC has dedicated staff to monitor and assess the banks' valuation process, supplemented by periodic target examinations that involve transaction testing. As the back-up regulator for national banks and state-member banks, the FDIC participates in OCC and Federal Reserve led reviews of the financial controller's group and front office business to assess valuation practices. These reviews can be conducted as part of evaluation of compliance with market requirements or as a separate review targeting the financial controller's group.</p> <p>The OCC's Bulletin 2014-8 requires examiners to determine whether the bank's valuation policies, processes, and controls produce consistent and reliable valuation of positions. Examiners review the bank's valuation policies and identify deficiencies. Examiners evaluate the valuation control function's effectiveness at ensuring the accuracy of marks transferred to the bank's general ledger through the review of price-testing results and fair value adjustments by the independent valuation control unit.</p>
<p>EC5</p>	<p>The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.</p>
<p>Description and findings re EC5</p>	<p>Banking Institutions with aggregated trading assets and liabilities of at least \$1 billion or 10 percent of total assets</p> <p>The Market Risk Capital rules require a banking organization to have a rigorous process for assessing its overall capital adequacy in relation to its market risk. In addition, a banking organization must have a process for prudent valuation of its trading positions covered by the market risk requirements, including policies and procedures on the valuation of positions, marking positions to market or to model, independent price verification, and valuation adjustments or reserves. The valuation process must consider, as appropriate, unearned credit spreads, closeout costs, early termination costs, investing and funding costs, liquidity, and model risk.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>The U.S. Federal Banking Agencies implement section 165(i)(2) of the DFA, which requires financial companies with more than \$10 billion in assets to conduct annual company-run stress tests using scenarios provided by the FBAs.</p> <p>Banking Institutions with at least \$50bn of Assets</p>

	<p>Section 165(i)(1) of the DFA requires the Federal Reserve to conduct annual stress tests of U.S. Bank Holding Companies with total consolidated assets of \$50 billion or more. The board of directors and senior management must use the results of the stress tests in (i) their capital plan and capital planning process; (ii) assessing their exposures, concentrations, and risk positions; and (iii) their update to the covered company's resolution plan.</p>
<p>EC6</p>	<p>The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.</p>
<p>Description and findings re EC6</p>	<p>Capital rules require a banking organization to stress test the market risk of its covered positions at a frequency appropriate to each portfolio, taking into account concentration risk, illiquidity under stressed market conditions, and risks arising from the banking organization's trading activities that may not be adequately captured in its internal models. In addition, banking organizations must calculate a stressed VaR.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>Guidance outlines broad principles for a satisfactory stress testing framework and describes the manner in which stress testing should be employed as an integral component of risk management that is applicable at various levels of aggregation within a banking organization, as well as for contributing to capital and liquidity planning. The guidance states that an effective stress testing framework covers a banking organization's full set of material exposures, activities, and risks, whether on or off the balance sheet, based on effective enterprise-wide risk identification and assessment. Risks addressed in a firm's stress testing framework may include (but are not limited to) credit, market, operational, interest-rate, liquidity, country, and strategic risk.</p> <p>Supervisors also published final rules implementing section 165(i)(2) of the DFA, which require financial companies with more than \$10 billion in assets to conduct annual company-run stress tests using scenarios provided by the FBAs. The FBAs may require such financial companies with significant trading activity to include a market shock component into their stress tests.</p> <p>Under the Federal Reserve's stress testing rule for Bank Holding Companies with total consolidated assets of between \$10 billion and \$50 billion, as well as for state member banks and Savings and Loan Holding Companies with total consolidated assets greater than \$10 billion, the Federal Reserve may similarly require Bank Holding Companies and Savings and Loan Holding Companies subject to that rule with significant trading activity to include a market shock component into their stress tests. This component may also be required for state member bank stress tests if the state member bank is subject to the Federal Reserve's market risk capital requirements.</p> <p>The OCC requires nationally chartered banks and savings associations with consolidated assets of more than \$10 billion to perform a company-run stress test annually. The annual stress-testing report collects detailed data on covered institutions' quantitative projections of balance sheet assets and liabilities, income, losses, and capital across a range of macroeconomic scenarios. It also collects qualitative supporting information on the methodologies used to develop internal projections of capital across stressed economic scenarios. A key component of the annual stress test is the stress test scenarios. Scenarios are sets of conditions that affect the U.S. economy or the financial condition of covered institutions. Each scenario includes the values of the variables specified for each quarter over a nine-quarter stress test horizon. The variables specified for each scenario generally address economic activity, asset prices, and other measures of financial market conditions for the U.S. and key foreign countries. For banks with significant trading activities, the OCC may require a</p>

	<p>“market shock” scenario to estimate projected losses in the trading portfolio. The OCC annually will determine scenarios that are appropriate for use for each annual stress test.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>In addition, under the Federal Reserve’s stress testing rules, the Federal Reserve may use a “market shock” scenario in its supervisory stress test, as well as require some companies subject to the rule to include such a scenario in their company-run stress tests. In including a market shock in the stress tests, the Federal Reserve may use a combination of methodologies (including companies’ internal models) to estimate projected losses in the trading portfolio. Currently, the market shock component for stress testing applies to Bank Holding Companies subject to the Federal Reserve’s market risk capital requirements and that have total consolidated assets greater than \$500 billion.</p>
Assessment of Principle 22	Compliant
Comments	<p>The Market Risk regime is comprehensive and understood.</p> <p>The assessors found very active engagement from supervisors on implementing the regime they have in place and in dealing with material market risk issues, such as valuation allowances, profit and loss attributions, etc. They make appropriate use of peer-group comparison such as through Hypothetical Portfolio Exercises.</p> <p>The material weaknesses identified in the 2009 BCP—such as market risk monitoring and management—have been significantly improved. The Supervisors have implemented much of the Basel II approach and also supplemented that for those banks subject to the Market Risk Rule. This improved market risk measurement and monitoring processes and models at certain major firms and lack of reliable valuation of MTM positions. The Stress Test Regime mandated under DFA has also improved the completeness and use of market stress testing.</p>
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁸¹ in the banking book on a timely basis. These systems take into account the bank’s risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank’s strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank’s changing risk profile and market developments.
Description and findings re EC1	The U.S. Supervisors define interest rate risk in the banking book to be the current or prospective risk to both earnings and capital arising from adverse interest rate movements that affect the bank’s and holding company’s banking book. The main sources of interest rate

⁸¹ Wherever “interest rate risk” is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

risk in the banking book are re-pricing risk, yield curve risk, basis risk, and the option features embedded in many financial instruments.

Unlike many of the other risks that are covered in this BCP Assessment, there is no specified tiering of the approach, instead guidance is written as requiring standards in proportion to the risk being run. The safety and soundness statutes and supervisory guidance provide the legal basis for the imposition and enforcement of these requirements by the U.S. FBAs. The U.S. Supervisors do not apply a specific, rules based, capital charge for interest rate risk. However, the agencies appear to have the ability, if necessary, to increase capital if they feel capital levels do not sufficiently support the firm's risks, including interest rate risk.

The principals-based approach to interest rate risk examinations relies on the interagency policy statement from 1996 (for example SR 96-13), the 2010 interagency Advisory on Interest Rate Risk Management (for example SR 10-1), and the FAQs on 2010 Interagency Advisory on Interest Rate Risk Management (for example SR 12-2). Supervisors adhere to the Uniform Financial Institutions Ratings System (UFIRS) and evaluate every bank against UFIRS guidelines during on-site examinations. UFIRS has a component to rate *Sensitivity to Market Risk* in the CAMELS ratings (S) that requires supervisors to evaluate the bank's exposure to, and management of, the interest rate risk in its banking book. Specifically, this component reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a bank's earnings or economic capital. For most U.S. banks and holding companies, the primary source of market risk is the interest rate risk that arises from non-trading positions in their banking book. In some larger banks and holding companies, foreign operations can be a significant source of market risk. For some banks and holding companies, trading activities are a major source of market risk.

The Sensitivity to market risk evaluation is based upon, but not limited to, an assessment of the following evaluation factors:

- The sensitivity of the bank's earnings and the economic value of its capital to adverse changes in interest rates, foreign exchange rates, commodity prices, or equity prices.
- The ability of management to identify, measure, monitor, and control exposure to market risk given the size, complexity, and risk profile.
- The nature and complexity of interest rate risk exposure arising from non-trading positions.
- Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.
- Effectiveness of board and senior management oversight of a bank's interest rate risk activities;
- Comprehensiveness and effectiveness of risk management processes and control of interest rate risk;
- Assumed interest rate risk is effectively managed and that appropriate policies and practices are established to control and limit risks;
- Accurateness and timeliness of the identification and measurement of interest rate risk to ensure proper risk management and control; and,
- Quality of the system for monitoring and reporting risk exposures by senior management and associated reporting to the board.

The safety-and-soundness statute explicitly requires the U.S. FBAs to prescribe standards for banks, savings associations and holding companies relating to interest rate exposure (see 12

	<p>U.S.C. § 1831p-1(a)(1)(D). The interagency safety-and-soundness guidelines specify that a bank should: (i) manage* interest rate risk in a manner appropriate to the size and complexity of its assets and liabilities; and (ii) provide for periodic reporting to management and the board of directors regarding interest rate risk with adequate information for management and the board of directors to assess the level of risk. Interest rate risk management also is integral to ensuring compliance with regulatory capital standards and the interagency capital rules.</p> <p>In our review of material the assessors also saw evidence of supervisors making assessments of the risk appetite and risk profile of banks taking into account market and macroeconomic conditions.</p> <p>(*this would incorporate identification, management, monitoring and mitigation consistent with the U.S. approach for other risks)</p>
<p>EC2</p>	<p>The supervisor determines that a bank’s strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank’s Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.</p>
<p>Description and findings re EC2</p>	<p>The Guidance set out in EC1 sets out the Supervisors’ expectations that the Board for setting the bank’s or holding company’s “tolerance for interest rate risk, including approving relevant risk limits and other key policies, identifying lines of authority and responsibility for managing risk, and ensuring adequate resources are devoted to interest rate risk management” as well as monitoring “the bank’s overall interest rate risk profile and ensuring that the level of interest rate risk is maintained at prudent levels.” The policy statement also indicates that senior management is responsible for ensuring that interest rate risk is managed appropriately. In this regard, senior management should develop and implement policies and procedures; ensure adherence to board approved responsibilities for measuring, managing, and reporting interest rate risk exposures; oversee the implementation and maintenance of management information and other systems that identify, measure, monitor, and control the bank’s and holding company’s interest rate risk; and establish internal controls over the interest rate risk management process. U.S. federal banking supervisors confirm a bank’s or holding company’s compliance with this statement during on-site examinations. Additionally, the 2010 Interagency Advisory on Interest Rate Risk Management states that “management is responsible for maintaining:</p> <ul style="list-style-type: none"> • Appropriate policies, procedures and internal controls addressing interest rate risk management, including limits and controls over risk taking to stay within board-approved tolerances; • Comprehensive systems and standards for measuring interest rate risk, valuing positions, and assessing performance, including procedures for updating interest rate risk measurement scenarios and key underlying assumptions driving the institution’s interest rate risk analysis; and, • Sufficiently detailed reporting processes to inform senior management and the board of the level of interest rate risk exposure.” <p>In assessing the strategy, policies, procedures and processes for the identification, measurement, monitoring, and control of interest rate risk, supervisors perform off-site risk assessments and on-site examinations.</p> <p>Supervisors obtain, review, and evaluate the interest rate risk and other relevant policies and procedures (written or unwritten); board and asset liability committee and other management meeting minutes; current strategic plan; and internal risk-management reports during the on-</p>

	<p>site examination. Examination procedures also call for supervisors to assess board and senior management oversight; evaluate the quality of interest rate risk management; evaluate the internal controls and internal audit function; and evaluate the exposure to interest rate risk from an earnings and economic-value perspective.</p>
<p>EC3</p>	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
<p>Description and findings re EC3</p>	<p>The Guidance set out in EC1 sets out the Supervisors' expectations that the board is responsible for setting the bank's or holding company's "tolerance for interest rate risk, including approving relevant risk limits and other key policies, identifying lines of authority and responsibility for managing risk, and ensuring adequate resources are devoted to interest rate risk management" as well as monitoring "the bank's overall interest rate risk profile and ensuring that the level of interest rate risk is maintained at prudent levels." The policy statement also indicates that senior management is responsible for ensuring that interest rate risk is managed appropriately. In this regard, senior management should develop and implement policies and procedures; ensure adherence to board approved responsibilities for measuring, managing, and reporting interest rate risk exposures; oversee the implementation and maintenance of management information and other systems (including models) that identify, measure, monitor, and control the bank's and holding company's interest rate risk; and establish internal controls over the interest rate risk management process. U.S. federal banking supervisors confirm a bank's or holding company's compliance with this statement during on-site examinations. Additionally, the 2010 Interagency Advisory on Interest Rate Risk Management states that "management is responsible for maintaining:</p> <ul style="list-style-type: none"> • Appropriate policies, procedures and internal controls addressing interest rate risk management, including limits and controls over risk taking to stay within board-approved tolerances; • Comprehensive systems and standards for measuring interest rate risk, valuing positions, and assessing performance, including procedures for updating interest rate risk measurement scenarios and key underlying assumptions driving the institution's interest rate risk analysis; and, • Sufficiently detailed reporting processes (including exception tracking) to inform senior management and the board of the level of interest rate risk exposure." <p>In assessing the strategy, policies, procedures and processes for the identification, measurement, monitoring, and control of interest rate risk, supervisors perform off-site risk</p>

	<p>assessments and on-site examinations.</p> <p>Procedures direct supervisors to obtain, review, and evaluate the interest rate risk and other relevant policies and procedures (written or unwritten); board and asset liability committee and other management meeting minutes; current strategic plan; and internal risk-management reports during the on-site examination. Examination procedures also call for supervisors to assess board and senior management oversight; evaluate the quality of interest rate risk management; evaluate the internal controls and internal audit function; and evaluate the exposure to interest rate risk from an earnings and economic-value perspective.</p>
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	<p>FBA's have an expectation (rather than a requirement) that the bank's or holding company's management should include both scenario and sensitivity analysis, as an integral component of interest rate risk management. Where this expectation is not met, FBA's would need to resort to a determination that failure to include appropriate scenarios into a bank's stress testing program would be an unsafe or unsound practice. If they made such a determination they could then require banks to include such scenarios and sensitivities. In practice the assessors saw numerous examples of banks providing scenarios into their supervisory programs at the request of the supervisor.</p> <p>In general, scenario analysis uses a model to predict a possible future outcome given an event or series of events, while sensitivity analysis tests a model's parameters without relating those changes to an underlying event or real world outcome.</p> <p>When conducting scenario analyses, institutions are expected to assess a range of alternative future interest rate scenarios in evaluating interest rate risk exposure. This range is expected to be sufficiently meaningful to fully identify basis risk, yield curve risk and the risks of embedded options. In many cases, static interest rate shocks consisting of parallel shifts in the yield curve of plus and minus 200 basis points may not be sufficient to adequately assess an institution's interest rate risk exposure. As a result, institutions are expected to assess regularly interest rate risk exposures beyond typical industry conventions, including changes in rates of greater magnitude (e.g., up and down 300 and 400 basis points) across different tenors to reflect changing slopes and twists of the yield curve. Institutions are also expected to ensure their scenarios are severe but plausible in light of the existing level of rates and the interest rate cycle.</p> <p>Depending on an institution's interest rate risk profile, stress scenarios were expected to include but not be limited to:</p> <ul style="list-style-type: none"> • Instantaneous and significant changes in the level of interest rates (instantaneous rate shocks); • Substantial changes in rates over time (prolonged rate shocks); • Changes in the relationships between key market rates (i.e., basis risk); and • Changes in the slope and the shape of the yield curve (i.e., yield curve risk).
Additional criteria	
AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.

<p>Description and findings re AC1</p>	<p>All Banks</p> <p>Supervisors use the bank's or holding company's internal measures of risk, require sound risk-management practices, and use surveillance screens to identify those banks and holding companies that appear to be taking excessive risk. The agencies' regulatory Call Reports include maturity and re-pricing information on each bank's investment, loan and deposit portfolios. Banks and holding companies must also report the current fair value of their investment portfolios.</p> <p>During on-site examinations, supervisors review the bank's or holding company's internal interest rate risk exposure reports and also evaluate whether the interest rate risk measurement system, structure and capabilities are adequate to accurately assess the risk exposure, support the risk management process, and serve as a basis for internal limits and authorizations.</p> <p>Interest rate risk exposure estimates, whether linked to earnings or economic value, use some form of forecasts or scenarios of possible changes in market interest rates. In conducting this analysis, supervisors confirm that a bank's or holding company's interest rate risk measurement systems assess all material interest rate risk associated with its assets, liabilities, and off-balance-sheet positions over an appropriate range of interest rate scenarios; use generally accepted financial concepts and risk-measurement techniques; and have well documented assumptions and parameters.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>At the largest banks and holding companies, the agencies maintain on-site examination staff that receives more detailed information on those banks' and holding companies' portfolios and risk exposures.</p>
<p>AC2</p>	<p>The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.</p>
<p>Description and findings re AC2</p>	<p>The 1996 Joint Agency Policy Statement: Interest Rate Risk (<i>footnote 3</i>) states that the adequacy and effectiveness of a bank's or holding company's interest rate risk management process and the level of its interest rate exposure are critical factors in an agency's evaluation of the bank's and holding company's capital adequacy. A bank or holding company with material weaknesses in its risk-management process or high levels of exposure relative to its capital will be directed by the appropriate agency to take corrective action. Depending on the facts and circumstances, such actions could include recommendations or directives to raise additional capital, strengthen management expertise, improve management information and measurement systems, reduce levels of exposure, or some combination thereof.</p>
<p>Assessment of Principle 23</p>	<p>Compliant</p>
<p>Comments</p>	<p>The assessors find the U.S. compliant. The principles-based approach seems to be backed by adequate supervision proportionate to the size and complexity of the bank and the risk being run. The assessors saw a number of examples of supervisors applying the guidance they have.</p> <p>The assessors would, however, make some comments in the spirit of further strengthening the framework in line with evolving international best practices.</p> <p>The assessors found that the approach to interest rate risk was in marked contrast to other risks in the BCP assessment. There is no tiering for example (although supervisory practice seems proportionate to the risk) and the philosophy is firmly one of a principles based approach. No specific capital is being set aside against a change in interest rates, nor any</p>

	<p>supervisory limits. The assessors certainly did see active supervisory engagement at the individual bank level (for example interventions on the appropriateness of modeling assumptions) and in horizontal reviews (such as one on the risk arising from a sudden rise in interest rates—so called Snap Back risk). There was also evidence of prescribed stress testing scenarios.</p> <p>The assessors are however left with a concern that given the stage of the economic cycle in the U.S., the inherent interest rate exposure is high and that there are particular concentrations in the small bank (community bank) sector. The risk of a principles based approach is its inconsistency across a sector and also with time and as such banks or a group of banks may be overly exposed.</p> <p>The assessors would recommend that the Agencies consider revising their 1996 guidance to include more quantitative guidelines. The advantage of guidelines would be: (i) to provide a signal as to what authorities regard as acceptable, as such they can have a powerful preventative effect; (ii) the time gap between going past a guideline and action is short and not as now where supervisors tend to first ask for a plan of rectification; (iii) they provide a useful reference point for offsite and continuous monitoring and can indicate when a bank might need to be reviewed by supervisory management. Clearly this could be done in line with any initiative that the Basel Committee Banking Supervision might take.</p>
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	As with many aspects of the supervisory regime, the approach is tiered. In the case of liquidity risk. The safety and soundness statutes and supervisory guidance provide the legal basis for the imposition and enforcement of liquidity-risk management requirements by the U.S. FBAs. See Table 24.1

	1	2	3	4	5	6	7	
Table 24.1	All US banking organisations	Banking Institutions with at least \$10bn of Assets	Banking Institutions with at least \$50bn of Assets	Globally Systemically Important Banks	Foreign Banking Organisations with Combined US assets of at least \$100bn	Foreign Banking Organisations with Combined US assets of at least \$50bn	Foreign Banking Organisations with Combined US assets of less than \$50bn	
Liquidity Risk Management	An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material liquidity risks. Interagency guidance (SR10-6, and OCC Bulletin 2010-13, FDIC 5000)		Largely set as requirements for the Board, Risk Committee and Senior Management		Largely set as requirements on the US Chief Risk Officer and the US Risk Committee		An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material liquidity risks. Interagency guidance (SR10-6, and OCC Bulletin 2010-13, FDIC 5000)	
Cash Flow Projections			Produce and frequently update cash flow projections					
Contingency Funding Plan			Must maintain and update a Contingency Funding Plan					
Liquidity Risk Limits			Must have limits on areas such as funding concentrations, liabilities that mature by time horizon and off-balance sheet and other exposures					
Risk Monitoring			Must monitor collateral within and across legal entities, currencies and business lines and intraday exposures.					
Reporting	Call Report	Form FR 2052 b Quarterly	Form FR 2052 b Monthly	Form FR 2052 a Daily	Form FR 2052 a twice Monthly and on occasion	Form FR 2052 b on occasion	Call Report	
Stress Testing	Must carry out a stress test		Must carry out a monthly liquidity stress test					
Liquidity Buffer	"Cushion of liquid Assets"		Must maintain a buffer equivalent to the net stressed cash-flow need over 30 days		Must maintain separate buffers for its branches and intermediate holding company equivalent to the net stressed cash-flow need over 30 days for the Intermediate Holding Company and 14 days for the US Branches		No requirement	
Composition of Buffer	No Requirement		Only unencumbered high quality liquid assets					No requirement

Note:

Banking Institutions with at least \$10bn of Assets

The U.S. FBAs are also in the process of implementing in the U.S. an LCR requirement consistent with the Basel III LCR (as modified). On 29 November 2013, the U.S. FBAs jointly published a proposed rule to implement an LCR requirement in the U.S. (proposed rule or proposed LCR). The proposed rule would apply to all internationally active banking organizations (depository institutions, Bank Holding Companies, and those Savings and Loan Holding Companies not substantially engaged in insurance underwriting and commercial activities, and to the consolidated insured depository institution subsidiaries of the foregoing with \$10 billion or more in total consolidated assets). The proposed rule would also apply to nonbank financial companies supervised by the Federal Reserve that do not have significant insurance operations. Under the proposed rule, an institution would be required to hold minimum amounts of high-quality liquid assets such as central bank reserves and certain government and corporate debt that can be converted easily and quickly into cash.

