SELF ASSESSMENT OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES

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Introduction to the Self-Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision by the U.S. Federal Banking Agencies

The following introduction to the U.S. self-assessment of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) includes an overview of the U.S. banking supervisory and regulatory structure and framework. The federal banking agencies' respective regulatory and supervisory roles over U.S. banks and holding companies (defined below) and mechanisms governing cooperation and consultation among the agencies and with other functional regulators are briefly described as a complement to the detailed responses to the 29 BCPs. Legal and regulatory preconditions for effective banking supervision are addressed in the *Legal and Regulatory Framework* under each BCP. This introduction also summarizes major statutory and regulatory changes since the preceding self-assessment.

For purposes of this self-assessment, the following terminology will be used:

- *U.S. federal banking agencies* – includes the Federal Reserve System (Federal Reserve), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC). Also referred to as the "federal banking agencies" or the "agencies."
- *U.S. federal banking supervisors* – includes the staff of the U.S. federal banking agencies. Also referred to as the "supervisors," which in this context is interchangeable with "regulators" and "examiners." The Consumer Financial Protection Bureau (CFPB) generally oversees consumer protection regulations applicable to banking organizations with assets of more $10 billion and participates in examinations under certain circumstances described below.
- *Banks* – includes all FDIC-insured national banks (supervised by the OCC), FDIC-insured state-chartered banks (both Federal Reserve member (supervised by the Federal Reserve) and nonmember (supervised by the FDIC)) and FDIC-insured savings associations (supervised by the OCC and FDIC), unless the content indicates otherwise.
- *Commercial banks* – includes "banks" as described above, but excludes savings associations.
- *Foreign banking organizations (FBOs)* – foreign banks that conduct commercial banking operations in the United States.
- *Bank holding companies (BHCs) and savings and loan holding companies (SLHCs)* – includes any company that has control over a bank or savings association, respectively. For the purposes of this document, they are referred to as "*holding companies*" except in cases where there is a

material difference between BHCs and SLHCs (in terms of legal authority, operations, or structure). BHCs and SLHCs are supervised by the Federal Reserve.

- *Financial holding companies* – holding companies that, along with their depository institution subsidiaries, meet enhanced capital and managerial standards and are authorized to engage in expanded financial activities, including securities, insurance, and merchant banking.
- *Consolidated organization* – the consolidated entity including the parent and its bank and nonbank subsidiaries.
- *Banking group or banking organization* – the holding company and its banking and non-banking subsidiaries.
- *Functionally regulated affiliate* – entities within the consolidated organization that are regulated by the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, or state insurance regulators.
- *Designated nnonbank financial companies* – companies that are predominately engaged in financial activities and that have been designated by the Financial Stability Oversight Council for supervision by the Federal Reserve.

Methodology

The U.S. self-assessment was conducted in accordance with the *Core Principles for Effective Banking Supervision* published by the Basel Committee for Banking Supervision (BCBS) in September 2012. The general guidance for completing the self-assessment against those BCPs were the BCBS publication, *Conducting a Supervisory Self-Assessment – Practical Application,* published in April 2001, and the *Financial Sector Assessment – A Handbook*, published by The World Bank and the IMF.

To complete the self-assessment, legal staff and subject matter experts from each U.S. federal banking agency provided input in response to the principles and their associated criteria. Special emphasis was placed on describing the practical application of the principles within the U.S. legal and regulatory framework. Authors made every attempt to critically review the practical application of all regulatory requirements and activities. While not required, the self-assessment offers U.S. regulators' assessment of compliance in conformance with the BCP methodology.

Background Information

Current Structure and Supervisory Responsibilities

U.S. federal banking agencies addressed in this self-assessment include the Federal Reserve, OCC, and FDIC. As agreed in advance, the self-assessment does not include an assessment of the state banking agencies, the National Credit Union Administration, the CFPB, or the Federal Housing Finance Authority.

The current framework for the regulation and supervision of financial institutions in the United States has developed over many decades primarily in response to a series of financial crises and other important social, economic, and political events. The structure of the financial system necessitates a high degree of coordination among all relevant supervisors (both federal and, where applicable, state), both in formulating regulatory and supervisory standards and supervising individual banks and holding companies.

Significant changes were made to the supervisory structure in 2010, as described in detail below. These changes included dissolution of the Office of Thrift Supervision (OTS) and creation of the CFPB. In addition, the Financial Stability Oversight Council (FSOC) was established to coordinate the activities of the financial regulatory agencies and to provide a mechanism to comprehensively monitor and identify risks to U.S. financial system.

Responsibilities of the Federal Banking Agencies

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. National banks and federal savings associations operate pursuant to a federal grant of powers, subject to national standards pursuant to federal law and regulations, and administered 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, this is the OCC;
- for state banks that choose to be members of the Federal Reserve System (state member banks), this is the Federal Reserve;
- for state banks that choose not to become members of the Federal Reserve System (nonmember banks) and state savings associations, this is the FDIC.

Additionally, legislation was enacted in 2010 to address, among other things, risks to U.S. financial stability posed by companies that predominately engage in financial activities but do not own banks. As a result of these legislative changes, the Federal Reserve now has responsibility for the supervision and regulation of nonbank financial companies designated by FSOC.

Summary of Primary Federal Supervisory Responsibilities – Table 1

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

The FDIC operates the federal deposit insurance program in the United States. Virtually all banks have deposit insurance coverage through the FDIC. All banks are subject to regulation by a U.S. federal banking agency. 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.