High quality liquid assets are broken into three levels: level 1 liquid assets (such as central bank excess reserves), level 2A liquid assets (such as U.S. government-sponsored agency debt), and level 2B liquid assets (such as corporate debt of nonfinancial companies) that are liquid and readily marketable and can be converted easily and quickly into cash.

Each institution would be required to hold high-quality, liquid assets in an amount equal to or greater than its projected cash outflows minus its projected cash inflows during a 30-day stress period. The proposed rule is generally consistent with the Basel III LCR standard, but is more stringent in several areas, including the range of assets that will qualify as high-quality liquid assets and the assumed rate of outflows of certain kinds of funding. In addition, the proposed transition period is shorter than that included in the BCBS standard.

Banking Institutions with at least \$50bn of Assets, but not internationally active

The Federal Reserve also proposed in the same rulemaking to apply a less stringent version of the LCR (based on a 21-day stress scenario) to Bank Holding Companies and Savings and Loan Holding Companies that are not internationally active, but have \$50 billion or more in total

	<i>consolidated assets.</i>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	<p>All banking institutions</p> <p>Under the Liquidity Risk Policy Statement, banks and Bank Holding Companies are expected to have a liquidity management process sufficient to meet their daily funding needs and cover both expected and unexpected deviations from normal operations. This includes comprehensive liquidity risk measurement and monitoring systems that are commensurate with the complexity and business activities of an institution. Banks and Bank Holding Companies are also expected to conduct stress tests regularly for a variety of institution-specific and market-wide events across multiple time horizons and take remedial or mitigating actions to limit exposures, build up a liquidity buffer, and adjust liquidity positions to the institution's risk tolerance taking into consideration the results of the stress tests. They are expected to perform cash flow projections that assess the liquidity risk of complex assets, liabilities and off-balance positions.</p> <p>The U.S. FBAs' historical approach to supervising liquidity risk has been qualitative in nature – focusing on sound practices instead of specific quantitative standards and tests. In general, supervisors confirm that a regulated bank or holding company has a process in place for managing liquidity that is commensurate with the size and complexity of its operation and its overall risk profile. As noted above, the U.S. FBAs assess each bank and holding company's liquidity as part of the Uniform Financial Institutions Rating System ("UFIRS"). The rating system directs that:</p> <p><i>"In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost, or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions."</i></p> <p>The U.S. FBAs' regulatory Call Reports collect information on each bank and holding company's liability and deposit mix, including information on deposit maturities and re-pricing characteristics. These reports also capture the level of large deposits that may not be covered by FDIC deposit insurance, non-maturity deposits, non-deposit borrowings that may be credit sensitive, and off-balance-sheet commitments. Each agency uses these and other market-related data in various surveillance and monitoring tools to identify banks and holding companies that may have high potential liquidity-risk exposures.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>U.S. Bank Holding Companies are subject to the enhanced liquidity standards in Regulation YY must fulfill a number of requirements of the rule that are intended to ensure that these institutions are managing their liquidity risk and maintaining a liquidity position that reflects their liquidity risk profile in the market and macroeconomic conditions in which they operate. For example, they must regularly produce cash flow projections for flows arising from assets, liabilities, and off-balance sheet exposures over, at a minimum, short- and long-term time horizons. The cash flows must be reviewed regularly by senior management to ensure that the</p>

liquidity risk of the company is within the liquidity risk tolerance established by the board of directors. In addition, when conducting the internal liquidity stress tests required under Regulation YY, companies subject to those requirements must take into consideration the balance sheet exposures, off-balance sheet exposures, size, risk profile, complexity, business lines, organizational structure, and other characteristics of the company. In addition, each liquidity stress test must include, at a minimum, a stress scenario reflecting adverse market conditions, a scenario reflecting idiosyncratic stress event, and a scenario reflecting combined market and idiosyncratic stress. The company must also incorporate additional liquidity stress scenarios as appropriate based on the financial condition, size, complexity, risk profile, scope of operations, or activities of the company. Under Regulation YY, a buffer of highly liquid assets must be held to cover 30 days of net outflows identified by the internal stress tests.

Additionally, the Regulation YY liquidity requirements are a part of a set of enhanced prudential standards that increase in stringency based on the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the institution being supervised. As a result, the supervisors expect a range of sound practices based on the business activities, objectives, and risk profile of the bank and holding company. Through the examination process, supervisors evaluate each bank and holding company's process for managing liquidity risk to ensure that it is appropriate for the nature and scale of the bank or holding company's business activities and commensurate with the bank or holding company's liquidity risk arising from both on and off-balance-sheet activities. The operational context of the bank or holding company's liquidity risk profile, including international liquidity flows, must also be monitored.

Furthermore, banks must constantly monitor and update their daily funding needs by legal entities. Banks are also required to develop an adequate intercompany liquidity/funding reporting framework, such as funding source and usage by legal entities and the legal entities' liquidity buffer. These will provide a roadmap to the single point of entry approach under DFA's Title II—FDIC resolution planning.

The Federal Reserve collects monthly liquidity information that provides information on each firm's unencumbered liquidity buffer and funding structure.

FBOs with Combined U.S. Assets of at least \$50bn

Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than the whole company, Board of Directors or Senior Management. The liquidity buffer for the Intermediate Holding Company must be sufficient to meet the projected "net stressed cash-flow need" over the 30-day planning horizon of the liquidity stress tests, taking into account the various scenarios required for those liquidity stress tests. The liquidity buffer for the U.S. Branches must be sufficient to meet the projected net stressed cash-flow need over only the first 14 days of the 30-day planning horizon. The liquidity buffer must be composed of unencumbered highly liquid assets.

Globally Systemically Important Banks

As part of its supervision, the Federal Reserve has collected detailed daily liquidity information from the globally systemically important institutions that include funding risks as well as liquidity buffers.

Note:

In addition, under the proposed LCR, banking organizations and other institutions subject to the

	<i>rule would be required to hold a minimum amount of high-quality liquid assets to cover net outflows calculated using a standardized regulatory stress scenario, consistent with the Basel standard. The net outflows calculation considers both on-and-off balance sheet risks.</i>
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	<p>All banking institutions</p> <p>The Liquidity Risk Policy Statement establishes the supervisory expectation that banks and Bank Holding Companies have a comprehensive management process for identifying, measuring, monitoring, and controlling liquidity risk, which is integrated fully into the institution's risk management process. Under the guidance, the board of directors of a bank or BHC is expected to ensure that an institution's liquidity risk tolerance is established and communicated to all levels of management, and that they or a committee of the board oversee the establishment and approval of liquidity risk management strategies, policies and procedures. Senior management is expected to appropriately execute board-approved strategies, policies, and procedures for managing liquidity risk, including overseeing the development and implementation of appropriate risk measurement and reporting systems, liquidity buffers, contingency funding plans, and internal control infrastructure. In addition (see EC2 above) under the guidance, banks and Bank Holding Companies are expected to conduct liquidity stress tests and adjust their liquidity position taking into account the results of those tests.</p> <p>Supervisors also confirm that these policies and procedures are approved by the board of directors of the bank and holding company or an appropriate committee of the board, and reflect the objectives, risk tolerances and goals of the board of directors.</p> <p>Generally, while formal supervisory approval of a bank or holding company's policies and procedures is not required, the policies and procedures are reviewed through the supervisory process. Deficiencies and recommendations to rectify the deficiencies are noted in the report of examination (or similar communications) and discussed with senior management and, if necessary, the board of directors.</p> <p>U.S. Banking Institutions with at least \$50bn of Assets</p> <p>Regulation YY requires firms subject to the rule to have a robust and comprehensive liquidity risk management framework as provided by the rule. Under Regulation YY, the board of directors must establish the liquidity risk tolerance for the company. Senior management must establish and implement strategies, policies and procedures designed to manage effectively the liquidity risk of the company and determine whether the company is operating in accordance with those policies and procedures. Senior management must report regularly to the board of directors or the company's risk committee regarding the liquidity risk profile and liquidity risk tolerance of the company, and the board of directors must regularly review the procedures and policies established by senior management and whether the company is operating in accordance with its established liquidity risk tolerance.</p> <p>Regulation YY requires that firms conduct internal liquidity stress tests and sets out how these should be done. Firms must hold liquid assets sufficient to cover net outflows over 30 days as identified by the stress tests.</p>

	<p>Through a combination of on-going monitoring and an annual comprehensive liquidity assessment review (CLAR), supervisors confirm that banks and holding companies have documented strategies for managing liquidity risk and clear policies and procedures for limiting and controlling risk exposures. Strategies should identify primary sources for meeting daily operating cash outflows as well as seasonal and cyclical cash flow fluctuations. In addition, the bank's and holding company's strategies and policies and procedures should address alternative responses to various adverse business scenarios including, but not limited to, deterioration in the institution's asset quality or capital adequacy. When necessary, policies, procedures, and limits should address liquidity separately for major currencies in which the bank and holding company conducts business. Policies and processes should take into account both specific legal entities and an enterprise-wide view.</p> <p>Regulation YY also provides that firms must conduct regular stress tests on cash-flow projections by identifying liquidity stress scenarios based on the company's full set of activities, exposures and risks, both on and off-balance sheet, and by taking into account non-contractual sources of risks, such as reputational risks.</p> <p>FBOs with Combined U.S. Assets of at least \$50bn</p> <p>Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than the whole company, Board of Directors or Senior Management.</p> <p><i>Note</i></p> <p><i>In addition, under the proposed LCR, banking organizations and other institutions subject to the rule would be required to implement and maintain appropriate policies and procedures and systems to enable them to exercise operational control over high-quality liquid assets to ensure that they are available to provide liquidity when needed, consistent with the Basel standard.</i></p>
<p>EC4</p>	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
<p>Description and findings re EC4</p>	<p>All banking institutions</p> <p>Under the Liquidity Risk Policy Statement, banks and Bank Holding Companies are expected</p>

to have a comprehensive liquidity risk management process and liquidity risk tolerance established by the board of directors or its risk committee. Policies and procedures should limit and control risk exposures and appropriately reflect the risk tolerance, and clearly articulate a liquidity risk tolerance appropriate for the business strategy of the company. The board of directors (or a delegated committee thereof) is also expected to oversee the establishment and approval of liquidity management strategies policies and procedures, and review them at least annually. The board of directors is expected to ensure that it understands the nature of liquidity risks and periodically reviews information necessary to maintain this understanding, establishes lines of authority and responsibility for managing liquidity risk, and enforces senior management's duties to monitor and control liquidity risks. In addition, banks and Bank Holding Companies are expected to clearly identify the individual or committees responsible for implementing and making liquidity risk decisions.

Institutions are expected to have the ability to calculate all of their collateral positions in a timely manner, including the value of assets pledged and assets available to be pledged, and the collateral should be monitored. Liquidity risk reports should provide aggregate information with sufficient supporting detail to enable management to assess the sensitivity of the institution to changes in market conditions, its own financial performance, and other risk factors. Institutions are expected to actively monitor and control liquidity risk exposures and funding needs within and across currencies, legal entities and business lines. Also, institutions with material payment, settlement, and clearing activities are expected to manage actively their intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under normal and stressed conditions.

Banking Institutions with at least \$50bn of Assets

Regulation YY requires a robust and comprehensive liquidity risk management framework that requires the board of directors to establish a liquidity tolerance for the company and requires policies and procedures to conform to that liquidity risk tolerance. The board of directors must regularly review how liquidity risk is being managed, within the liquidity risk tolerance that is set. Regulation YY also requires establishment of a liquidity risk management review function that is independent of the management functions that execute funding. This review function must regularly review and evaluate the adequacy and effectiveness of the company's liquidity risk management processes, including stress testing, and whether the liquidity risk management function complies with applicable law and sound business practices. This review function must report material risk management issues to the board of directors or its risk committee. Regulation YY also requires monitoring sources of liquidity risk and establishing limits on liquidity risks, including with regard to concentration and maturity mismatch risks. A company must also establish and maintain policies and procedures to monitor assets that have been, or are available to be, pledged as collateral, including calculating collateral positions regularly and monitoring shifts in the company's funding position.

With regard to intraday risk, Regulation YY provides that procedures must be established and maintained for monitoring intraday liquidity risk exposure of the company. These procedures must address how management will monitor and measure expected daily inflows and outflows, manage and transfer collateral for intraday credit, identify and prioritize obligations to meet them as needed, manage the issuance of credit, and consider collateral and liquidity needed to meet payment system obligations.

FBOs with Combined U.S. Assets of at least \$50bn

Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than

	the whole company, Board of Directors or Senior Management.
EC5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the on-going measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g. credit, market, operational and reputation risk) may impact the bank’s overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	<p>All Banks</p> <p>Under the Liquidity Risk Policy Statement, banks and Bank Holding Companies are expected to establish a funding strategy that provides effective diversification in the sources and tenor of funding. Institutions should maintain an on-going presence in its chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources. Institutions are expected to regularly gauge capacity to raise funds quickly from each source and to diversify available funding sources over different horizons and by different types of sources. Management is expected to ensure that market access is being actively managed, monitored, and tested. Institutions should also, according to the guidance, identify alternative sources of funding to be accessed during liquidity shocks. In addition, under the Liquidity Risk Policy Statement, banks and Bank Holding Companies are expected to maintain a cushion of highly liquid assets available to be sold or pledged to obtain funds in a range of stress scenarios.</p> <p>All institutions, regardless of size and complexity, are also expected to have a formal contingency funding plan that sets out the strategies for addressing liquidity shortfalls in emergency situations, establishing clear lines of responsibility, and articulating clear implementation and escalation procedures. The contingency funding plan should be regularly tested and should identify stress events, assess levels of severity and timing, assess funding sources and needs, identify potential funding sources, establish liquidity event management processes and establish a monitoring framework for contingent events. It is expected that an institution have effective strategies for communication with counterparties, credit rating agencies and other stakeholders when liquidity problems arise.</p> <p>The Liquidity Risk Policy Statement sets out that liquid assets are an important source of both primary (operating liquidity) and secondary (contingent liquidity) funding at many institutions, noting that these assets must be unencumbered to properly serve a liquidity function. Supervisors view the availability of a cushion of highly liquid assets that can be sold or pledged without legal, regulatory, or operational impediments (i.e., unencumbered) to obtain funds in a range of stress scenarios as a critical component of an institution’s ability to effectively respond to potential liquidity stress.</p> <p>Institutions should establish a funding strategy with effective diversification in the sources and tenor of funding. An institution should regularly gauge its capacity to raise funds quickly from</p>

each source. It should identify the main factors that affect its ability to raise funds and monitor those factors closely to ensure that estimates of fund raising capacity remain valid.

Institutions should also maintain an on-going presence in their chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources.

Supervisors expect banks and holding companies to have policies and processes to measure and monitor liquidity needs appropriate to the bank and holding company's risk profile; the agencies do not mandate or consider specific implicit or explicit scenarios in their assessment of the liquidity position of a bank and holding company given the diversity of the U.S. banking industry. Rather, supervisors review the robustness of the scenario analyses and stress tests conducted by banks and holding companies based on the size, complexity, and risk profile of the institution. The resiliency of a bank's or holding company's funding liquidity to firm-specific and market-wide stress conditions is also assessed through the supervisory process, which includes off-site monitoring and targeted examinations.

Supervisors ensure banks and holding companies conduct stress testing or scenario analysis of their liquidity position. Supervisors evaluate whether the stress tests or scenario analyses include an assessment of the potential impact of plausible stress events that are bank- and holding company-specific and/or externally-driven events. Also, supervisors determine whether events are stressed under different levels of severity, funding needs are quantified, funding sources are identified, and management processes, reporting, and external communication are addressed throughout a stress event. During the stress testing process, effective liquidity managers ensure that they choose potential adverse liquidity scenarios that entail appropriate degrees of severity; maintain an appropriate level of diversified funding sources; and model cash flows consistent with each level of stress.

In evaluating the adequacy of a bank's and holding company's liquidity position, supervisors consider the current level and prospective sources of liquidity compared with funding needs, as well as the adequacy of funds-management practices relative to the bank's and holding company's size, complexity, and risk profile. In general, supervisors confirm that funds-management practices ensure that a bank or holding company is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking needs of its community. Practices should reflect the ability of the bank or holding company to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the firm's ability to quickly liquidate assets with minimal loss. In addition, supervisors evaluate whether funds-management practices limit a bank or holding company's reliance on funding sources that may not be available in times of financial stress or in the face of adverse changes in market conditions.

Banking Institutions with at least \$50bn of Assets

Regulation YY requires U.S. Bank Holding Companies to establish and maintain a contingency funding plan. The contingency funding plan must be commensurate with the company's capital structure, risk profile, complexity, activities, size, and established liquidity risk tolerance. The company must update the contingency funding plan at least annually, and when changes to market and idiosyncratic conditions warrant. The contingency funding plan should include the identification of liquidity stress events and their potential impact on the company's liquidity, the circumstances under which the plan would be implemented, and identification of alternative funding sources that may be used during liquidity stress events. The plan must also include an event management process that sets out the company's procedures for managing liquidity during identified liquidity stress events. Additionally, the plan must include procedures for monitoring emerging liquidity stress events. The company must also test the

components of the plan regularly, including its operational elements, and the methods the company will use to access alternative funding sources.

Regulation YY also requires U.S. Bank Holding Companies to hold a buffer of highly liquid assets sufficient to cover net outflows under the company's liquidity stress tests using a 30-day planning horizon. Highly liquid assets may be cash, U.S. Treasuries, or any other security that the company demonstrates to the satisfaction of the Federal Reserve meets criteria specified under the rule to be considered a highly liquid asset (typically one traded in a deep and active market that has been purchased by investors during crises as a "flight to quality"). Assets in the buffer must be free of regulatory and contractual restrictions and not have been pledged to secure credit. The buffer also must be diversified and not include significant concentrations of assets by issuer, business sector, region or other factor related to the risk of the company, except with respect to U.S. Treasuries and securities issued by U.S. government-sponsored entities.

In addition, assets used as cash flow sources during a liquidity stress test planning horizon must be diversified. The fair value of the asset must be discounted to reflect any credit risk and market volatility of the asset.

Regulation YY liquidity requirements also recognize the importance of unencumbered assets as a source of liquidity. It requires a liquidity buffer that is composed of unencumbered highly liquid assets sufficient to meet projected net cash outflows for 30 days over the range of liquidity stress scenarios used in the internal stress testing.

Regulation YY also requires that the buffer of unencumbered highly liquid assets be sufficiently diversified by instrument type, counterparty, geographic market, and other liquidity risk identifiers for institutions subject to the enhanced liquidity requirements.

FBOs with Combined U.S. Assets of at least \$50bn

Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than the whole company, Board of Directors or Senior Management. The liquidity buffer for the Intermediate Holding Company must be sufficient to meet the projected "net stressed cash-flow need" over the 30-day planning horizon of the liquidity stress tests, taking into account the various scenarios required for those liquidity stress tests. The liquidity buffer for the U.S. Branches must be sufficient to meet the projected net stressed cash-flow need over only the first 14 days of the 30-day planning horizon. The liquidity buffer must be composed of unencumbered highly liquid assets.

Note

As discussed above, the proposed LCR would also require institutions to maintain a buffer of high-quality liquid assets to cover net outflows as calculated using the standardized stress test in the proposed rule. In addition, it would require that assets in the buffer be diversified and that an institution have the operational capacity to liquidate the assets during a crisis by implementing and maintaining appropriate procedures and systems for liquidation and by periodically testing access to the market through actual monetization of a sample of the assets held in the buffer. Institutions would have to hold and report to regulators a measurable amount of unencumbered assets. The proposed LCR requires a covered company to demonstrate that it can periodically liquidate a representative sample of high-quality liquid assets in order to demonstrate that they are under management control and liquid and readily marketable. Supervisors anticipate that they will propose regulatory reporting requirements, which will provide supervisors with

	<i>additional data related to liquidity risk management.</i>
EC6	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	<p>All Banks</p> <p>The Liquidity Risk Policy Statement sets out a set of supervisory expectations for contingency plans that all banks and Bank Holding Companies are expected to establish.</p> <p>Supervisors expect banks and holding companies to have an appropriate contingency funding plan in place. Supervisors review and assess a bank's or holding company's Contingency Funding Plan during examinations. These assessments consider whether the Contingency Funding Plan includes policies, procedures, and action plans for responding to contingent liquidity events, including changes in the funding markets or the bank's and holding company's market access (e.g., access to commercial paper markets) caused by either firm-specific or market-wide events. Action plans are expected to include the bank's and holding company's plans for dealing with retail customers and large funds providers, the press, and the bank's and holding company's supervisors. Supervisors evaluate if the Contingency Funding Plan is commensurate with the complexity, risk profile, and scope of operations of the bank and holding company and aligned with its business and risk-management objectives, strategies, and tactics. Supervisors confirm that senior management periodically reviews the Contingency Funding Plan as well as the bank's and holding company's liquidity-risk management strategies, policies, and procedures to ensure that they remain appropriate and sound. Supervisors evaluate if management also coordinates the Contingency Funding Plan with the bank's and holding company's liquidity risk management efforts for disaster, contingency, and strategic planning. The Contingency Funding Plan should also provide a reasonable timeframe to liquidate the liquidity buffer and address intercompany transactions.</p> <p>As part of the consideration of potential firm-specific events, a bank or holding company is also expected to consider the impact of potential declines in regulatory capital that would cause the bank or the BHC's subsidiary depository institution(s) to be less than "well capitalized" for purposes of the Prompt Corrective Action (PCA) regulatory scheme. For example, a bank that relies upon brokered deposits should also incorporate PCA-related downgrade triggers into its Contingency Funding Plan because a change in PCA status could have a material bearing on the availability of this funding source. As outlined in the Joint Agency Advisory on Brokered and Rate Sensitive Deposits (SR0114a1), banks that are considered "adequately capitalized" must receive a waiver from the FDIC before they can accept, renew, or roll-over any brokered deposit. In addition, banks that are not "well capitalized" are subject to interest rate restrictions paid on deposits.</p> <p>In addition, when a bank becomes undercapitalized for purposes of PCA, limits are placed on its asset growth and its ability to acquire an interest in another bank. Additional limitations are placed on the bank if it becomes significantly or critically undercapitalized or if it fails to carry out its approved capital restoration plan. Critically undercapitalized banks generally may not</p>

	<p>borrow from the discount window.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Regulation YY requires U.S. Bank Holding Companies subject to the rule and covered FBOs with more than \$50 billion in total U.S. assets to establish comprehensive and robust contingency funding plans. This includes (S252.34) clearly setting out the roles in relation to the contingency funding plan.</p> <p><i>Note</i></p> <p><i>The proposed LCR prescribes a process for reporting when a covered company falls below the minimum liquidity coverage ratio.</i></p>
<p>EC7</p>	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.</p>
<p>Description and findings re EC7</p>	<p>All Banks</p> <p>Under the Liquidity Risk Policy Statement, banks and Bank Holding Companies are expected to conduct stress tests regularly for a variety of institution-specific and market-wide events across multiple time horizons and take remedial or mitigating actions to limit exposures, build up a liquidity buffer, and adjust liquidity positions to the institution’s risk tolerance taking into consideration the results of the stress tests. The results of the stress test are expected to play a key role in shaping an institution’s contingency planning.</p> <p>Supervisors view stress testing as a critical component of liquidity risk management and firms should have a liquidity stress testing framework that assesses the potential impacts of stressed scenarios and environments, and clearly identifies and quantifies the liquidity risk vulnerabilities of the firm. The set of scenarios within the stress testing framework should capture the vulnerabilities of the firm. The scenarios should assess the impacts to the firm across a range of severities, including highly severe and less likely but plausible scenarios.</p> <p>The Liquidity Risk Policy Statement emphasizes, among other things, that institutions should conduct stress tests. For example, the size of the cushion of high-quality liquid assets should be supported by estimates of liquidity needs performed under an institution’s stress testing.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Regulation YY requires U.S. Bank Holding Companies to conduct internal liquidity stress tests at least monthly. The stress tests must take into consideration various aspects of the company and its activities and there must be policies and procedures governing the liquidity stress testing practices, methodologies, and assumptions that provide for the incorporation of the results of liquidity stress tests into future stress testing and for the enhancement of the stress testing practices over time. In addition, each liquidity stress test must include, at a minimum, a stress scenario reflecting adverse market conditions, a scenario reflecting idiosyncratic stress events, and a scenario reflecting combined market and idiosyncratic stress. The company must also incorporate additional liquidity stress scenarios as appropriate based on the financial condition, size, complexity, risk profile, scope of operations, or activities of the company. The company must also establish controls and oversight that ensure that each liquidity stress test appropriately incorporates conservative assumptions with respect to the stress scenarios and other elements of the stress test process, taking into consideration the capital structure, risk</p>

	<p>profile, complexity, activities, size, business lines, legal entity or jurisdiction, and other relevant factors of the company. The results of the stress tests are used to determine the size of the buffer of highly liquid assets required by Regulation YY and results of the stress test must be incorporated into the contingency funding plan required by the rule.</p> <p>Regulation YY also includes requirements for regular stress tests on cash-flow projections by identifying liquidity stress scenarios based on the company's full set of activities, exposures and risks, both on and off-balance sheet, and by taking into account non-contractual sources of risks, such as reputational risks.</p> <p>FBOs with Combined U.S. Assets of at least \$50bn</p> <p>Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than the whole company, Board of Directors or Senior Management.</p>
EC8	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>All Banks</p> <p>Supervisors expect banks and holding companies to have a system in place to measure, monitor, and control the liquidity positions for each major currency in which business is conducted. The treatment of foreign currencies in a bank's or holding company's internal liquidity assessment is largely determined by the bank or holding company. Currency mismatches are reviewed during the examination process. Banks and holding companies are expected to be able to manage, monitor, and control their currency exposures. The assumptions regarding currency convertibility are left to each individual bank and holding company to determine. Supervisors review the reasonableness of these assumptions, under both normal and stressed conditions, and supporting documentation. Under the Interagency Country Exposure Review Committee, the supervisors review countries in default to provide an assessment of the degree of transfer risk that is inherent in the cross-border and cross-currency exposures of U.S. banks and, if applicable, determine minimum allocated transfer risk reserves. Supervisors also evaluate cross-border concentrations.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Regulation YY does not prescribe steps for addressing foreign currency liquidity transformation, but the Federal Reserve explained its expectations with respect to foreign currency mismatches in the preamble to the final rule. The currency matching of projected cash inflows and outflows is an important aspect of liquidity risk that companies subject to the rule should account for in their stress tests and the risks associated with currency mismatches should be incorporated in determining the liquidity buffer. When determining appropriate haircuts for buffer assets, currency mismatches should be considered as well as potential frictions associated with currency conversions in certain stress scenarios. Regulation YY does not disqualify foreign-currency denominated assets from inclusion in the buffer of highly</p>

	liquid assets. However, currency matching of projected cash inflows and outflows is an important aspect of liquidity risk management that is expected to be monitored on a regular basis and accounted for in the composition of a U.S. Bank Holding Companies or FBO's liquidity buffer for its U.S. operations under the rule.
Additional criteria	
AC1	The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	<p>All Banks</p> <p>Under the Liquidity Risk Policy Statement, institutions are expected to establish appropriate limits to mitigate their liquidity risks, including ensuring sufficient unencumbered liquidity resources. Institutions are expected to establish processes to provide to senior management and the board of directors a clear understanding of the institution's liquidity risk exposure, compliance with risk limits, consistency between management's strategies and tactics, and consistency between these strategies and the board's expressed risk tolerance.</p> <p>Currently, firms are required to disclose pledged securities to total securities in regulatory reports both at the bank and at the holding company, these reports are publicly available.</p> <p>The Liquidity Risk Policy Statement specifically discusses holding liquid assets as a source of primary and secondary funding, noting that these assets must be unencumbered to properly serve a liquidity function.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Under Regulation YY, U.S. Bank Holding Companies must establish limits on liquidity risk, including limits on: (i) concentrations in sources of funding by instrument type, single counterparty, counterparty type, secured and unsecured funding, and as applicable, other forms of liquidity risk; (ii) the amount of liabilities that mature within various time horizons; and (iii) off-balance sheet exposures and other exposures that could create funding needs during liquidity stress events. Each limit must be consistent with the established liquidity risk tolerance for the company and must reflect the capital structure, risk profile, complexity, activities, and size of the company. Senior management must review the company's compliance with the limits at least quarterly, or more often as conditions warrant.</p> <p>Regulation YY liquidity requirements also recognize the importance of unencumbered assets as a source of liquidity. A liquidity buffer must be composed of unencumbered highly liquid assets sufficient to meet projected net cash outflows for 30 days over the range of liquidity stress scenarios used in the internal stress testing.</p> <p>FBOs with Combined U.S. Assets of at least \$50bn</p> <p>Regulation YY also applies to FBOs with Combined U.S. Assets of at least \$50bn. The requirements are similar to those for U.S. Banking Institutions except that the requirements are placed on the U.S. Operations, U.S. Chief Risk Officer and U.S. Risk Committee rather than the whole company, Board of Directors or Senior Management. In terms of liquidity buffer requirements, the FBO must maintain in the U.S. separate liquidity buffers for its Intermediate Holding Company and its U.S. Branches. The liquidity buffer for the Intermediate Holding Company must be sufficient to meet the projected "net stressed cash-flow need" over the 30-</p>

	<p>day planning horizon of the liquidity stress tests, taking into account the various scenarios required for those liquidity stress tests. The liquidity buffer for the U.S. Branches must be sufficient to meet the projected net stressed cash-flow need over only the first 14 days of the 30-day planning horizon. The liquidity buffer must be composed of unencumbered highly liquid assets.</p> <p>Once the LCR is finalized, the U.S. agencies anticipate proposing public reporting requirements consistent with the liquidity coverage ratio disclosure standards issues by the Basel Committee on Banking Supervision. The Enhanced Disclosure Task Force (EDTF) has provided recommendations for enhancing risk disclosures including a recommendation that firms provide a summary of encumbered and unencumbered assets. The Federal Reserve supports the work of the EDTF and has communicated its support of the EDTF's principles and recommendations to its supervised firms.</p> <p>Lastly, the proposed LCR would require certain institutions to hold a measurable amount of unencumbered assets, and the U.S. FBAs would collect additional data on those unencumbered assets.</p>
Assessment of Principle 24	Compliant
Comments	<p>The Liquidity Risk Regime for banks below \$50bn of Assets is quite high level, but the assessors did see numerous examples of supervisory action in support of the overall principle. Current levels of reporting for these banks (for example in respect of encumbered assets) are inadequate with only one line in the Call Report. The Authorities recognize this deficiency and have proposed a greater level of reporting depth as part of the implementation of the Liquidity Coverage Ratio. The assessors did not see evidence of encumbrance being a particular concern.</p> <p>For Banking Institutions with at least \$50bn of Assets and indeed beyond that level those of Global Systemic Importance, the regime (mostly in Regulation YY) is comprehensive and robust.</p> <p>For example, the Federal Reserve has been conducting coordinated horizontal examinations of liquidity risk across large bank holding companies. For the largest firms, an annual Comprehensive Liquidity Assessment and Review (CLAR) have been conducted. A separate, tailored horizontal assessment has also been conducted for other large firms that are subject to the enhanced liquidity prudential standards under Regulation YY. These horizontal assessments are informed and augmented by firm-specific monitoring conducted by dedicated large bank supervisory examination teams. During these horizontal reviews, staff evaluated the following:</p> <ul style="list-style-type: none"> • The firms' quantitative liquidity position including its holding of unencumbered highly liquid assets and its structural funding profile, • Liquidity risk governance, • Liquidity risk management policies and procedures, • Liquidity risk limits, monitoring and escalation procedures, • Liquidity risk measurement and monitoring including cash flow projections, collateral location and encumbrance, currency, legal entity and intraday exposures, • The independence of liquidity risk oversight, • Liquidity stress test frameworks, including assumptions, production frequency,

	<p>outcomes and governance, and</p> <ul style="list-style-type: none"> • The adequacy and suitability of contingency funding plans. <p>As a result of these horizontal assessments and other supervisory work, over one hundred Matters Requiring Attention (MRAs) were issued to improve liquidity risk management at the firms. Issues included: deficiencies in the stress-modeling framework, modeling of over-the-counter derivative collateral flows, limits for secured funding activities, inclusion of appropriately calibrated quantitative early warning indicators tailored to the firm's risk profile, updated contingency funding plans, contingent liquidity event and establishing guidelines and limits on buffer composition to avoid undue concentrations.</p> <p>Further the regime is supported by extensive reporting—some of which, for the large banks, is daily. Industry sources however did point out that small differences of interpretation between the agencies were creating implementation challenges for the LCR.</p>
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁸² on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	As with many aspects of the supervisory regime, the approach is tiered in the case of operational risk. The safety and soundness statutes and supervisory guidance provide the legal basis for the imposition and enforcement of these requirements by the U.S. FBAs. See Table 25.1.

⁸² The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

Table 25.1	1	2	3
	All Banks	Banking Institutions with at least \$50bn of Assets	Advanced Approach U.S. Banking Organizations with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total off-balance sheet foreign exposure
Operational Risk Management	An expectation (under the Safety and Soundness provisions) that all banks and holding companies have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material operational risks.	Heightened expectations as set out Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013 and OCC's proposed formalizing of its "heightened expectations" for risk management and governance in its <i>Heightened Standards Guidance</i> .	<i>"Interagency Guidance on the Advanced Measurement Approaches for Operational Risk"</i> . Also, <i>"Supervisory Guidance for Data, Modelling, and Model Risk Management Under the Operational Risk Advanced Measurement Approaches"</i> .

All Banks

Supervisors expect a banking organization to implement an appropriate risk-management program, corresponding to the size and the nature and complexity of its structure and products, and to ensure compliance with all consumer protection laws and regulations.

The agencies have identified operational risk as one of the risk categories inherent in a banking organization's activities and confirm that a banking organization has risk-management policies and processes to identify, assess, mitigate, and monitor operational risk. The agencies use on-going supervision techniques, including on-site and off-site examination procedures and surveillance processes, to evaluate the adequacy of a banking organization's operational risk-management policies and processes in the context of its size, nature, and complexity of operations and activities, and considering the external environmental and market factors in which it operates. The supervision process includes an identification and evaluation of a banking organization's critical and/or key operational risks and an evaluation of associated risk-management policies and processes, including the banking organization's periodic re-evaluation of operational risk exposure in light of changes in its activities and risk profile and developments in external markets and the environment. Supervisors also review how a banking organization addresses operational risks in its capital planning process. There is no standardized capital charge however.

Supervisory assessment of a banking organization's risk-management processes and practices are largely captured in the agencies' Uniform Financial Institutions Rating System (UFIRS) that evaluates each bank's capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Risk management is found in all of the ratings. The agencies also consider the risk management practices captured in the Uniform Rating System for Information Technology (URSIT) and the Uniform Interagency Trust Rating System (UITRS). The agencies have various internal risk-assessment systems that they use to evaluate the adequacy of a banking organization's risk-management processes. For example, OCC supervisors use a Risk Assessment System to evaluate the quantity of risk, the quality of risk management, the level of supervisory concern (measured as aggregate risk) and the direction of risk across various categories of risk, including transaction/operational risk.

In addition, a banking organization is encouraged to manage operational risk consistent with the principles outlined in the BCBS's *Principles for the Sound Management of Operational Risk*. Supervisors also expect a banking organization to implement an appropriate risk-management program, again corresponding to its size and the nature and complexity of its structure and products, to ensure compliance with all consumer protection laws and regulations.

The U.S. FBAs have also issued supervisory guidance on various aspects of operational risk management, including internal controls, information technology, outsourcing of financial services, payment systems, audit, business continuity planning, compliance, insurance, and fiduciary operations. In all cases, risk-management practices are expected to be commensurate with the size, complexity, and risk profile of the entity.

Banking Institutions with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure (Advanced Approach)

Risk-based capital rules effective 1 January 2014 for advanced approaches banks, establish an integrated regulatory capital framework that addresses shortcomings in capital requirements. The rules implement in the U.S. the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the DFA. In addition to the credit and market risk requirements, the rule imposes specific regulatory requirements for operational risk, as well as specific qualification requirements, including the development of operational-risk management processes, operational-risk data and assessment systems, and operational-risk quantification systems for estimating operational risk capital exposure and the associated capital charge. While section 171 of the DFA requires the agencies to establish minimum risk-based and leverage capital requirements subject to certain limitations, the agencies have general authority to establish capital requirements under other laws and regulations, including under the National Bank Act, Federal Reserve Act, FDI Act, BHC Act, International Lending Supervision Act, and Home Owners Loan Act. The operational risk aspects of the risk-based capital rules parallel the U.S. FBAs' rules implementing the advanced approaches published in December 2007.

In addition, in June 2011, the U.S. FBAs issued "Interagency Guidance on the Advanced Measurement Approaches for Operational Risk," which discusses certain common implementation issues, challenges, and key considerations for addressing these challenges in order to implement a satisfactory advanced approaches framework. Also, in June 2014 the U.S. FBAs issued "Supervisory Guidance for Data, Modeling, and Model Risk Management Under the Operational Risk Advanced Measurement Approaches," which addresses supervisory expectations for data, modeling, and model risk management under the operational risk advanced measurement approaches (AMA) to calculate a regulated banking organization's operational risk. The supervisory evaluation of a banking organization's capital adequacy may consider, among other things, whether a banking organization has significant exposure due to operational risks. Advanced approaches banking organizations are subject to an explicit operational risk capital requirement. For the 8 bank holding companies that have received approval to exit parallel run, the operational risk capital requirement as a percentage of common equity tier 1 capital on a weighted average basis is 16.7%, based on data from public reports as of the second quarter of 2014.

Supervisors have increased their oversight of banks' and holding companies' management of operational risk, and have adopted final rules imposing an explicit operational-risk capital requirement. This has been in the wake of recent, highly visible breakdowns in internal controls and corporate governance that have exposed banks and holding companies to large losses. These facts combined with several key factors, including greater use of technology;

	proliferation of new and highly complex products; growth of e-banking transactions and related business applications; large scale acquisitions, mergers, and consolidations; greater use of outsourcing arrangements; rapid and significant changes in the regulatory and operating environments; and evolving and increasingly sophisticated cyber threats have contributed to increased operational risk exposures at banks and holding companies.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	<p>All Banks</p> <p>The U.S. Federal Banking Agencies take the view that Boards have ultimate accountability for the level of risk taken by their banking organization. They do however set out a series of expectations (under the Safety and Soundness provisions), on areas such as whether the board understands the nature and extent of operational risks and takes steps necessary to ensure management identifies, measures, monitors, and controls such risks. More specifically, supervisors' examination procedures require verification that a board periodically reviews and approves significant operational risk management-related strategies, policies, and processes. While the volume and content of such strategies, policies, and processes at each banking organization vary according to its size and the nature and complexity of its activities, the expectation for board review and approval of such policies, and for a board's active oversight of management's execution/implementation of them, are universal. More detailed requirements usually fall to bank senior management.</p> <p>Largely through on-site examinations, and secondarily through on- and off-site supervisory activities, supervisors identify a banking organization's operational risk management-related strategies, policies, and processes and verify that they are current, reflect the organization's actual operating characteristics. Additionally, supervisors evaluate the board oversight of management's effectiveness in implementing operational risk-management policies. This assessment is conducted in several ways: i) review of board and committee minutes; ii) evaluation of the frequency, coverage, and quality of external and internal audit reports; and iii) assessment of the reporting frequency, nature, and integrity of applicable management information systems that reflect effective policy/control implementation through reported residual risk levels.</p> <p>The OCC's <i>Large Bank Supervision</i> and <i>Community Bank Supervision</i> handbooks establish a risk-focused supervision process that builds on an annual assessment of the quality of risk management—including operational risk—through an evaluation of policies, processes, personnel, and controls; this includes periodic review and approval of policies by the board or an appropriate committee of the board.</p> <p>Setting of risk appetite is covered by general risk management guidelines. There is no specific guidance on operational risk appetite.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Supervisors also assess the oversight and controls applied to operational risk models used for the CCAR capital adequacy assessment.</p> <p>Banking Institutions with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure (Advanced Approach)</p> <p>With respect to a banking organization that is required to use, or chooses to opt-in and use, the advanced approaches under the new risk-based capital rules, the board must at least</p>

	<p>annually review the effectiveness of and approve the organization’s advanced systems. The Board must approve operational risk management-related strategies, policies, and processes and these must reflect the organization’s actual operating characteristics.</p>
EC3	<p>The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank’s overall risk management process.</p>
Description and findings re EC3	<p>All Banks</p> <p>Supervisors review and evaluate the same information inputs available to a banking organization’s board. External and internal audit reports and selected management information system reports are reviewed and evaluated to verify that management has implemented the board-approved operational risk-management strategies, policies and procedures effectively. Additionally, on a risk-focused basis and/or where warranted based on initial evaluation findings or other changes in circumstances, on-site supervisors will perform select transaction testing to validate conformance with, and effectiveness of, operational risk management and control policies and processes.</p> <p>Banking Institutions with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure (Advanced Approach)</p> <p>The U.S. banking supervisors have also established uniform review procedures for use in all advanced approaches institutions. The procedures ensure even implementation and evaluation of the advanced measurement approaches, which include operational risk management processes, throughout the jurisdiction. Additionally U.S. regulators participated in, and served as the central processor for, the 2008 LDCE (loss data collection exercise) sponsored by the Basel Committee. This effort, on a voluntary basis, provided supervisors and institutions with a broad base of information to ensure consistent and even implementation of strategies and to help ensure that regulatory expectations are met. In addition, supervisors evaluate operations risk implementation during periodic stress testing.</p>
EC4	<p>The supervisor reviews the quality and comprehensiveness of the bank’s disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption that might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.</p>
Description and findings re EC4	<p>All Banks</p> <p>Supervisors have adopted examination procedures and perform risk-focused reviews of a banking organization’s business resumption and contingency plans during on-site examinations, with the scope/breadth of review contingent upon the risk profile of the organization. The risk profile is based on i) the size and nature of the organization’s current operations and activities, considering any significant changes since the previous regulatory review; ii) the scope/breadth and findings of previous regulatory reviews; and iii) any significant changes in the external or environmental factors that can materially impact business continuity risk. Additionally, under certain circumstances, the business resumption and contingency plans of banking organizations, individually by organization and/or horizontally across groups of banking organizations, are the subject of both on-site and off-site supervisory activities at the U.S. FBAs. When applicable, supervisors require banks to periodically test Business Continuity Plans and review the results with supervisors.</p> <p>Various supervisory policies, standards, and/or guidance statements relevant to business resumption and contingency planning have been issued on an interagency basis.</p>

	<p>In addition, supervisors have issued policy statements and guidance on a wide variety of bank activities that routinely address the importance of contingency planning, and the supervisory expectation that a banking organization will implement and test continuity plans, and report results of testing activities to the board or its designated committee.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>Key financial firms and market utilities that support critical financial markets have dedicated supervisory teams that assess the adequacy of governance and risk management of critical business/service lines on an on-going basis. These firms generally provide core clearing and settlement services that are the backbone of the U.S. financial and international financial systems. As such, U.S. federal supervisors have adopted guidelines that are outlined in the April 2003 <i>Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System</i>. These guidelines outline recovery and resumption objectives for clearance and settlement activities that support critical financial markets, with the specific goal of limiting systemic/disruption risk to the U.S. financial system. Supervisory programs have integrated these guidelines into their continuous monitoring program and periodic targeted control validation reviews, both of which leverage work already performed by, or conducted in concert with, other banking supervisors and functional regulators.</p> <p>A related principle in the consolidated supervision framework is that large holding companies should provide sufficient resiliency measures for the recovery and/or resumption of their most important business processes in the event of a business disruption. The Federal Reserve's supervisory approach focuses on the areas of the greatest systemic risk, e.g., clearing and settlement activities related to critical financial markets. The resulting supervision program establishes a mechanism to conduct on-going evaluations of the adequacy of risk management over the resiliency and recovery of clearing and settlement activities related to critical financial markets as originally contemplated under SR letter 03-09 and OCC Bulletin 2003-14, the <i>Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System</i>. The supervisory program combines an examination team's continuous monitoring activities, an annual assessment of any material changes in a firm's related activities or characteristics, and periodic targeted control validation reviews. Also, the OCC and the FDIC expect banks under their jurisdiction to also provide for sufficient resiliency measures.</p> <p><i>Note</i></p> <p><i>FFIEC Business Continuity Planning Booklet is also in the process of being updated with a new appendix that will stress the importance of resiliency in the use of business critical third parties, as well as guidance published for responses to Hurricanes Katrina and Rita.</i></p>
EC5	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings re EC5	<p>Supervisors address information security and system development through on-site examinations that consider the risk profile of the banking organization, and have supervisory procedures to determine if a banking organization has appropriate policies and procedures in place to effectively respond to cyber-attacks. The agencies have examiners with specialized IT skill sets who can lead or assist in examinations of a banking organization that has a complex IT or operating environment. Also, consumer compliance examiners work with IT examiners to</p>

	<p>review a banking organization’s compliance with statutory consumer privacy provisions to ensure that controls are in place to protect sensitive customer information and that appropriate disclosures are made regarding the banking organization’s information sharing practices.</p> <p>Various supervisory policies, standards, and guidance statements relevant to risk management of IT activities have been issued on an interagency basis, many through the FFIEC’s IT Sub-committee, a standing subcommittee of the FFIEC Task Force on Supervision.</p> <p>The FFIEC’s <i>Information Security</i> booklet provides extensive guidance and examination procedures to evaluate IT security practices. The FFIEC’s IT Sub-committee develops and publishes IT-related risk-management policies and guidance statements based on industry/market trends or developments in the broader IT environment.</p>
EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyse operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks’ Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>All Banks</p> <p>As part of the supervisory process supervisors evaluate the quality of a banking organization’s management information systems and their ability to facilitate appropriate board and senior management risk management. During the course of our assessment work the assessors saw a number of examples of the Supervisors making determinations on the appropriateness and effectiveness of banks’ management information systems and appropriate reporting to the Board (in particular through regular assessment of Board Risk packs). This was in both vertical examinations, horizontal reviews and continuous monitoring in the case of the larger institutions.</p> <p>Banking organizations use a variety of tools exist for the management of operational risk, including, scenario analysis; risk and control self-assessments; scorecards; key risk indicators; risk assessment processes for information security risk under the Gramm-Leach-Bliley Act; and business continuity, internal audit, and internal control assessments under the Sarbanes-Oxley Act. Regardless of the specific tools used by a banking organization, the U.S. banking agencies expect an accurate assessment of operational risk levels and appropriate risk-management controls or mitigants to effectively manage that risk. It was, however, readily acknowledged that assessment of some rare and tail risk losses are hard to evaluate – the particular examples being quoted were the severe losses from litigation and cyber attacks.</p> <p>Banking Institutions with \$250bn or more in consolidated total assets or \$10bn or more in consolidated total on-balance sheet foreign exposure (Advanced Approach)</p> <p>Banking organizations subject to the advanced measurement approaches are subjected to targeted examinations of their AMA implementation, including data and management information system quality.</p>
EC7	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</p>
Description and findings re EC7	<p>Supervisors do not require reporting. They instead rely upon a combination of their supervisory activities and required regulatory and public disclosures and reporting by banking organizations (public requirements stem from accounting and audit-related statutes and rules</p>

	<p>applicable to publicly held firms, such as Gramm-Leach Bliley (largely in relation to personal data) and the requirements under FDIA 363(b) to make a statement on financial controls) to keep apprised of developments affecting operational risk at their supervised entities.</p> <p>Furthermore, regulations requiring a banking organization to file a formal, written application or notification with its primary federal banking agency regarding proposed mergers, acquisitions, changes in control, and/or expansions into certain new activities, provide each agency with indicators of events that could potentially affect the banking organization's inherent operational risk profile.</p> <p>Supervisors maintain on- and off-site supervisory monitoring of firms' current and planned activities on an on-going basis. At larger banking organizations, this may include supervisors with specialized skills in IT or operational risks. Supervisory analysis of a banking organization's operational risk and risk management also draws upon public disclosures of financial and managerial information and audit-related internal controls attestations required of publicly held banks and holding companies. Moreover, the agencies maintain surveillance units that analyze the balance sheet, profit/loss, and supplemental information routinely submitted by all banking organizations through required quarterly regulatory financial reports. Performance trends in various financial indicators can directly or indirectly point to developments in a particular organization's operational risk profile.</p> <p>Under safety and soundness standards banking organizations' internal controls and information systems must ensure compliance with applicable laws and regulations.</p> <p>Supervisors assess a banking organization's compliance with applicable laws and regulations as part of their supervision activities.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>Supervisors maintain that although a banking organization may outsource data processing and/or other business processes to outside parties, the banking organization's board of directors and management remain responsible and accountable for the safe and sound performance and legitimacy/legality of the outsourced activity. Safety and soundness considerations associated with outsourcing include the security, integrity, and availability of any sensitive data or other assets transferred to the service provider.</p> <p>Supervisors' examination procedures ensure supervisors evaluate, through on-site exams, that a banking organization establishes appropriate policies and processes to assess, manage, and monitor outsourced activities. Supervisors confirm that each banking organization's program includes conducting due diligence on potential service providers; structuring the outsourcing arrangement; assessing, managing, and monitoring applicable risk; ensuring effective controls;</p>

	and establishing and testing back-up plans. Interagency guidance on this topic has been issued through the FFIEC. While both <i>Guidance on the Risk Management of Outsourced Technology Services (Federal Reserve, November 2000)</i> and the <i>Outsourcing Technology Services Booklet (FFIEC, June 2004)</i> address regulatory risk-management expectations largely from the perspective of IT-related outsourcing, the same risk-management elements are applied in practice to any material outsourcing arrangement at banking organizations, whether technology or business process related. These include contingency planning arrangements. Indeed the OCC have published OCC Bulletin 2013-29 "Third Party Relationships – Risk Management Guidance" which addresses outsourcing risks well beyond those related to IT.
Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g. outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	<p>All Banks</p> <p>Supervisors regularly assess and evaluate potential common points of exposure to operational risk or potential vulnerability.</p> <p>Banking Institutions with at least \$10bn of Assets</p> <p>In addition, resolution plan documents required under the DFA are reviewed and assessed to evaluate whether banks have common risk exposures from business activities, markets or products, or are subject to concentration risks associated service providers, central counterparties, and central clearinghouses. Furthermore, the supervisory agencies have internal risk committees that evaluate the ranges of risks to which their supervised banks are exposed to provide early identification of common or systemic risk exposures. Examples include transaction processing and BCP service provider concentrations, software vendor concentrations, payment system dependency concentrations, and clearinghouse and central counterparty (CCP) membership concentrations. The OCC publishes its <i>Semi-annual Perspective on Risk</i>, which provides a public assessment of significant risk exposures, including operational risks. The FDIC publishes <i>Supervisory Insights</i>, a journal that promotes sound principles and practices for bank supervision.</p> <p>Deriving authority and jurisdiction from the Bank Service Company Act, supervisors pool resources to perform IT-related risk management evaluations/examinations of data processing service providers with significant client bases comprised of supervised banking organizations. For large service providers whose performance is identified as having systemic implications, periodic evaluations are performed under the Multi-regional Data Processing Servicers (MDPS) Program administered by the FFIEC IT Subcommittee. Other data processing service providers with less significance, yet multiple client banks and holding companies, are identified and evaluated under the Regional Technology Service Provider (Regional TSP) program administered by the agencies' regional or local offices.</p>
Assessment of Principle 25	Largely Compliant
Comments	The U.S. Federal Agencies are placing increasing emphasis on operational risk issues and are co-coordinating on the production of additional inter-agency guidance, as well as identifying and seeking mitigation of a number of issues in their vertical and horizontal issues. They are also alert to the changing threat landscape, such as the escalation of fines and other penalties

	<p>from litigation and cyber.</p> <p>The overall regime, however, has not reached a sufficient level of maturity (equivalent to market and credit risk for example). Guidance for banks under AMA (at the time of this assessment, only 8 banks) is well specified, however for all other bank operational risk management falls within the scope of "general" risk management (see CP 15). Guidance for other banks is highly disparate, and the weakness is compounded by the absence of a comprehensive reporting regime—only certain operational risks are covered by GLBA 501(b). It was also noted that there is not a standardized capital charge for operational risk.</p> <p>The assessors saw some positive developments on aspects of operational risk aimed at Banking Institutions with at least \$50bn of Assets, for example the Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013, which covers operational loss data and the OCC's proposed formalizing of its "heightened expectations" for risk management and governance in its Heightened Standards Guidelines, which seeks to bring operational risk (and strategic and reputational risks) to the same level as market and credit risk in Board Risk Appetite statements for example.</p> <p>The absence of a comprehensive reporting regime is also a weakness as so much of the assessment of operational risk is assessing what could happen in terms of operational risks. At the time of the assessment, such initiatives were yet to bear fruit and documentation indicates a more structured approach to operational risk management for non-AMA banks is recommended.</p> <p>The assessors also noted the priority all of the agencies were attaching to Cyber Risk and also the establishment of working groups at the FFIEC, but the assessors agree that this will not be an easy task given the challenge of co-coordinating across not just the banking agencies but beyond given the nature of the risk.</p>
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁸³ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these

⁸³ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>controls address:</p> <ul style="list-style-type: none"> (a) organisational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g. clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g. business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access. 																		
<p>Description and findings re EC1</p>	<p>As with many aspects of the supervisory regime, the approach is tiered. In the case of internal control and audit. The safety and soundness statutes and supervisory guidance provide the legal basis for the imposition and enforcement of these requirements by the U.S. FBAs. See Table 26.1.</p> <table border="1" data-bbox="391 758 1409 1266"> <thead> <tr> <th>Table 26.1</th> <th>1</th> <th>2</th> <th>3</th> <th>4</th> <th>5</th> </tr> </thead> <tbody> <tr> <td>Table 26.1</td> <td>Banking Institutions with less than \$500mn of Assets</td> <td>Banking Institutions with between \$500mn and \$1bn of Assets</td> <td>Banking Institutions with more than \$1bn of Assets</td> <td>Banking Institutions with more than \$3bn of Assets</td> <td>Banking Institutions with at least \$50bn of Assets</td> </tr> <tr> <td>Audit Committee</td> <td>Must have an Audit Committee of Directors</td> <td>Must have an Audit Committee of Outside Directors, the majority of which should be Independent</td> <td>Must have an Audit Committee of Outside Independent Directors</td> <td>Must have an Audit Committee of Outside Independent Directors. These should include members with banking or related financial management expertise, have access to its own outside counsel, and not include any large customers of the institution.</td> <td>Audit Committee, should possess the skills, knowledge, and programmatic depth to effectively identify and detect risks. Internal Audit has direct access to the Audit Committee</td> </tr> </tbody> </table> <p>All Banks</p> <p>The safety-and-soundness provisions of the Federal Deposit Insurance Act (“FDIA”) (section 39) require the Supervisors to prescribe standards relating to internal controls, information systems and audits. These are further amplified by Section 36 of FDIA. Interagency guidelines implement the standards, such as SR 95-51. They specify that a bank and holding company should have internal controls and information systems that are appropriate to the size of the company and the nature, scope and risk of its activities and that provide for (a) an organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies; (b) effective risk assessment; (c) timely and accurate financial, operational, and regulatory reports; (d) adequate safeguards to manage assets; and (e) compliance with laws and regulations. A bank and holding company should also have an internal audit system that is appropriate to the size of the company and the nature and scope of its activities and that provides for (a) adequate monitoring of the system of internal controls through an internal audit function (for smaller banks: a system of independent reviews of key internal controls); (b) independence and objectivity; (c) qualified persons; (d) adequate testing and review of information systems; (e) adequate documentation of tests and findings and any corrective actions; (f) verification and review of management actions to address material weaknesses; and (g) review by the bank’s and holding company’s</p>	Table 26.1	1	2	3	4	5	Table 26.1	Banking Institutions with less than \$500mn of Assets	Banking Institutions with between \$500mn and \$1bn of Assets	Banking Institutions with more than \$1bn of Assets	Banking Institutions with more than \$3bn of Assets	Banking Institutions with at least \$50bn of Assets	Audit Committee	Must have an Audit Committee of Directors	Must have an Audit Committee of Outside Directors, the majority of which should be Independent	Must have an Audit Committee of Outside Independent Directors	Must have an Audit Committee of Outside Independent Directors. These should include members with banking or related financial management expertise, have access to its own outside counsel, and not include any large customers of the institution.	Audit Committee, should possess the skills, knowledge, and programmatic depth to effectively identify and detect risks. Internal Audit has direct access to the Audit Committee
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audit committee or board of directors of the effectiveness of the internal audit system. The effectiveness of internal controls, information systems, and audits is evaluated as part of the supervisory process.

An agency may require the bank to submit a plan to achieve compliance, or take other supervisory actions.

Supervisors evaluate the adequacy of bank and BHC's internal control during on-site examinations, on- and off-site periodic monitoring and supervisory activities, and through various surveillance activities. In conducting these activities, supervisors determine that banks and holding companies have in place an internal control structure that is adequate for the nature and scale of their business. When evaluating the adequacy of a bank's and holding company's internal control and audit procedures, supervisors consider whether:

- The system of internal control is appropriate to the type and level of risks posed by the nature and scope of the bank's and holding company's activities.
- The organizational structure of the bank and holding company establishes clear lines of authority and responsibility for monitoring adherence to policies, procedures, and limits.
- Reporting lines for the control areas are independent from the business lines, and there is adequate separation of duties throughout—such as duties relating to accounting, trading, custodial, and back-office activities.
- Official organizational structures reflect actual operating practices.
- Financial, operational, and regulatory reports are reliable, accurate, and timely, and, when applicable, exceptions are noted and promptly investigated.
- Adequate procedures exist for ensuring compliance with applicable laws and regulations.
- Internal audit or other control-review practices provide for independence and objectivity.
- Internal control and information systems are adequately tested and reviewed. The coverage of, procedures for, and findings and responses to audits and review tests are adequately documented. Identified material weaknesses are given appropriate and timely high-level attention, and management's actions to address material weaknesses are timely, and objectively verified and reviewed.
- The bank's and holding company's audit committee or the board of directors reviews the effectiveness of internal audits and other control-review activities.

Supervisors review documentation that banks and holding companies produce for internal control reviews, including those under section 404 of Sarbanes-Oxley, to determine whether there are any material weaknesses or significant deficiencies that should be followed up during the course of examination work. Supervisors will also assess the risks inherent in the bank and/or holding company, and the risk mitigants and controls as part of the on-going examination processes. Supervisors conduct horizontal examinations and use this information in assessing the risks of the bank and/or holding company relative to its peers.

Supervisors assess a bank's and holding company's compliance with the *Interagency Policy Statement on the Internal Audit Function and Its Outsourcing* (for example SR13-01a1). Also, supervisors determine the quality and reliability of the bank's and holding company's policies, procedures, and processes with respect to internal control functions and reach an overall

	<p>assessment of the internal control system. During targeted examinations of specific product areas within the bank and holding company or as part of an annual review, supervisors evaluate the adequacy of internal control. When supervisors determine that the work performed by internal audit is effective, they will leverage off that work to evaluate the effectiveness of internal control.</p> <p>Supervisors review various external assurance reports as well as the list of weaknesses or deficiencies from auditor's opinions under Sarbanes-Oxley to determine where control weaknesses exist and whether management is addressing these deficiencies in a timely manner.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013 which set out their expectations of the internal practices and policies a firm uses to determine the amount and composition of capital that should be adequate, given the firm's risk exposures and corporate strategies as well as supervisory expectations and regulatory standards. Two of the seven principles are particularly relevant to this Core Principle: <i>Principle 6 - Robust Internal Controls</i> that requires Bank Holding Companies to have robust internal controls governing capital adequacy process components, including policies and procedures; change control; model validation and independent review; comprehensive documentation; and review by internal audit; and <i>Principle 7 - Effective Governance</i> - that requires Bank Holding Companies to have effective board and senior management oversight of the capital adequacy process, including periodic review of the BHC's risk infrastructure and loss- and resource-estimation methodologies; evaluation of capital goals; assessment of the appropriateness of stressful scenarios considered; regular review of any limitations and uncertainties in all aspects of the capital adequacy process; and approval of capital decisions.</p> <p><i>Note</i></p> <p><i>Banking Institutions with at least \$50bn of Assets</i></p> <p><i>The OCC issued its Heightened Standards Guidelines in September 2014. It established minimum standards for the design and implementation of a Risk Governance Framework and the role of the board of directors in the oversight of the framework. The guidelines apply to large national banks, federal savings associations, and insured Federal branches of foreign banks with average total consolidated assets of \$50bn or more. The guidelines are consistent with the principles embedded in the Federal Reserve's expectations for large bank holding companies. The Guidelines will be phased in according to the bank's size: (i) banks with average total consolidated assets of \$750 billion or more should comply with the Guidelines on 10 November 2014; (ii) banks with average total consolidated assets of \$100 billion or more but less than \$750 billion should comply by 10 May 2015; (iii) banks with average total consolidated assets of \$50 billion or more but less than \$100 billion should comply by 10 May 2016; (iv) banks with average total consolidated assets of less than \$50 billion that are subject to the Guidelines by virtue of being a subsidiary of a parent company that controls another bank subject to the Guidelines should comply with the Guidelines on the same date that the affiliated bank should comply; and (v) banks with average total consolidated assets of less than \$50 billion on the effective date (November 10, 2014) that subsequently becomes subject to the Guidelines should comply within 18 months as of date of the most recent Call Report used to calculate the average.</i></p>
<p>EC2</p>	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business</p>

	<p>origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.</p>
Description and findings re EC2	<p>As part of on-site examinations, on- and off-site periodic monitoring and supervisory activities, and various surveillance activities, supervisors evaluate a bank's and holding company's internal control functions when assessing the control functions and processes of the bank and holding company as a whole and for specific activities and operations. Supervisors coordinate the review of internal control with the reviews of other areas of the bank and holding company (e.g., credit, capital markets, compliance, and information systems) as a cross check of the bank's and holding company's compliance and process integrity. Supervisors also perform periodic reviews of control monitoring functions such as internal audit. If internal audit is effective, supervisors may take into account internal audit results as part of risk-focused examinations. Supervisors regularly conduct targeted reviews of high-risk areas such as trading to determine whether effective controls, including segregation of duties, are in place. Supervisory guidance cautions supervisors to be alert for indications that adverse circumstances may exist (such as inappropriate balance of skills and resources between operational and back office functions) when reviewing internal controls. Supervisors evaluate the competency and skills of personnel assigned to various control functions and the adequacy of resources the bank and holding company has available to effectively meet its internal control objectives.</p>
EC3	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function⁸⁴ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.</p>
Description and findings re EC3	<p>Supervisors' guidance and examination procedures set out how to determine whether the bank and holding company have an effective compliance function. Supervisors confirm that the compliance function is independent of the bank's and holding company's business activities and has controls commensurate with the bank's and holding company's size and activities. The guidance also indicates that the bank's and holding company's board of directors is ultimately responsible for developing and administering a compliance management system that ensures compliance with laws and regulations. Supervisors confirm that the board of directors and management collectively establish and maintain an effective compliance management system including:</p> <ul style="list-style-type: none"> • demonstrating clear and unequivocal expectations about compliance; • adopting clear policy statements; • appointing a compliance officer with authority and accountability; • allocating resources to compliance functions commensurate with the level and complexity of the bank's and holding company's operations (e.g., sufficient to address

⁸⁴ The term "compliance function" does not necessarily denote an organisational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	<p>compliance in specialty areas such as leverage leasing, insurance and private banking);</p> <ul style="list-style-type: none"> • conducting periodic compliance audits; • ensuring that business lines have appropriate personnel with compliance expertise; and • providing for recurrent reports by the compliance officer.
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁸⁵ charged with:</p> <ul style="list-style-type: none"> (a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank’s business; and (b) ensuring that policies and processes are complied with.
Description and findings re EC4	<p>All Banks</p> <p>Under the “Interagency Guidance on Internal Audit and its Outsourcing and the Federal Reserve’s Supplemental Guidance on Internal Audit and its Outsourcing”, each bank’s and holding company’s audit committee and management must consider the type of internal audit oversight that is necessary to ensure that internal controls are effective. While the benefits of a full-time audit function will largely outweigh the costs at a large bank or holding company, the cost may not outweigh the benefits at smaller ones. Small banks and holding companies should still have a comprehensive review of significant internal controls by an independent party. Supervisors determine the adequacy of the internal audit function through their on-going supervisory activities.</p> <p>Banking Institutions with less than \$50bn of Assets</p> <p>Current guidance suggests annual evaluation of changes to Internal Audit through continuous monitoring and a full scope review of Internal Audit every three years.</p> <p>Banking Institutions with at least \$50bn of Assets</p> <p>The Federal Reserve published <i>Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice</i> in August 2013 which set out their expectations of the role Internal audit should play a key role in evaluating internal capital planning and its various components. Audit should perform a review of the full process, not just of the individual components, periodically to ensure that the entire end-to-end process is functioning in accordance with supervisory expectations and with a BHC’s board of directors’ expectations as detailed in approved policies and procedures. Internal audit should review the manner in which deficiencies are identified, tracked, and remediated. Audit staff should have the appropriate competence and influence to identify and escalate key issues, and the internal audit function should report regularly on the status of all aspects of the capital planning process—including any identified deficiencies related to the BHC’s capital plan—to senior management and the board of directors.</p> <p><i>Note</i></p> <p><i>Banking Institutions with at least \$50bn of Assets</i></p>

⁸⁵ The term “internal audit function” does not necessarily denote an organisational unit. Some countries allow small banks to implement a system of independent reviews, e.g. conducted by external experts, of key internal controls as an alternative.

The OCC issued its Heightened Standards Guidelines in September 2014. The guidelines expect institutions to develop and maintain appropriate audit functions to control risk taking that includes keeping the board of directors informed of the covered bank's risk profile and risk management practices to allow the board of directors to provide credible challenges to management's recommendations and decisions.. It also calls for the establishment of an Internal Audit QAIP program..

Supervisors assess the quality and scope of a bank's and holding company's internal audit function, regardless of whether it is performed by the bank's and holding company's employees or by an outsourcing vendor. Specifically, supervisors consider whether

- *The internal audit function's control risk assessment, audit plans, and audit programs are appropriate for the bank's and holding company's activities;*
- *The internal audit activities have been adjusted for significant changes in the bank's and holding company's environment, structure, activities, risk exposures, or systems;*
- *The internal audit activities are consistent with the long-range goals and strategic direction of the bank and holding company and are responsive to its internal control needs;*
- *The internal audit manager's impartiality and independence is promoted by having him or her directly report audit findings to the audit committee;*
- *The internal audit manager is placed in the management structure in such a way that the independence of the function is not impaired;*
- *The bank and holding company have promptly responded to significant identified internal control weaknesses;*
- *The internal audit function is adequately managed to ensure that audit plans are met, programs are carried out, and results of audits are promptly communicated to senior management and members of the audit committee and board of directors;*
- *Work papers adequately document the internal audit work performed and support the audit reports;*
- *Management and the board of directors use reasonable standards, such as the Institute of Internal Auditor's Standards for the Professional Practice of Internal Auditing, when assessing the performance of internal audit; and*
- *The audit function provides high-quality advice and counsel to management and the board of directors on current developments in risk management, internal control, and regulatory compliance.*

These standards apply to large national banks and are consistent with the principles embedded in the Federal Reserve's expectations for large bank holding companies. The Guidelines will be phased in according to the bank's size: (i) banks with average total consolidated assets of \$750 billion or more should comply with the Guidelines on 10 November 2014; (ii) banks with average total consolidated assets of \$100 billion or more but less than \$750 billion should comply by 10 May 2015; (iii) banks with average total consolidated assets of \$50 billion or more but less than \$100 billion should comply by 10 May 2016; (iv) banks with average total consolidated assets of less than \$50 billion that is subject to the Guidelines by virtue of being a subsidiary of a parent company that controls another bank should comply with the Guidelines on the same date that the affiliated bank should comply; and (v) banks with average total consolidated assets of less than \$50 billion on the effective date that subsequently becomes subject to the Guidelines should comply within 18 months as of date of the most recent Call Report used to calculate the

	<i>average.</i>
EC5	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank’s Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank’s risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	<p>In addition to supervisory guidance, supervisors also use widely accepted industry standards (e.g., those of the Institute of Internal Auditors although industry guidance is not formally endorsed or adopted by the Supervisory Agencies) to assess the adequacy of their work against these standards.</p> <p>The scope of periodic reviews includes audit independence and competency, the role of the Board and Audit Committee, the identification of the audit universe, audit’s planning and risk assessment methodology, audit’s plans, audit work including work papers and sampling methodology, audit reports and ratings, follow-up of audit issues, and audit’s interaction with management.</p> <p>In addition, the “Interagency Policy Statement on the Internal Audit Function and Its Outsourcing” and the “Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing” instruct supervisors to perform additional steps when reviewing outsourcing arrangements. Supervisors are required to determine whether:</p> <ul style="list-style-type: none"> • The arrangement maintains or improves the quality of the internal audit function and the bank’s and holding company’s internal control; • Key employees of the bank and holding company and the outsourcing vendor clearly understand the lines of communication and how any internal control problems or other matters noted by the outsourcing vendor are to be addressed; • The scope of the outsourced work is revised appropriately when the bank’s and holding company’s environment, structure, activities, risk exposures, or systems change significantly; • The directors have ensured that the outsourced internal audit activities are effectively managed by the bank or holding company; • The arrangement with the outsourcing vendor satisfies the independence standards described in this policy statement and thereby preserves the independence of the internal audit function, whether or not the vendor is also the bank’s and holding

	<p>company's independent public accountant; and</p> <ul style="list-style-type: none"> The bank and holding company has performed sufficient due diligence to satisfy itself of the vendor's competence before entering into the outsourcing arrangement and has adequate procedures for ensuring that the vendor maintains sufficient expertise to perform effectively throughout the arrangement. <p>Supervisors also assess the competence of the bank's and holding company's internal audit staff and management by considering the education, professional background, and experience of the principal internal auditors.</p>
Assessment of Principle 26	Compliant
Comments	<p>The Federal Banking Agencies are clearly raising the bar for control functions. In respect of this particular Core Principle, this is particularly true of Internal Audit and the assessors have seen evidence that the supervisors are finding issues with Internal Audit that are classified as Matters Requiring Attention—at the OCC there were 405 outstanding at the time of this report. The general view the assessors established was that Internal Audit had improved since the last BCP review, but that, in technical areas in particular; these functions still have some way to go.</p> <p>By contrast the assessors found very little mention of Compliance except with reference to the very robust regime in respect of the BSA and Anti-Money Laundering. Compliance functions for example are not mentioned in The Federal Reserve published Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice in August 2013 or the OCC's proposals to formalize its "heightened expectations" in its Heightened Standards Guidelines. As the assessors state in CP29, there is a risk that given both legislative and regulatory focus on BSA/AML issues, the assessors found evidence of significant resource deployed within the authorities and within firms to meet the very stringent standards. The vulnerabilities to other forms of criminal abuse (e.g. fraud) are more disparate within the regime and within the banks themselves and risk being deemphasized. The assessors would recommend that the authorities seek to find an appropriate balance in their surveillance and also in their guidance - perhaps by consolidating it into fewer places than at present.</p>
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor ⁸⁶ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.

⁸⁶ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

<p>Description and findings re EC1</p>	<p>Banks below the minimum asset threshold of \$500 million are exempt from requirements to publish financial statements, which are reviewed by an independent public accountant. That said, many of those banks do not avail themselves of this exemption. (See also EC 5 which describes what is required from exempt banks).</p> <p>Banks exceeding a minimum asset threshold of \$500 million are required to prepare annual financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP). See U.S.C §1831m(b)1 and section 37 of FDI Act, 12 U.S.C §1831n. These banks may comply with the requirement at the holding company level under certain conditions. The appropriate federal banking agency may determine that the application of any U.S. GAAP principle to any bank is inconsistent with the objective of section 37 and may prescribe an accounting principle applicable to such banks and holding companies which is no less stringent than U.S. GAAP.</p> <p>Banks between \$500 million and \$1bn must produce audited comparative annual financial statements; and an independent public accountant’s report on the audited financial statements and a management report that contains a statement of management’s responsibilities for preparing the annual financial statements; establishing and maintaining an adequate internal control structure over financial reporting; and complying with the designated safety and soundness laws and regulations pertaining to insider loans and dividend restrictions.</p> <p>If the bank has assets of \$1bn or greater than the management and independent public accountant reports are further expanded. The management report must also include an assessment of the effectiveness of the internal control structure over financial reporting. The independent public accountant’s attestation report concerning the institution’s internal control structure over financial reporting include the Call Report and/or the FR Y-9C report.</p> <p>If a bank is \$5bn or greater and has a CAMELS rating of 1 or 2 it may comply with these requirements through the bank’s holding company if the holding company holds at least 75 percent of the consolidated group’s assets. . If the CAMELS rating is lower, the supervisor may accept compliance through the holding company.</p> <p>To ensure accuracy and reliability, banks and holding companies must establish and maintain adequate financial record-keeping systems. See, e.g., 12 U.S.C §§161, 1464(v), 1831m. The FBAs have been provided broad remedial authority to take enforcement actions against a bank and its IAPs, including board members and management, if they provide false or misleading information.</p>
<p>EC2</p>	<p>The supervisor holds the bank’s Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor’s opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.</p>
<p>Description and findings re EC2</p>	<p>For financial statements prepared in accordance with the Acts mentioned under EC1, U.S.C.1831(m)(d)1 prescribes that they must be audited by an independent public accountant. Publicly traded institutions registered with the SEC are required to undergo a quarterly review of their financial statements by an independent public accountant, who must report findings to the bank’s audit committee, That committee, in turn, must provide the report to the relevant federal or state banking agency. Supervisory guidance requires audits of banking organizations to be performed in accordance with the Public Company Accounting Oversight Board (PCAOB)’s and American Institute of Certified Public Accountants (AICPA)’s auditing standards.</p> <p>The supervisors have broad enforcement powers for holding board members and</p>

	<p>management responsible for ensuring that financial statements issued annually to the public are reviewed and properly verified by an independent, appropriately credentialed public accountant, for those banks or holding companies that have external audit requirements.</p> <p>U.S. supervisors require banks and holding companies to file reports that include financial statements and reports of condition that reflect the capital to be accurate. These reports, for both public and non-public banks and holding companies, are made public by the FBAs with the exception of certain information deemed as confidential. Such financial statements are required to be certified by the bank's or holding company's CFO and a specified number of directors (trustees).</p>
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.
Description and findings re EC3	As noted under EC1, banks must apply U.S. GAAP or other, no less stringent principles. Such principles encompass the standards and practices for valuation. The accounting rules allow for assets and liabilities to be reported on different accounting bases including historical cost, amortized cost, the lower of cost and fair value, and fair value. FASB ASC Topic Fair Value Measurement defines fair value and establishes a framework for measuring the fair value of assets and liabilities, based on a three-level hierarchy, and for making disclosures about fair value measurements. The FBAs, through guidance and examination procedures, determines that institutions have robust controls and documentation on the accounting policies and processes surrounding the valuation processes.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.
Description and findings re EC4	<p>In general, external auditors determine and report whether the financial statements of a bank are presented fairly in accordance with GAAP. Further, the external audits must meet or exceed the scope and procedures required by GAAS or PCAOB auditing standards. See 12 U.S.C §1831(m)(f)1. The scope of the audit shall be sufficient to permit an auditor to determine whether the financial statements taken as a whole are presented fairly and in accordance with U.S. GAAP. While some banks and holding companies are not subject to independent audit requirements, the agencies encourage them to obtain independent audits. GAAS and PCAOB auditing standards generally require an auditor to adequately plan the audit on a risk-based basis, e.g. focusing on major exposures and significant activities and risks.</p> <p>When external auditors and supervisors meet before an audit is finalized, the supervisor may encourage, but not require, the auditor to expand the scope of the audit, for instance based on the supervisor's specific knowledge about the bank.</p>
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	Those banks and holding companies which meet the criteria set out in legislation are required to obtain annual audits of financial statements and external audits of internal control over financial reporting. Such audits cover, as a minimum, all the areas mentioned in this

	<p>assessment criterion (EC5).</p> <p>For smaller banks, not subject to the audit requirements, a non-audit agreed-upon procedure is commonly used. Alternatively, an attestation engagement may be performed for all internal controls relating to the preparation of financial statements or specified schedules of the bank's regulatory reports. This type of engagement is performed under generally accepted standards for attestation engagements. There must be an agreed-upon procedure which is objective and verified. It must also be integrated with the audit of internal controls.</p>
EC6	<p>The supervisor has the power to reject and rescind the appointment of an external auditor, who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.</p>
Description and findings re EC6	<p>Independent public accountants providing audit services to banks must meet certain statutory qualifying criteria. See U.S.C §1831m(g)(3). The FDIC or another appropriate federal banking agency may remove, suspend, or bar an independent public accountant upon a showing of good cause. This would include, for example, when the auditor is determined to have inadequate expertise or independence or not to follow established professional standards.</p> <p>If a supervisor concludes that the auditor does not have the requisite expertise, independence, or does not follow established professional standards, the agency may talk with the bank's senior management, board of directors and the external auditor. If the issue cannot be resolved, the agency can bar the accountant from performing audits under the act. Such enforcement action has only rarely taken place; and never against a whole audit firm.</p> <p>In addition, each bank is required to provide the appropriate agency with written notice of the engagement of an independent public accountant, or the resignation or dismissal of such a person and must include a statement of the reason for such event. In addition, a person who ceases to be the accountant of a bank is required to notify the appropriate agency in writing of such termination and set forth the reasons for the termination.</p>
EC7	<p>The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.</p>
Description and findings re EC7	<p>Section 203 of the Sarbanes-Oxley Act of 2002 made it unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner having primary responsibility for the audit or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the five previous fiscal years. See 15 U.S.C §78j-1. In addition, the rules also mandate a five year "timeout" period after rotation. The rules provide an alternative for accounting firms with fewer than five public audit clients and fewer than ten partners. The assessors saw evidence that the supervisors determine that banks adhere to these rules. For instance, there were orders from the supervisors to banks to rotate external auditors.</p> <p>Part 363 of the FDIC rules includes some (but not comprehensive) requirements for non-public banks to rotate their auditors.</p>
EC8	<p>The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.</p>
Description and findings re EC8	<p>The FBAs meet periodically with external audit firms as well as the FASB, the SEC, the AICPA and the PCAOB to discuss general accounting, audit, and financial disclosure issues related to banks and holding companies. Supervisors also meet periodically with external audit firms with respect to individual banks and holding companies to discuss general and specific issues with respect to their accounting and disclosure practices. In addition, external auditors will</p>

	typically ask to speak to the supervisors before signing off on annual financial statements to ensure that supervisors do not have information that would preclude their sign-off. See Interagency Guidance on Coordination and Communication Between External Auditors and Examiners (July 1992).
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	<p>There is no requirement for the external auditor to report directly to the FBAs, and there is no "safe harbor" protection for auditors who do report. However, according to Part 363 of the FDIC rules, the bank itself must inform the supervisors within 15 days of any written information from the auditor about a violation. Also, supervisors generally meet the auditors of banks and will then be informed. Supervisors do not use auditors for supervisory purposes. However, as part of the evaluation of a bank's compliance with part 363 of the FDIC rules, supervisors would review communication to the management and audit committee made by the external auditors. External auditors must also notify management and the audit committee (or the full board of directors) of any control issues noted as the result of the financial statement audit.</p> <p>As noted, supervisory guidance requires audits of banking organizations to be performed in accordance with the PCAOB's and AICPA's auditing standards. Under those standards, when an auditor concludes that an illegal act, including violations of laws or government regulations, has or is likely to have occurred, he must ensure that those charged with governance are informed of the illegal act and this must be documented in writing.</p>
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	External auditors of large banks are required to agree to provide related audit work papers, policies and procedures to supervisors, if requested. See 12 U.S.C. §1831m(g)(3)(A). As a matter of best practice, supervisors expect all banks – regardless of size – to obtain agreement of an independent public accountant or other external auditor in the engagement letter to grant supervisors access to all the accountant's work papers and other material pertaining to the bank prepared in the course of performing the external auditing program. Banks that fail to grant access of such working papers are subject to informal or formal enforcement action.
Assessment of Principle 27	Largely compliant
Comments	<p>Not all banks are required to issue full financial statements which are reviewed by an independent accountant in accordance with independent audit requirements.</p> <p>There is no requirement for external auditor to report immediately directly to the supervisor, but rather through the bank, should they identify matters of significant importance.</p> <p>There is no comprehensive requirement, apart from some provisions, only an expectation for non-public banks to rotate their external auditors.</p> <p>The supervisor cannot set the scope of the external audit but could encourage the auditor,</p>

	<p>after the preliminary audit but before it is finalized, to include new issues. (This deficiency does not affect the rating of compliance, since EC 4 only requires that “Laws or regulations set, or the supervisor has the power to establish the scope...” The U.S. legislation clearly sets out the minimum scope of the external audit making the U.S. compliant with this proviso. However, the assessors recommend that the FBAs are given legal powers to add issues to the scope of the external audit in specific cases in order to address a relevant issue not normally covered in an external audit).</p>
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁸⁷ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank’s true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>All banks regardless of size must submit regulatory reports that include financial and other information, while holding companies with assets of U.S.D500 million or more and SLHC of all sizes must submit regulatory reports that include financial and other information on a consolidated basis. This reporting includes information about balance sheet items, off-balance-sheet-exposures, profit and loss, capital adequacy, asset quality, loan loss provisioning as well as some information on interest rate risk sensitivity and market risk. See 12 U.S.C.§§161 and 1464(v).</p> <p>The FBAs ensure the periodic public disclosure of information in these regulatory reports and require that they adequately reflect the true financial condition of the bank or holding company. The disclosure and reporting requirements are subject to uniform submission deadlines, and ensure the timeliness and relevance of information. Uniform standards for reporting ensure comparability of information.</p> <p>Under the Basel III disclosure framework, U.S. banks and holding companies adopting the Advanced Approaches and certain U.S. banks and holding companies adopting the Standardized Approach rules will, from January, 1st, 2015, also be subject to the Pillar 3 disclosure requirements.</p> <p>Each bank with consolidated assets of more than U.S.D 500 million is required to prepare a Part 363 Annual Report and submit it to the FDIC, the appropriate federal banking agency (if other than the FDIC) and any appropriate state bank supervisor. The bank must also make this report available to the public. The report includes audited financial statements and the auditor’s opinion thereon, and a management report that contains (1) a statement of management’s responsibilities for preparing the annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with certain designated laws and regulations relating to safety and soundness, and (2) an assessment by management of the bank’s compliance with such laws and regulations during the year.</p>

⁸⁷ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	It should be noted that the U.S. interpretation of “solo basis” is different from the one used in the BCP Methodology. Namely, in the U.S. “solo basis” is considered to encompass the bank and its subsidiaries. (In the Methodology “solo basis” means the bank on a stand-alone basis).
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank’s financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	As noted under EC1 and further elaborated under CP 10, the FBAs have a robust reporting framework from which disclosures will be selected. In addition, some of the regulatory reports provide the opportunity for the reporting banks to provide footnotes or narrative disclosures, which may be either quantitative or qualitative in nature. Regulatory reports that allow banks to provide additional information include, but are not limited to, the following: call reports (FFIEC 031 and FFIEC 041), FR Y-9C, FR Y-9LP, FR Y-9 SP, FR Y-11, FR 2314, and FR Y-7N. See BCP #10 Supervisory Reporting for additional information on these reports. As mentioned previously, U.S. banks adopting Basel III will be subject to the Pillar 3 disclosure requirements; these disclosures are both qualitative and quantitative in nature as well.
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	Pursuant to Regulation Y (12 CFR 225.5(b) for BHCs and LL (12 CFR 238.4 for SLHCs, and FR Y-6 report is filed by all top-tier holding companies. Inter alia, the report requires the submission of an organizational chart and an annual verification of domestic branches within the organization and includes information on the identity, percentage ownership, and business interests of principal shareholders, directors and executive officers. In addition, report FR Y-10 provides data on organizational structural changes for reportable companies in the group. The FR Y-7 and FFIEC 002 are required for foreign banking organizations (FBOs) that have a U.S. banking presence. The report collects financial statements, organizational structure information, shares and shareholder information, and data on the eligibility to be a qualified FBO as defined in Regulation K. All these reports are publicized unless the reporting institution provides reason for an exemption. This has never happened.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	As discussed under Principle 10, U.S. FBAs require by statute that banks comply with reporting requirements and ensure the disclosure of relevant financial information. Failure to comply can provide the basis for informal or formal enforcement measures, including cease-and-desist (C&D) proceedings and the imposition of civil monetary penalties (CMP), against a bank and/or its IAPs. See 12 U.S.C. §§ 164, 1813(u), 1817(a), and 1818(b) and (i). The remedial provisions are structured to be appropriate to the severity of the violation. The supervisory review of a bank’s and a holding company’s safety and soundness includes review of internal controls related to financial reporting and Basel III Pillar 3 disclosures when implemented for applicable U.S. banks and holding companies. The SEC has the primary responsibility for ensuring review of public disclosures of public

	companies and for taking enforcement action, as necessary. The SEC coordinates with the appropriate federal banking agency on enforcement matters affecting banks and holding companies
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	<p>The FBAs publish aggregate information on the banking system, including balance sheet indicators and statistical parameters reflecting the principal aspects of banks' operations (e.g., balance sheet structure, capital ratios, income earning capacity, and risk profiles). This facilitates public understanding of the banking system and the exercise of market discipline.</p> <p>For each bank, the FBAs publish quarterly Uniform Bank Performance Reports (UBPR) that are primarily based on the information reported in the Call Reports. The UBPR include various indicators and ratios involving financial position, financial performance, and capital for peer groups, including deposit composition and stability, ratios of loan commitments to total loans and of standby letters of credit to total loans, the loan-to-deposit ratio (at community banks), the ratio of temporary investments to volatile liabilities, and the ratio of pledged securities to total securities. A similar report is produced by the Federal Reserve for aggregated BHC information, the BHC Performance Report (BHCPR).</p> <p>The FDIC publishes the Quarterly Banking Profile (QBP), which provides the public with a comprehensive summary of financial results for all banks each quarter. The QBP includes aggregate balance sheet and income statement data, key performance ratios, loan performance and quality data, and data on holdings of derivative contracts as well as servicing, securitization, and asset sales activities. The QBP also includes breakdowns of these data for banks by asset size range and geographic area. The FDIC publishes Statistics on Depository Institutions (SDI) each quarter, which is a publicly available and searchable database that provides industry information. SDI includes a set of frequently used financial data reports in standardized formats and provides the public with the ability to create reports containing customized peer groups of banks and bank holding companies</p> <p>The OCC and the Federal reserve each publishes a quarterly report on developments of banks' credit underwriting criteria</p>
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	There are no examples of such disclosures.
Assessment of Principle 28	Compliant
Comments	There are no examples of disclosures of information which covers ongoing developments during a financial reporting period, except for occasional analytical papers. Since the periodicity of the most comprehensive published report is quarterly (call reports), the assessors did not consider this deficiency significant. Nevertheless, the authorities are

	<p>encouraged to promote the disclosure of such information, where relevant.</p> <p>The FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries). In principle, this means that regulatory requirements such as Basel III capital that are intended to be imposed on a bank on both a stand-alone and consolidated basis can only be tracked on the latter basis. The assessors are satisfied, however, that in practice this omission has no prudential significance. The FBAs have explained that U.S. bank subsidiaries tend to be small relative to the parent bank and can only undertake activities that the bank itself could undertake in its own name.</p>
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁸⁸
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>The FBAs have clear statutory authority to regulate banks and holding companies, examine them for compliance with laws and regulations relating to the prevention of criminal misuse, and enforce these requirements through civil enforcement actions. See e.g. 12 U.S.C. §§ 1818(s)(2) and (s)(3); 1818 (i). These provisions are enforced by the agencies and, over the years, a number of banks and holding companies have been assessed penalties for BSA/AML failures (Note: BSA refers also to fraud and tax evasion transactions). In addition to the FBAs, certain other federal or state government agencies play critical roles in safeguarding the U.S. financial sector from criminal activities. The FBAs issue a BSA/AML Examination Manual that is frequently updated to ensure compliance with the rules and regulations. Fin CEN also provides guidance on emerging fraud and AML threats. The FBAs meet regularly to coordinate and share information, e.g. through the National Bank Fraud Working group, the FFIEC BSA/AML Working Group and the BSA Advisory Group.</p> <p>The Bank Protection Act, 12 U.S.C. §1882, requires the agencies to promulgate rules applicable to banks with respect to the installation and operation of security devices and procedures to discourage robberies, burglaries, and larcenies and to assist in the identification and apprehension of persons who commit such acts. See e.g. 12 CFR 21, subpart A (Minimum Security Devices and Procedures (OCC); 12 CFR 326 (FDIC), and 12 CFR 208.61 (Federal Reserve). The Interagency Guidelines Establishing Information Security Standards 12 CFR 30, appendix B (OCC); 12 CFR 364 appendix B (FDIC); and 12 CFR appendix D-2 (Federal Reserve) and 12 CFR 225, appendix F (Federal Reserve) set standards for banks to develop and implement safeguards for the security, confidentiality, and integrity of customer information, including protecting against unauthorized access, and advise banks to perform background checks for employees with responsibilities for, or access to, customer information. See 31 U.S.C. §5318(l); 12 CFR 21.21(b)(2), 12 CFR 163.177(b)(2) (OCC); 12 CFR 208.63(b)(2) (Federal</p>

⁸⁸ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	Reserve); 12 CFR 326.8(b)(2) (FDIC); and 31 CFR 1010.220 (FinCEN).
EC2	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	<p>The FBAs and Treasury have issued regulations requiring banks to establish and maintain BSA/AML Compliance Programs that include the following elements, at a minimum: (a) internal controls to ensure BSA compliance, (b) independent testing of compliance, (c) an individual responsible for coordinating and monitoring day-to-day compliance and (d) training for appropriate personnel. The agencies and Treasury have issued separate regulations requiring banks to establish a customer identification program (CIP). The agencies and Treasury have issued regulations requiring banks and holding companies to file a suspicious activity report with Fin CEN within 30 days of the initial detection of certain facts (within 60 days if attempting to identify a subject).</p> <p>The Bank Protection Act requires the agencies to promulgate rules applicable to banks with respect to the installation and operation of security devices and procedures to discourage robberies, burglaries, larcenies and to assist in the identification and apprehension of persons who commit such acts.</p> <p>The Interagency Guidelines Establishing Information Security Standards set standards for banks to develop and implement safeguards for the security, confidentiality and integrity of customer information, including protecting against unauthorized access, and advise banks to perform background checks for employees with responsibilities for, or access to, customer information.</p> <p>Section 12 U.S.C 1818 (e) allows the FBAs to remove or to prohibit an institution affiliated party (IAP) from engaging in an act, omission or practice which constitutes a violation of law or written agreement with the bank supervisors, an unsafe or unsound practice, or breach of such party's fiduciary duty, provided certain additional factors are satisfied (such as loss to the bank, gain to the IAP, etc.).</p> <p>Supervisors promote high ethical and professional standards through various means, such as conducting outreach, providing training opportunities, or issuing guidance on appropriate compliance with BS/AML regulations. The FBAs have also brought enforcement actions against banks and individuals based upon failures to meet ethical and professional standards. The FBAs have publicly issued their FFIEC BSA/AML Examination Manual with the aim to inform banks of examination criteria and disseminate uniform guidance on supervisory expectations.</p> <p>The federal and state supervisors also assess more broadly whether a bank or holding company have adequate policies and processes in place to promote high ethical and professional standards to prevent the bank from being used for criminal activities. However, beyond requirements on the fitness and propriety of management there are no explicit requirements that banks must have policies to ensure high ethical and professional standards.</p> <p>As a part of the BSA/AML Compliance Program, the FBAs examine whether a bank has the appropriate policies, procedures and processes in place to monitor, identify and report unusual activity, concentrating on high-risk products, services, customers and geographic locations. The FBAs also confirm that an institution's board meets the regulatory mandate of formally approving the bank's BSA/AML program.</p>
EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks

	report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. ⁸⁹
Description and findings re EC3	<p>In cases involving violations requiring immediate attention, an example being an intrusion into the bank's IT-systems, the filing institution must immediately notify law enforcement and the relevant FBA. Banks and holding companies are required at all times to conduct their business and exercise their powers with due regard to safety and soundness. As part of this obligation, the FBAs expect banks to report to them directly any suspicious activities and incidents of fraud which might be material to the safety, soundness, or reputation of the institution.</p> <p>As part of its examination scoping process, the FBAs review BSA data (including SARs) to identify BSA/AML and fraud risks and document the examination plan based upon these risks and other risks to the institution. Additionally, the agencies review SARs that report known or suspected criminal activities by current or former officials, directors, employees, and other IAPs to ensure that appropriate enforcement actions are brought against such parties.</p>
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	The agencies are authorized to inform relevant authorities, including Treasury and Fin CEN, of suspicious transactions. Within these prescribed procedures, the agencies may also share such information with judicial authorities. The Right to Financial Privacy Act provides exceptions with respect to disclosures for law enforcement purposes. The FBAs and FinCEN have specific regulations that address the disclosure of SARs to other government agencies. Assessors have verified this takes place. In most cases, however, suspicious activities are reported by the banks themselves, and reporting is verified by FBAs. When noncompliance indicates possible criminal activity, matters are also referred to the U.S. Department of Justice (DOJ).
EC5	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence programme on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g. escalation to the bank's senior

⁸⁹ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	<p>management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);</p> <p>(e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank’s senior management level of decisions on entering into business relationships with these persons); and</p> <p>(f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.</p>
<p>Description and findings re EC5</p>	<p>The agencies have enforced supervisory guidance that directs banks to establish CDD policies, procedures and processes, which are risk based and integrated into the bank’s overall risk management strategy. The agencies have identified failures of such during examinations evidenced by recent public enforcement actions (as shown on the website of each agency). Over 300 such enforcement actions related to AML/CFT have been initiated in the last 4 years.</p> <p>Pursuant to 31 U.S.C §5318(1), the FBAs and Treasury have issued regulations requiring various account opening procedures, including verifying the identity of any persons seeking to open an account and maintaining records of such information. Banks must establish a Customer Identification Program and maintain records of the information used to verify the person’s identity. The BSA and CIP regulations generally require that the banks properly safeguard and maintain copies of reports and records for a period of five years following the completion of the transaction or after the account has been closed.</p> <p>The CIP also must include procedures for responding to circumstances in which the bank cannot form a reasonable belief that it knows the true identity of a customer. For certain non-U.S. accounts and transactions, banks must identify all beneficial owners. For U.S. transactions where the client is a legal entity, the identification of the ultimate beneficial owner is not required.</p> <p>The FBAs evaluate whether the CIP enables a bank to form a reasonable belief of the customer’s true identity at account opening and to ensure that account profiles are kept current. In addition, supervisors will review if the bank has identified PEPs and, if so, how the corresponding risks are managed. There is, however, no explicit requirement that decisions on entering into relationship with such persons shall be escalated to the bank’s senior management. The current definition of PEPs in the U.S. only includes foreign nationals. Domestic PEPs are not defined, but are expected to be included in high net worth individuals monitoring as a higher risk category.</p> <p>12 U.S.C §5318(i) and 31 CFR Part 1010 requires risk based due diligence for U.S. private banking and correspondent accounts involving foreign persons. The statute requires reasonable steps to ascertain the identity of nominal and beneficial owners (except of legal entities) of, and the source of funds deposited into, such accounts. Stricter requirements apply when the customer is defined as a foreign PEP. However, in practice banks are expected to, and do, apply these higher standards to all other transactions and accounts.</p> <p>Banks must have an adequate BSA/AML compliance program in place that includes ongoing monitoring to detect criminal and suspicious activities. Specifically, the program must have sufficient internal controls for monitoring suspicious activity, a qualified BSA compliance officer to oversee the program, independent testing to verify vulnerabilities in the program, and regular BSA/AML compliance training for all relevant personnel. The FFIEC BSA/AML Examination Manual specifically addresses the regulatory expectations pertaining to internal controls, including CDD requirements, which are an essential component of a bank’s internal controls. See, e.g. 12 CFR Part 1010, subpart D. The Manual also states that the Board of</p>

	<p>Directors is responsible in setting policies regarding BSA/AML risk, which include prescribing the relationships with high risk accounts and countries the bank will enter into.</p> <p>Supervisors determine whether the internal controls include prudent account opening procedures and ongoing monitoring systems, including a customer acceptance policy identifying business relationships the bank will not accept, if any, and that standards are followed on an ongoing basis The FFIEC Manual also states that "Management should have a thorough understanding of the money laundering terrorist financing risk of its customer base. Under this approach the bank will obtain information at account opening sufficient to develop an understanding of normal and expected activity of the customer's occupation or business operations."</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	<p>31 U.S.C §5318(i) and its implementing regulation at 31 CFR 1010.610 require banks to establish risk-based due diligence policies and procedures reasonably designed to detect and report money laundering through correspondent accounts established, maintained, administered or managed in the U.S. for a foreign financial institution.</p> <p>In addition, banks must perform enhanced due diligence for foreign correspondent banks operating under certain high-risk banking licenses. Enhanced due diligence includes obtaining ownership information about certain correspondents, conducting additional scrutiny of the transactions routed through these accounts, and ascertaining whether the foreign correspondent provides access to other foreign financial institutions. 31 U.S.C §5318(j) prohibit U.S. banks from providing correspondent accounts to foreign shell banks.</p> <p>The FFIEC BSA/AML Examination Manual has a chapter specifically addressing correspondent banking relationships. The agencies supervise banks to ensure compliance with foreign correspondent banking requirements. Supervisors are provided a number of significant high profile BSA/AML factors that may be used to help identify potential risk characteristics of a foreign correspondent customer in the Manual.</p> <p>The agencies have enforced (in several cases) requirements that banks establish enhanced due diligence policies and processes regarding correspondent banking and have cited failures of such rules as a concern during examinations.</p> <p>U.S. agencies generally view BSA/AML risks in domestic correspondent banking as low compared to other types of financial services. Nevertheless, U.S. agencies evaluate the policies and procedures for U.S. banks that offer correspondent banking services to domestic respondent banks, particularly with a view to detecting and reporting suspicious activities. These requirements, including that correspondent relationship are not initiated when adequate controls are not in place by the counterpart, are detailed in 31CFR 103.176.</p>
EC7	<p>The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.</p>
Description and	<p>The FBAs are responsible for examining banks and holding companies within their respective</p>

findings re EC7	<p>jurisdictions for safety and soundness and compliance with applicable laws. For instance, supervisors expect that the internal audit and compliance functions of a bank would identify and report instances of potential abuse. Specifically, federal law requires that each federal banking agency’s examination of a bank includes a review of the BSA Compliance Program and that its reports of examination describe any problems identified within the BSA Compliance Program. See 12 U.S.C. § 1818(s).</p> <p>A key component of the BSA/AML on-site examination is to ensure that the bank maintains an effective BSA/AML Compliance Program for its business activities that is commensurate with the bank’s risk profile. Prior to the examination, banking supervisors routinely conduct an off-site review of the FinCEN databases relative to bank SARs and CTRs to determine if the bank has filed such reports, and to determine if those reports were filed completely and in a timely manner. The agencies assess a bank’s compliance with BSA/AML and OFAC obligations using the core examination procedures detailed in the FFIEC BSA/AML Examination Manual during each examination. For larger and more complex banking organizations, the agencies maintain resident on-site supervisors who perform continuous monitoring of the control infrastructure and annually assess the organization’s condition and risk assessment.</p> <p>Supervisors also determine that banks comply with relevant standards for dealing with operational risks, including risks of criminal abuse of the bank.</p>
EC8	<p>The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.</p>
Description and findings re EC8	<p>An agency may take formal or informal enforcement actions to address violations of BSA/AML requirements (including those related to BSA Compliance Programs and SAR and CTR regulatory obligations), OFAC deficiencies, and unsafe and unsound practices or breaches of fiduciary duty, involving failure to comply with obligations related to criminal activity. 12 U.S.C. §1818(s)(3) requires an agency to issue a cease and desist order to address a violation of the BSA Compliance Program requirement for banks. Actions also may be taken to enforce compliance with the requirements of the Bank Protection Act. See 12 U.S.C. § 1882.</p> <p>The FBAs and FinCEN also have the authority to assess penalties for violations of the BSA. See 31 U.S.C. § 5321. The Department of Justice (DOJ) has the authority to bring criminal cases against banks or holding companies for violations against criminal statutes, including parts of the BSA. See 31 U.S.C. § 5322; 18 U.S.C. §§ 1956 and 1957. The DOJ has the authority to bring criminal cases against banks and holding companies for violations of criminal statutes, including certain provisions of the BSA, 31 U.S.C. § 5322; 18 U.S.C. §§ 1956 and 1957. The FBAs are also authorized to take formal administrative action against an IAP of any banking organization and are able to take informal actions with respect to less serious deficiencies or more technical violations of the BSA/AML requirements. See 12 U.S.C. § 1813(u) and 1818. The most serious sanction that the FBAs may impose upon a bank that has been found guilty of certain criminal offenses relating to money laundering is to terminate the activities of a financial institution (including a branch or agency of a foreign bank).</p> <p>Depending on the degree of noncompliance, an agency can issue written orders that impose remedial actions; impose civil money penalties; reprimand individuals or bar them from employment within the industry; restrict or suspend the specific activities of the organization; revoke the charter or deposit insurance coverage of the organization; and/ or refer the matter to the DOJ for possible criminal penalties.</p> <p>The assessors found numerous evidences of supervisory criticisms and actions against deficient BSA/AML compliance. Thousands of AML/CFT inspection actions are carried out by</p>

	the FBAs each year, and hundreds of related enforcement actions have been initiated.
EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts⁹⁰ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	<p>The agencies have issued guidelines that advise banks to use reasonable employment screening processes and perform background checks for employees in particular with responsibilities for, or access to, customer information to minimize the risk of fraud, embezzlement, money laundering, and other crimes. The agencies have also issued risk management guidance for third party relationships. The agencies consider that a reasonable policy might include checking references, performing credit and/or background checks, Internet searches, and performing criminal background checks, including an FBI fingerprint check, for prospective employees. Further, the FDIC issued a FIL-46-2005, "Pre-employment Background Screening", that provided guidance on such a policy. The agencies have also issued guidance to the industry concerning best practices in this area.</p> <p>The agencies have also issued risk management guidance for third party relationships (OCC Bulletin 2013-29) and payment processors (OCC Bulletin 2008-12).</p> <p>Banks may not hire an IAP convicted of a crime involving dishonesty, breach of trust or money laundering, or who attended a pretrial diversion or similar program without the written consent of the FDIC (12 U.S.C. 1829(a)). Similarly, a bank or savings association holding company cannot hire an IAP convicted of a crime involving dishonesty, breach of trust or money laundering, or who attended a pretrial diversion or similar program without the written permission of the Federal Reserve (12 U.S.C. § 1829 (d) & (e)). However, referring to subsection (c) in the EC 9 there is no supervisory requirement that banks have screening policies for hiring staff in general.</p> <p>Referring to subsection (d) above, banks are required to regularly arrange training programs for their staff on BSA/AML issues. Banks are expected, but not required, also to arrange training on other criminal abuse issues.</p> <p>Banks are examined for compliance with these obligations in accordance with the standards set forth in the FFIEC BSA/AML Examination Manual on a regular, scheduled basis. A bank must have an adequate BSA/AML Compliance Program in place that includes: internal controls for the operation and function of the bank's program; independent testing of the bank's compliance; a designated individual or individuals responsible for coordinating and</p>

⁹⁰ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>monitoring day-to-day compliance of BSA/AML matters including SAR reporting; ongoing training programs on all BSA/AML obligations, including CDD and suspicious activity monitoring; and CIP and methods to detect criminal and suspicious activities. The FFIEC Manual requires that the compliance officer must have the expertise and authority to undertake the job.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings re EC10	<p>Banks are required to have BSA compliance programs that have procedures that are reasonably designed to detect and report suspicious activity to FinCEN and an officer responsible for the program, including adequate management information systems. See EC 2; 12 CFR 21.11(h). Whenever a bank files a SAR, it must promptly notify the board of directors or the relevant board committee. See 12 CFR 21.11(h) (OCC); id. at 208.62(h) (Federal Reserve); and id. at 353.3(f) (FDIC). Under these rules, banks must file SARs on insiders regardless of the amount involved in the suspicious activities. In addition to the SAR requirements, the audit committees of publicly held banks and holding companies that are subject to section 301 of Sarbanes-Oxley must establish procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters. See 15 U.S.C. § 78j-1(m)(4).</p> <p>The Bank Protection Act, 12 U.S.C. § 1882, requires the agencies to promulgate rules applicable to banks with respect to the installation, maintenance, and operation of security devices and procedures to discourage robberies, burglaries, and larcenies and to assist in the identification and apprehension of persons who commit such acts. See e.g. 12 CFR 21, subpart A (Minimum Security Devices and Procedures) (OCC); and 12 CFR 326 (FDIC).</p> <p>SAR filing, monitoring and investigation activities are important components to a bank's BSA compliance program (i.e., internal controls). The agencies assess a bank's and holding company's policies, procedures, and processes, including internal controls and day-to-day supervision, for monitoring and identifying unusual activity and for referring unusual activity from all business lines to the personnel or department responsible for evaluating unusual activity. Banking supervisors evaluate the effectiveness of the monitoring systems by considering the bank's overall risk profile, the volume of transactions, and the adequacy of staffing assigned to the identification, research, and reporting of suspicious activities. Additionally, the agencies evaluate the escalation process from the point of initial detection to disposition of the investigation to determine whether management's documented decisions to file or not file a SAR are reasonable, and whether SARs are filed in a timely manner. Finally, the agencies review management information systems to ensure that they inform the board (or board committee) and senior management of suspicious activities, compliance deficiencies, and corrective action.</p>
EC11	<p>Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.</p>
Description and findings re EC11	<p>The BSA and the agencies' SAR regulations provide protection to financial institutions and their employees from civil liability for filing a SAR or for making disclosures in a SAR. The agencies and Fin CEN have issued interagency guidance on the scope of this "safe harbor", as judicially interpreted, on May 24, 2004. Federal law provides protection from civil liability for</p>

	<p>all reports of suspicious transactions made to appropriate authorities, regardless of whether such reports are filed pursuant to the SAR instructions. Specifically, the law provides that a bank or holding company and its directors, officers, employees, and agents that make a disclosure of any possible violation of law or regulation, including a disclosure in connection with the preparation of SARs “shall not be liable to any person under any law or regulation of the U.S., any constitution, law, or regulation of any state of political subdivision of any state to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure.”. Each of the FBAs has applicable regulations that specifically include a safe harbor provision for the filing of SARs.</p> <p>The agencies regularly review that appropriate procedures are being conducted. The FFIEC BSA/AML Examination Manual—Suspicious Activity Reporting Overview reiterates the safe harbor provision.</p> <p>Note that the “safe harbor” provision only applies to SARs and not to suspicions of other criminal activities.</p>
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>The FBAs have broad authority to share relevant supervisory information. Upon request, the FBAs work cooperatively with relevant domestic and foreign counterparts to share non-public information involving potentially criminal activities. In addition, MOUs are in place that set forth the framework for the routine sharing of information. When criminal activity is identified, the FBAs will coordinate directly with all domestic banking supervisors. The agencies may also share information with other supervisory and enforcement agencies, subject to confidentiality restrictions.</p> <p>Under the relevant statutes and regulations, the agencies may share information with foreign bank supervisors, spontaneously or upon request. They also have authority to exchange information with foreign bodies other than banking supervisors, including the relevant law enforcement agencies. See 12 CFR 4.37(c); 12 CFR 309; 12 U.S.C. § 1817(2)(C). All of the agencies have established procedures under which requests for information are processed. On cooperation, see CP 3 and CP 13.</p>
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	The FBAs employ expertise for a number of specialties, including BSA/AML compliance and terrorist financing offences. The experts are skilled, receive ongoing training, are deployed in the most complex and high-risk institutions, and are prepared to identify unusual or potentially criminal activities. In addition, the agencies have fraud experts on staff to handle fraud cases and liaise with law enforcement agencies. The FBAs also alert the industry of fraud schemes through issuing guidance and conducting presentations at industry conferences. In addition the FinCEN routinely issues alerts and notices to banks via the established network and through guidance documents.
Assessment of Principle 29	Largely Compliant
Comments	There rules and supervisory expectations on BSA/AML issues are comprehensive. In relation to the requirements of the BCP further improvements should be made, as the assessors did not see evidence that these deficiencies in the legislation were compensated for in the supervisory

	<p>process:</p> <ul style="list-style-type: none"> Supervisors should explicitly require, rather than “expect”, that a bank’s decision to enter into relationships with high-risk accounts and countries, including with foreign and domestic PEPs, should be escalated to the senior management level. Current legal and regulatory framework does not require the identification of the ultimate beneficiary owner of legal entity clients. Proposed amendments open for public consultation will introduce requirements to address this deficiency. Assessors welcome the proposed rule and understand its approval and implementation will improve compliance with this CP. <p>CP 29 deals with all forms of criminal abuse and the need to protect banks. It is clear that there is strong political and supervisory focus on BSA/AML and the assessors saw evidence that significant resources are deployed within the authorities and banks to meet very stringent standards. The vulnerability to other forms of criminal abuse is more disparately addressed within the regime and risk being deemphasized. The assessors would recommend that the authorities seek to find an appropriate balance in their surveillance and also in their guidance – perhaps by consolidating the related issues in fewer places than at present.</p>
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SUMMARY COMPLIANCE WITH THE BCP

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	The DFA reforms have resulted in some rationalization of responsibilities in the U.S. supervisory structure, with the dissolution of the OTS and the establishment of a specialized, stand-alone consumer protection regulator. Nonetheless, the problems associated with multiple regulators with distinct but overlapping mandates remain. Further effort can be made to clarify the priorities of the FBAs in their mission statements and to make the division of responsibilities between the FBAs and the CFPB more coherent at the working level. In the assessors’ view, there remains further work on making the new supervisory structure more focused and effective.
2. Independence, accountability, resourcing and legal protection for supervisors	C	Since the crisis, the FBAs have strengthened their accountability and transparency, and have improved their internal decision-making processes. Further steps could be taken to assure the independence of the Federal Reserve’s supervisory role. The FBAs have also been able to strengthen their capacities through active hiring and training programs. The challenge will be to retain those capacities as U.S. economic conditions continue to improve and specialist skills become even more attractive to industry. The assessors encourage the FBAs to keep their hiring programs flexible and responsive, and their training programs fully funded.
3. Cooperation and collaboration	C	The FBAs have made a substantial effort since the crisis to improve their cooperation and collaboration to ensure that consolidated supervision is targeted, comprehensive and timely. International cooperation would be further strengthened if state supervisory agencies consulted fully, in all cases, with the FBAs and foreign supervisors on impending enforcement actions.

Core Principle	Grade	Comments
4. Permissible activities	C	<p>There is a well-established framework for defining the permissible activities of banks and protecting the integrity of the term “bank”. Though not a specific responsibility of the FBAs, it is important that the U.S. authorities closely monitor the disclosure practices of “bank-like” institutions to ensure the community is well informed about the security of their savings.</p>
5. Licensing criteria	C	<p>The evaluation processes for banks seeking a national charter and access to the deposit insurance fund appear thorough and testing. The DFA has given statutory force to interagency initiatives to address inappropriate regime shopping, but further guidance could be provided. The FBAs need to guard against creating perceptions of differences in supervisory style or intensity in their regional offices that could sway the choices made by banks on charter conversions.</p>
6. Transfer of significant ownership	C	<p>The FBAs have comprehensive definitions for “controlling interest”, taking into account both quantitative and qualitative factors of control. There are clear rules for prior approval or notifications of changes in ownership. Supervisors may deny improper changes in ownership and may in certain circumstances require the reversal of completed transactions or require other remedial actions. The assessors saw evidence of supervisors taking such actions.</p> <p>The concept of “significant ownership” is not defined per se. However, in practice the international practice of a five percent threshold for the reporting of significant shareholders is applied.</p> <p>The assessors saw evidence, including supervisors’ responses to applications for ownership changes, that the above rules and policies are applied in practice.</p> <p>There is no explicit regulatory requirement for a bank to immediately report if they find that a major shareholder is no longer suitable. Nor did the assessors see any evidence of such reporting in the written documentation. The assessors recommend that such a supervisory requirement is introduced, with the aim to ensure that supervisors are promptly informed if a major shareholder is no longer suitable, since this might have a negative impact on the safety and soundness of the bank. Assessors chose to address this shortcoming under CP 9.</p>
7. Major acquisitions	C	<p>Laws and regulations exist to define which acquisitions and investments that require prior approval by the authorities, a notification after-the-fact or may be made under general consent. There are also clear criteria by which the authorities assess the applications.</p> <p>Legislation and regulations also put clear restrictions on the scope of permissible investments and acquisitions, such as in non-bank related activities.</p> <p>Assessors saw evidence, including supervisors’ reports on banks’ applications for investments/acquisitions, that the above rules and policies are applied in practice.</p>

Core Principle	Grade	Comments
8. Supervisory approach	C	<p>The U.S. system of regulation is changing rapidly. These changes have broadened the role of supervision and have introduced a greater level of tiering into the regime (e.g. Banking Institutions with at least \$50bn of Assets).</p> <p>The assessors find that the net effect of these changes has been positive. The supervisory regime is effective and risk-based. There is an increasing focus on resolution (for the larger firms).</p> <p>However, the agencies need to review approach to communication with firms. The system of supervisory issues requiring action (e.g. MRAs) needs to be simplified and ideally moved to a common interagency approach. The agencies need to continue their efforts in dealing with MRA that have been outstanding for a long time.</p>
9. Supervisory techniques and tools	LC	<p>The U.S. agencies have an array of tools and techniques to carry out their supervisory responsibilities and furthermore that they are also developing new techniques, such as stress testing and horizontal reviews. These new techniques are altering the balance of the work done by supervisors. The absence of formal reporting requirements on banks to inform supervisors of key changes and developments is a weakness in the system, which not only could undermine monitoring work but also delay supervisory action.</p> <p>The agencies need to ensure that their intentions for each horizontal review are clear from the outset and in particular whether firms are being judged against an absolute or relative standard.</p> <p>Communication with banks also needs to be improved: key messages need to be better brought out; the roles and expectations of boards and senior management should not be conflated; feedback needs to be appropriately balanced on should not stray into excessive praise or excessive reporting on recent history.</p> <p>Agencies should go further in aligning planning cycles to maximize the opportunities of joint working.</p>
10. Supervisory reporting	C	<p>The FBAs have a long-established and effective regulatory reporting framework, with the flexibility, demonstrated through the crisis, to expand reporting requirements in response to pressing supervisory needs. With the crisis passed, the FBAs are encouraged to review the level of granularity of data collected, particularly for stress testing and liquidity analysis purposes, to ensure that data continues to be needed at that level. The FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries) but the assessors understand that, in practice, this omission is not sufficiently material in its impact to warrant a lower rating for CP 12 under current circumstances.</p>
11. Corrective and sanctioning powers of supervisors	C	<p>The authorities are recommended to consider implementing rules for promoting early action also for other issues than bank capital and liquidity</p> <p>The assessors acknowledge that the U.S. legislation, regulations, and</p>

Core Principle	Grade	Comments
		<p>processes for taking supervisory action (informal or formal) are robust and have been further strengthened in recent years. For instance, the assessors noted earlier cases in which the escalation of supervisory measures, when warranted, took longer than appropriate given the severity of the deficiency at hand. However, in recent years there has been a clear reduction in such cases, reflecting the authorities' new and more explicit rules and stricter implementation. The assessors recommend the authorities to continue on this path, for instance by setting even more explicit rules for the ageing of MRAs and MRAs. The evolving practice of setting timelines for the completion of remedial actions, and requiring regular reporting of progress, is encouraged by the assessors. The assessors also encourage the implementation of planned OCC guidance on supervisory practices relating to MRAs.</p>
12. Consolidated supervision	LC	<p>A lack of full compliance with this principle is based on the fact that regulatory and supervisory rules, guidance, and a formal rating system for SLHCs have not been adopted, and on the absence of a capital rule for corporate and insurance company SLHCs. Capital standards are not required at the diversified financial group level under the Basel capital framework (which are to be calculated at the banking holding group level and banking group level), however the lack of an established supervisory assessment framework will likely hamper the supervisors in reviewing and taking action at the holding company (SHLC) level As noted in CP 10, the FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries). The assessors are satisfied; however, that in practice this omission has no prudential significance under the current circumstances as U.S. bank subsidiaries tend to be small relative to the parent bank and can only undertake activities that the bank itself could undertake in its own name.</p>
13. Home-host relationships	C	<p>Reflecting the large cross-border activities of U.S. banks abroad, and of foreign banking groups in the U.S., there exist a comprehensive framework of policies and processes for co-operation and exchange of information between the FBAs and foreign supervisory authorities. This is currently being strengthened by the work in supervisory colleges and in CMGs.</p> <p>The assessors encourage the authorities to establish agreements with their foreign counterparts on a framework of communication strategies, especially for crisis situations. International cooperation would be further strengthened if state supervisory agencies consulted fully, in all cases, with the FBAs and foreign supervisors on impending enforcement actions. The assessors were made aware of circumstances where this was not the case. Although this is a clear deficiency in cooperation arrangements, the assessors did not judge it as sufficient to lower the "Compliant" rating for CP 13, but improvements in such consultations should be a high priority.</p> <p>There remain some instances in which specific rules apply to foreign institutions, such as the shorter run-off period for foreign branches in the liquidity, asset maintenance requirements for branches and</p>

Core Principle	Grade	Comments
		<p>requirements on large FBOs to set up intermediate U.S. holding companies. The mandate of the BCP assessment is limited to ensure that prudential rules and supervision are applied to ensure a minimum level of safety and soundness of banks. The assessors find that these rules are aimed to obtain such effect. The BCP mandate and assessment do not include a judgment of level playing field issues</p>
14. Corporate governance	LC	<p>Since the financial crisis of 2008-09 major changes have taken place in supervisors' demands on banks' corporate governance and in the bank's own approaches to these issues. Laws and regulations have gradually raised the requirements, although from a low level. In particular, the expectations have been strengthened in those areas: (i) Board involvement in setting the bank's risk appetite; (ii) the establishment of Risk Management Committees and; (iii) the increased frequency of Board meetings. The BCP assessors saw evidence of this, for instance in the reports from supervisory examinations, including when taking informal supervisory actions or formal enforcement actions for non-compliance. Assessors' discussions with banks also indicate a clearly heightened focus by boards and management on corporate governance issues. One prominent area concerns the role and mandates of banks' boards relative to that of the senior management. Until very recently in the U.S., there was not a clear distinction between the two; for example the assessors saw numerous examples both in regulation and in actual supervision where the standard term "board and senior management" was used in situations where good current international practices would dictate that only one of the two should have the specific role and responsibility. The demands on board involvement and skills have increased substantially and this has also in many instances led to consequential changes in board compositions and calls for wider skill sets of directors. That said, both supervisors and banks agree that further steps need to be taken and implemented in the field of corporate governance. For instance, the stricter requirements and expectations by the supervisors seem to apply primarily to large banks. There seems to be a process of "trickling down", i.e., that strengthened corporate governance practices also reach midsize and smaller banks, but this will probably take some more time before reaching desired levels.</p> <p>The LC rating is based on the fact that some key regulations, such as the SR 12-17 by the FRB and Heightened Standards by the OCC, have only recently come into force and have therefore not yet been fully implemented (and, as mentioned above, they primarily refer to large banks.) The new requirements will imply a substantial improvement but, in fact, the new, higher level is no more than standard practice in some other jurisdictions. In addition, there continue to exist areas where the requirements on the roles and responsibilities of bank boards fall short of international standards (See for instance the comments on CP 20 on Lending to related parties). In addition, on AC1, the requirements that bank informs the supervisors promptly about material developments that affect the fitness and propriety of Board directors or senior</p>

Core Principle	Grade	Comments
		management are defined only for a narrow scope of events and should be broadened
15. Risk management process	LC	<p>The assessors were able to see substantial improvement in the risk management process, but it also has to be acknowledged from a low starting point. Some of the changes could only be said to have brought the U.S. up to standard practice in other jurisdictions such as frequency of board meetings, composition of the board and the existence of risk committees.</p> <p>Risk aggregation has improved.</p> <p>Risk oversight is still work in progress with much of the guidance being new or yet to be implemented. Guidance for Banking Institutions with less than \$10bn of Assets is needed as the supervision of these fails to meet many aspects of the essential criteria, but not sufficient to warrant material non-compliance.</p> <p>Greater weight in communication needs to be placed on the role of the Board and greater efforts should be made to delineate their role from that of senior management.</p> <p>Aspects of the role of the Chief Risk Officer, particularly surrounding their departure need to be clarified.</p> <p>Further work is needed on firm-led stress tests, where firms seem to prefer to stretch their scenarios (often beyond the point of credibility) rather than examine whether they are producing the appropriate level of losses from a given severity of shock.</p>
16. Capital adequacy	LC	<p>The FBAs have a robust and comprehensive approach to setting prudent and adequate capital adequacy requirements for banks and most holding companies, and this approach has been strengthened in response to Basel and DFA reform initiatives. In particular, stress testing has now become an essential element of capital adequacy assessments for banking organizations with more than \$10 billion of assets. As well, a number of concerns raised in the 2010 DAO about the quality of capital and the coverage of most savings and loan holding companies have been addressed in the new regulatory capital rule. However, savings and loan holding companies with substantial insurance or commercial activities are excluded from the new rule. At the same time there are a number of differences between the new capital rule and the relevant Basel framework in terms of definitions of capital, the risk coverage and the method of calculation. These differences warrant a "Largely Compliant" rating for this CP. Firstly, the risk-based capital requirements for internationally active banks under the advanced approaches are different in a number of respects to the Basel framework. In addition, the U.S. standardized approach, which provides the "floor" for the advanced approaches banking organizations and applies to all other banking organizations, does not impose a capital charge for operational risk or for CVA risk (and there are also some divergences regarding the standardized approach to market risk). This omission in risk coverage may be significant for a broad segment of the banking system, and it</p>

Core Principle	Grade	Comments
		distinguishes the U.S. capital regime from other major jurisdictions. It also makes the “standardized” floor less binding than it may appear.
17. Credit risk	C	<p>The U.S. Approach to Credit Risk is exceptionally codified in both regulation and guidance and reflects the emphasis placed on this risk by all of the Supervisors.</p> <p>Although the agencies do not set limits, the assessors found evidence that such limits were in place in the banks themselves and also in no doubt that if they were absent the agencies would determine such practice as unsafe and unsound and as such would have authority to require such limits and escalation criteria in individual cases.</p> <p>We would however recommend that the use of limits be considered when the guidelines are next reviewed.</p>
18. Problem assets, provisions, and reserves	C	<p>The FBAs have a long-established and rigorous process for evaluating banks’ approaches to problem assets and the maintenance of an adequate ALLL. The FBAs have shown a consistent willingness to challenge unrealistic bank estimates of the ALLL and to secure increases they judge necessary, taking enforcement action if required. This steadfastness in approach is likely to be tested as the U.S. economy improves. Supervisory judgments in this area, however, continue to be constrained by the “incurred loss” requirements of U.S. GAAP, but proposed reforms in this area will permit more forward-looking provisioning.</p>
19. Concentration risk and large exposure limits	LC	<p>The FBAs have a sound supervisory framework for dealing with credit concentration risk. Guidance has been issued on specific areas of credit concentration risk and this is followed up in supervisory reviews; some reassessment of the supervisory force of the thresholds for commercial real estate exposures is warranted. However the assessors saw little evidence of a comparable supervisory framework and supervisory guidance for other risk concentrations, as EC 1 requires. The widening of the definition of large exposures under the DFA to include counterparty credit risk from derivatives and securities financing transactions has brought the large exposure thresholds more into line with the requirements of AC1. However, the separate and additional limits for money market investments and security holdings available to banks (but not federal savings associations) continue to leave open the possibility of excessive risk concentrations. The 50 per cent limit on exposures to a corporate group also appears to be out of line with AC1 and the Federal Reserve’s proposed large exposures framework for large bank holding companies and foreign banking organizations.</p>
20. Transactions with related parties	LC	<p>The “related party” regime in the U.S. regulatory framework does not appear as broad as required by this CP, in terms of the definition of covered transactions, affiliates and insiders. In addition, the CP requires a higher degree of board involvement and oversight than presently required by U.S. laws and supervisory guidance. There are no formal requirements for prior board approval of transactions with affiliated parties or the write-off of related party exposures exceeding specified</p>

Core Principle	Grade	Comments
		<p>amounts (as per EC3) or for board oversight of related party transactions and exceptions to policies, processes and limits on an ongoing basis (as per EC6). However, the FBAs expect banks to apply a high degree of board oversight and monitoring of affiliate and insider transactions and review this as a matter of practice. The aggregate limit for lending to insiders of 100 per cent of a bank's capital and surplus (and 200 per cent for smaller banks) does not appear consistent with the general intent of this CP and creates the risk that a small group of insiders could deplete the own funds of a bank. There are no regulated limits for holding company transactions with their affiliates or insiders.</p>
21. Country and transfer risks	C	<p>A robust framework exists for regulation and assessment of country and transfer risks and for the allocation of loan loss reserves reflecting country and transfer risks.</p> <p>However:</p> <ul style="list-style-type: none"> • The rules do not cover savings associations. (Due to their tradition of having limited international exposures). The assessors would, however, recommend the introduction of a de minimis regime being applied to all categories of banks. Nor are U.S. affiliates of foreign banks covered since they are expected to be under consolidated supervision from the home authorities. The assessors find this acceptable, provided that there is good cooperation and information-sharing between the FBAs and the relevant foreign supervisory authorities on country risk matters as well as consolidated supervision. • Country risk has not yet been specifically tested in the stress tests mandated by the FBAs. While it has been covered on a case by case basis by internal stress testing conducted by banks, the assessors recommend that guidance and rules on stress test specifically include country risk.
22. Market risk	C	<p>The Market Risk regime is comprehensive and understood.</p> <p>The assessors found very active engagement from supervisors on implementing the regime they have in place and in dealing with material market risk issues, such as valuation allowances, profit and loss attributions, etc. They make appropriate use of peer-group comparison such as through Hypothetical Portfolio Exercises.</p> <p>The material weaknesses identified in the 2009 BCP—such as market risk monitoring and management—have been significantly improved. The Supervisors have implemented much of the Basel II approach and also supplemented that for those banks subject to the Market Risk Rule. This improved market risk measurement and monitoring processes and models at certain major firms and lack of reliable valuation of MTM positions. The Stress Test Regime mandated under DFA has also improved the completeness and use of market stress testing.</p>
23. Interest rate risk in the banking book	C	<p>The assessors find the U.S. compliant. The principles-based approach seems to be backed by adequate supervision proportionate to the size</p>

Core Principle	Grade	Comments
		<p>and complexity of the bank and the risk being run. The assessors saw a number of examples of supervisors applying the guidance they have.</p> <p>Given the concentrations that exist in small and community banks, the agencies approach would benefit from some tiering (as they do with other risks) and also should include quantitative guidelines that would serve as a preventative indicator of supervisory risk appetite, provide a quicker route to action and a useful point of reference and escalation within the agencies themselves.</p>
24. Liquidity risk	C	<p>The Liquidity Risk Regime for banks below \$50bn of Assets is quite high level, but the assessors did see numerous examples of supervisory action in support of the overall principle. Current levels of reporting for these banks (for example in respect of encumbered assets) are inadequate with only one line in the Call Report. The Authorities recognize this deficiency and have proposed a greater level of reporting depth as part of the implementation of the Liquidity Coverage Ratio. The assessors did not see evidence of encumbrance being a particular concern, but liquidity issues more generally were prominent in the supervisory actions directed at the firms.</p> <p>For Banking Institutions with at least \$50bn of Assets and indeed beyond that level those of Global Systemic Importance, the regime (mostly in Regulation YY) is comprehensive and robust. Further the regime is supported by extensive reporting.</p> <p>We would recommend that efforts are extended in developing an interagency approach to the implementation of LCR.</p>
25. Operational risk	LC	<p>The U.S. Federal Agencies are placing increasing emphasis on operational risk issues and are co-coordinating on the production of additional inter-agency guidance, as well as identifying and seeking mitigation of a number of issues in their vertical and horizontal issues. They are also alert to the changing threat landscape, such as the escalation of fines and other penalties from litigation and cyber.</p> <p>The overall regime, however, has not reached a sufficient level of maturity (equivalent to market and credit risk for example). Guidance for banks under AMA (at the time of this assessment, only 8 banks) is well specified, however for all other bank operational risk management falls within the scope of “general” risk management (see CP 15). Guidance for other banks is highly disparate, and the weakness is compounded by the absence of a comprehensive reporting regime—only certain operational risks are covered by GLBA 501(b). It was also noted that there is not a standardized capital charge for operational risk.</p> <p>The absence of a comprehensive reporting regime is also a weakness as so much of the assessment of operational risk is assessing what could happen in terms of operational events.</p> <p>The assessors also noted the priority all of the agencies were attaching to Cyber Risk and also the establishments of working groups at the FFIEC, but the assessors agree that this will not be an easy task given the</p>

Core Principle	Grade	Comments
		challenge of co-coordinating across not just the banking agencies but beyond given the nature of the risk.
26. Internal control and audit	C	<p>The Federal Banking Agencies are clearly raising the bar for control functions. In respect of this particular Core Principle, this is particularly true of Internal Audit and the assessors have seen evidence that the supervisors are finding issues with Internal Audit that are classified as Matters Requiring Attention—at the OCC there were 405 outstanding at the time of this report.</p> <p>By contrast the assessors found very little mention of Compliance except with reference to the very robust regime in respect of the BSA and Anti-Money Laundering. The vulnerabilities to other forms of criminal abuse (e.g. fraud) are more disparate within the regime and within the banks themselves and risk being deemphasized. The assessors would recommend that the authorities seek to find an appropriate balance in their surveillance and also in their guidance—perhaps by consolidating it into fewer places than at present.</p>
27. Financial reporting and external audit	LC	<p>Not all banks are required to issue full financial statements which are reviewed by an independent accountant in accordance with independent audit requirements.</p> <p>There is no requirement for external auditor to report immediately directly to the supervisor, but rather through the bank, should they identify matters of significant importance.</p> <p>There is no comprehensive requirement, apart from some provisions, only an expectation for non-public banks to rotate their external auditors.</p> <p>The supervisor cannot set the scope of the external audit but could encourage the auditor, after the preliminary audit but before it is finalized, to include new issues. (This deficiency does not affect the rating of compliance, since EC 4 only requires that “Laws or regulations set, or the supervisor has the power to establish the scope...” The U.S. legislation clearly sets out the minimum scope of the external audit making the U.S. compliant with this proviso. However, the assessors recommend that the FBAs are given legal powers to add issues to the scope of the external audit in specific cases in order to address a relevant issue not normally covered in an external audit).</p>
28. Disclosure and transparency	C	<p>There are no examples of disclosures of information which covers ongoing developments during a financial reporting period, except for occasional analytical papers. Since the periodicity of the most comprehensive published report is quarterly (call reports), the assessors did not consider this deficiency significant. Nevertheless, the authorities are encouraged to promote the disclosure of such information, where relevant.</p> <p>The FBAs do not collect data from banks at the solo level (i.e. at the level of the bank excluding its subsidiaries). In principle, this means that regulatory requirements such as Basel III capital that are intended to be</p>

Core Principle	Grade	Comments
		<p>imposed on a bank on both a stand-alone and consolidated basis can only be tracked on the latter basis. The assessors are satisfied, however, that in practice this omission has no prudential significance. The FBAs have explained that U.S. bank subsidiaries tend to be small relative to the parent bank and can only undertake activities that the bank itself could undertake in its own name.</p>
<p>29. Abuse of financial services</p>	<p>LC</p>	<p>There rules and supervisory expectations on BSA/AML issues are comprehensive. In relation to the requirements of the BCP further improvements should be made as the assessors did not see evidence that these deficiencies in the legislation were compensated for in the supervisory process:</p> <ul style="list-style-type: none"> • Supervisors should explicitly require, rather than “expect”, that a bank’s decision to enter into relationships with high-risk accounts and countries, including with foreign and domestic PEPs, should be escalated to the senior management level. • Current legal and regulatory framework does not require the identification of the ultimate beneficiary owner of legal entity clients. Proposed amendments open for public consultation will introduce requirements to address this deficiency. Assessors welcome the proposed rule and understand its approval and implementation will improve compliance with this CP. <p>CP 29 deals with all forms of criminal abuse and the need to protect banks. It is clear that there is strong political and supervisory focus on BSA/AML and the assessors saw evidence that significant resources are deployed within the authorities and banks to meet very stringent standards. The vulnerability to other forms of criminal abuse is more disparately addressed within the regime and risk being deemphasized. The assessors would recommend that the authorities seek to find an appropriate balance in their surveillance and also in their guidance—perhaps by consolidating the related issues in fewer places than at present.</p>

RECOMMENDED ACTIONS AND AUTHORITIES

COMMENTS

A. Summary of Recommended Actions

Recommended Actions to Improve Compliance with the BCP and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 1	<p>FBA's revisit their "mission and vision" statements to ensure they give primacy to safety and soundness and to clarify that the pursuit of other objectives must be consistent with, and if necessary subordinate to, that goal.</p> <p>FBA's and the CFPB explore ways to reduce duplication of effort, in matters such as risk reviews, and over time look to pursue opportunities for a more coherent division of responsibilities between safety and soundness, and consumer protection.</p>
Principle 2	The Federal Reserve further assure the independence of its supervisory role by making the governance rules for the boards of Federal Reserve district banks consistent with emerging global good practice.
Principle 3	FBA's ensure that the preparation of supervisory plans is on the same cycle, if practicable, and consider other ways of ensuring that collaboration becomes fully engrained in the <i>modus operandi</i> of each agency.
Principle 5	Incorporate handover "protocols" that would discourage inappropriate regime shopping in the FFIEC Statement on Regulatory Conversions.
Principle 6	Introduce explicit requirement for banks to immediately report if they find that a major shareholder is no longer suitable.
Principle 8	<p>Develop interagency approach to communicate issues of supervisory important to banks (MRAs, MRIAs, MRBAs).</p> <p>Develop interagency method of prioritization of such matters requiring attention.</p>
Principle 9	<p>Introduce requirements for banks to report developments to the supervisor, in particular for banks under less intensive supervision.</p> <p>Develop guidance to clearly distinguish, in supervisory recommendations and matters requiring attention, which are of Boards responsibility and which are the responsibility of senior management.</p> <p>Implement interagency guidance with more clarity regarding aging of MRAs.</p> <p>Carry out a combined interagency planning process for individual firms.</p> <p>Develop a supervisory best practice approach for horizontal reviews, which includes initial statements of expected minimum standards and the expected process of feedback to those that participate and the feedback to the wider population of firms to which it might be relevant.</p>

<p>Principle 11</p>	<p>Implement rules/policies promoting early action also for other issues than bank capital and liquidity.</p> <p>Implement more explicit rules for supervisory action, such as setting timelines for completion, partially or fully, of remedial action and requiring regular reporting of progress.</p>
<p>Principle 12</p>	<p>Develop and implement regulatory and supervisory rules, guidance, and a formal rating system for SLHCs.</p>
<p>Principle 14</p>	<p>Introduce clearer expectations and requirements for corporate governance also for banks not subject to heightened standards.</p> <p>On issues where still lacking, clarify supervisory expectations and requirements on the role and responsibilities of the bank board versus those of the bank management.</p> <p>Introduce explicit requirement that banks inform the supervisors promptly about material developments that affect the fitness and propriety of Board directors or senior management.</p>
<p>Principle 15</p>	<p>Introduce clear expectations and requirements regarding risk management standards applicable to banks with less than \$10bn of Assets.</p> <p>Introduce clear guidance on responsibilities of the Board with regards to risk management.</p> <p>Introduce clear requirements on the arrangements for the removal of CROs.</p> <p>Introduce clearer supervisory guidance on the severity of scenarios for stress tests run by the firms.</p> <p>Introduce clearer feedback mechanisms to firms on the components of supervisory run stress tests.</p>
<p>Principle 16</p>	<p>Introduce a comprehensive capital framework for savings and loan holding companies with substantial insurance or commercial activities.</p> <p>Clarify requirements for capital to be held against operational risk by non-AMA banks.</p> <p>Clarify supervisory expectations for capital to be held against interest rate risk in the banking book.</p>
<p>Principle 17</p>	<p>Introduce specific requirements that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management.</p> <p>Introduce specific requirements that credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities must be decided by the bank's Board or senior management.</p>
<p>Principle 19</p>	<p>Reassess the supervisory force of the thresholds for commercial real estate exposures.</p> <p>Develop a robust supervisory framework and supervisory guidance for other risk concentrations comparable to that for credit concentration risk.</p> <p>Review the separate and additional limits for money market investments and security holdings by banks, with a view to including them within the 15 plus 10 limits.</p>

	<p>Review the 50 per cent limit on exposures to a corporate group, which could result in excessive risk concentrations.</p> <p>The Federal Reserve complete the development of its large exposures framework, with limits, for large bank holding companies and foreign banking organizations.</p>
Principle 20	<p>Introduce formal requirements for prior board approval of transactions with affiliated parties and the write-off of related party exposures exceeding specified amounts.</p> <p>Introduce formal requirements for board oversight of related party transactions and exceptions to policies, processes and limits on an ongoing basis.</p> <p>Review the aggregate limit for lending to insiders of 100 per cent of a bank's capital and surplus (and 200 per cent for smaller banks).</p> <p>Introduce limits for holding company transactions with their affiliates or insiders.</p> <p>Amend the coverage and details of the "related party" regime to bring it into line with this CP.</p>
Principle 21	<p>Introduce <i>de minimis</i> regime to be applied to all categories of banks, and include savings associations.</p> <p>Introduce explicit reference to country risk in guidance and rules on stress tests guided by the authorities.</p>
Principle 23	<p>Revise the 1996 guidance to include more quantitative guidelines regarding interest rate risk in the banking book.</p>
Principle 25	<p>Introduce guidance on operational risk management and supervisory expectations applicable to non-AMA banks.</p> <p>Introduce appropriate reporting regime regarding operational risk.</p>
Principle 27	<p>Introduce requirements for all banks to issue full financial statements in accordance with agreed accounting standards that are reviewed by an independent accountant in accordance with independent audit requirements.</p> <p>Introduce requirement for external auditor to report immediately directly to the supervisor, should they identify matters of significant importance.</p> <p>Review supervisory powers to allow the supervisor to set the scope of the external audit.</p> <p>Introduce a requirement for non-public banks to rotate their external auditors.</p>
Principle 29	<p>Supervisors should explicitly require, rather than "expect", that a bank's decision to enter into relationships with high-risk accounts and countries, including with foreign and domestic PEPs, should be escalated to the senior management level.</p> <p>Current legal and regulatory framework does not require the identification of the ultimate beneficiary owner of legal entity clients. Proposed amendments open for public consultation will introduce requirements to address this deficiency. Assessors welcome the proposed rule and understand its approval and implementation will improve compliance with this CP.</p>

B. Authorities' Response to the Assessment

The U.S. authorities strongly support the IMF's Financial Sector Assessment Program (FSAP), which promotes the soundness of financial systems in member countries and contributes to improving supervisory practices around the world. The authorities appreciate the complexity of assessing the U.S. financial system and the time and resources dedicated by the IMF and its assessment teams to this exercise. The authorities commend the IMF on its diligence and constructive approach in undertaking the assessment. The U.S. authorities welcome the opportunity to provide the following comments.

The IMF rightly holds the United States to the highest and most stringent grading standard, given the complexity, maturity, and systemic importance of our financial sector. Despite this higher grading standard, the assessment found the U.S. regulatory system to be very strong and, in many ways, more rigorous than international standards.

We are pleased to note that the Report acknowledges that the U.S. federal banking agencies have improved considerably in their effectiveness since the previous FSAP was completed in 2010. This is particularly noteworthy since, compared to the 2010 assessment, the federal banking agencies were assessed against four additional Core Principles for Effective Banking Supervision (29 total) and significantly more Essential Criteria and Additional Criteria. This assessment also is more rigorous than the one completed in 2010 since the revised Core Principles have a heightened focus on risk management. The U.S. authorities are pleased that, even under these more stringent principles and when applying a higher standard, the IMF's assessment of the U.S. system broadly indicates compliance with the Core Principles. Moreover, while the approach of the federal banking agencies is principles-based, the Report reaches its conclusions against the backdrop of an assessment regime that places a premium on specificity in regulations.

The Report recognizes that global and domestic reforms implemented since the 2010 assessment, particularly the Dodd-Frank Act (DFA), have increased the intensity of the supervisory programs of the federal banking agencies. Since the previous review, substantial improvements have been made in risk management and the oversight of large bank organizations by putting enhanced emphasis on banks' capital planning, stress testing, and corporate governance. The U.S. authorities concede that some reforms are still pending and will take time to fully implement. Notably, the Report acknowledges that additional implementation of the reform programs will further improve the United States' compliance with the Core Principles.

The Report acknowledges that the federal banking agencies are operationally independent and have clear mandates for safety and soundness of the banking system. However, it concludes there are duplicative efforts by the federal banking agencies and a lack of delineation between safety and soundness and other missions. Although there is not a formal statement that safety and soundness is the sole or primary mission of a federal banking agency, there is no confusion on the part of the

agencies, the public, or the industry that the focus of supervision and regulation relates to safety and soundness. The U.S. authorities believe that responsibilities, such as assuring compliance with consumer laws and taking account of financial stability considerations, in no way conflict with the assessment of safety and soundness. Indeed, given the potential high level of operational and reputational risk associated with significant consumer compliance weaknesses, considerations related to such compliance are part of an overall safety and soundness risk assessment.

Furthermore, in practice, there is clarity of mission among the agencies. Clear distinctions exist between prudential safety and soundness responsibilities and consumer protection responsibilities that are shared between the Consumer Financial Protection Bureau (CFPB) and the federal banking agencies. In the view of the U.S. authorities, the federal banking agencies have met the requirement of collaboration required by DFA and have addressed the issue of duplicative efforts by coordinating with each other and the CFPB, as evidenced by interagency Memoranda of Understanding.

The federal banking agencies have taken a number of substantive actions that are not fully reflected in the Report. These include:

- Establishing forward-looking stress testing requirements for banks with less than \$10 billion in assets. Although banks with assets less than \$10 billion are not required to complete formal DFA capital stress tests, federal banking agencies require stress testing on certain high-risk and volatile activities, and all banks are expected to have appropriate capital planning processes.
- Publishing federal banking agencies' examination manuals and directors' guides, and conducting outreach and training initiatives, which articulate the responsibilities of boards of directors.
- Issuing extensive guidance on business resumption planning, which is included in the Federal Financial Institutions Examinations Council's booklets.
- Requiring institutions with total assets of less than \$500 million in certain instances to have an independent audit of their financial statements.
- Applying stricter regime standards for affiliate transactions, which include, among other things:
 - tighter U.S. quantitative limits of 10 percent of bank capital for transactions with a single affiliate and 20 percent of capital for the aggregate transactions with all bank affiliates, instead of 25 percent of the bank's capital,
 - inclusion of asset purchases by a bank from affiliates in the 10/20 limit structure noted above,
 - prohibition on a bank having any unsecured credit exposure to an affiliate,
 - prohibition on a bank purchasing low-quality assets from an affiliate.

Additionally, U.S. authorities not only meet many Basel III international standards, but significantly exceed some of the most important ones, especially those related to capital and liquidity. Examples include:

- Requiring the largest U.S. bank holding companies to have risk-based capital ratios that exceed Basel minimum capital requirements via the Federal Reserve's Comprehensive Capital Analysis and Review and annual stress tests programs.
- Utilizing a Global Systemic Important Bank surcharge to reflect short term wholesale funding, which increases banks' capital conservation buffer.
- Exceeding the Basel standard, the largest, most global, systemic U.S. bank holding companies must maintain a supplementary leverage ratio buffer greater than 2 percentage points above the 3 percent minimum, for a total of more than 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments. Insured depository institution subsidiaries of these firms must maintain at least a 6 percent supplementary leverage ratio to be considered "well capitalized."

The U.S. authorities look forward to continuing a dialogue with the IMF and global counterparts to jointly promote the mission of the FSAP to enhance global financial sector stability and supervisory practices. In terms of this Report's recommendations, specifically, the U.S. authorities will review them carefully. Action will be taken, where permissible, on items that enhance communication and information sharing among the agencies and ensure more effective oversight of systemic risk.