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. Its goal in supervising these institutions is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products. In regulating national banks and federal savings associations, the OCC has the power to examine these institutions; approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure; to take supervisory actions against national banks and federal savings associations that do not comply with laws and regulations or that otherwise engage in unsound practices; to remove officers and directors, negotiate agreements to change banking practices, and issue cease and desist orders and civil money penalties; and to issue rules and regulations, legal interpretations, and corporate decisions governing investments, lending, and other practices.

Holding companies are supervised by the Federal Reserve. The Federal Reserve is responsible under the Bank Holding Company Act 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. As set forth in the Home Owners' Loan Act, 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. SLHCs may engage only in financial activities, although certain SLHCs—the so-called unitary SLHCs—that control a single savings association acquired before 1999 are not subject to such limits.

The U.S. federal banking agencies 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 to inform the Federal Reserve of, among other things, the companies' conditions and stability of the U.S. financial system. Consistent with U.S. legal and regulatory framework, the Federal Reserve works closely, including through appropriate consultation, with other relevant state and federal regulators and relies to the fullest extent possible on the examinations and other reports made by other federal and state regulators relating to the holding companies and their subsidiaries. For example, for national banks, the Federal Reserve relies significantly on OCC banking examinations and for securities and insurance subsidiaries the Federal Reserve relies to the fullest extent possible on the existing work of other regulators in order to avoid duplication of examination and reporting requirements (though the Federal Reserve may directly examine and obtain reports from these subsidiaries).

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. National treatment is embedded in the key governing law pertaining to FBOs, the International Banking Act of 1978 (IBA).

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. Under the IBA, the Federal Reserve has broad supervisory oversight over the FBO's U.S. banking operations. 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 this country.

All banks and branches or agencies of FBOs have a primary federal regulator. An insured, state nonmember bank owned or controlled by an FBO is supervised primarily by the FDIC. A state-chartered member bank owned or controlled by an FBO is supervised primarily by the Federal Reserve. A national bank that is owned or controlled by an FBO is supervised and examined by the OCC. If the FBO acquires a savings association, either state-chartered or federally chartered, the Federal Reserve supervises the FBO as an SLHC, while subsidiary savings association would be supervised by either the OCC or FDIC depending on whether the institution was federally chartered or chartered by a state.[1]

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.

Information-Sharing and Coordination Among Supervisors

The sharing of information among supervisors is an integral part of the U.S. supervisory process. 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

[1] If the FBO controls both a savings association and at least one other type of bank, the FBO is supervised by the Federal Reserve as a BHC or an FHC.

U.S. federal banking agencies, and to encourage better coordination of federal and state regulatory activities. Through the FFIEC, state and U.S. federal banking agencies 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.

The U.S. federal banking agencies routinely share supervisory information with each other and with functional regulators, as needed. Banking supervisors have in place a number of formal and informal mechanisms for information sharing. For example, the federal banking agencies routinely share reports of examination, inspection reports, and other agency-to-institution communication. They also provide one another with access to their organizational, structural, financial, and other supervisory information. The federal banking agencies have statutory authority to share relevant supervisory information with each other and with foreign financial sector (banking and functional) supervisors of banks and banking groups of interest to the home or host supervisor. These are supplemented, in many instances, by written information-sharing arrangements or statements of cooperation.

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 federal banking agencies. Among other activities, FSOC has the ability to issue a nonbinding recommendation to any of its member agencies to take a particular action.

Agency Independence, Accountability, and Transparency

As discussed in the responses to the BCPs, each U.S. federal banking agency operates pursuant to an express statutory grant of authority and has clearly defined objectives and responsibilities. Several circumstances ensure the operational independence and accountability of each agency. These 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. These factors minimize the opportunity for government or industry interference which might compromise the agencies' independence or impede the agencies' ability to obtain and deploy the resources needed to carry out their mandate.

Legal Basis for Regulation and Supervision

As discussed in detail for each BCP below, U.S. federal banking agencies issue and regularly update regulations and guidelines implementing their statutory authority and supplement these with policy statements, formal and informal interpretations, and supervisory guidance and manuals. Agency rulemaking is subject to procedural requirements intended to foster public and stakeholder participation in the formulation of relevant standards.

The statutes and regulations provide for the licensing of banks and address permissible bank and nonbank affiliations, acquisitions, and activities. Together, the statutes, regulations, guidelines, policy statements, interpretations, and supervisory guidance and manuals establish a framework of minimum prudential standards that banks must meet. The standards address, among other things, capital adequacy, 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, and AML/CFT/anti-fraud measures.

Holding companies also are subject to prudential requirements under governing statutes, regulations, guidelines, and supervisory guidance, consistent with the principle that holding companies should serve as a source of financial and managerial strength to their subsidiary, insured banks. As described in the self-assessment, holding companies must comply with prudential measures governing capital adequacy, asset quality, risk management, affiliate transactions, and large exposures.

The U.S. federal banking agencies keep apprised of industry, financial markets, and legislative developments, and continually evaluate the need for changes in or additions to existing regulations, guidance, and policies. They also consider whether policies and procedures comport with international standards and collaborate with other supervisors in developing and implementing emerging best practices.

Summary of Recent Changes to the U.S. Federal Bank Regulatory Framework

The 2008 financial crisis showed that financial regulations must focus on both the safety and soundness of individual financial institutions as well as the emerging threats to financial stability that arise across many firms. In response to the crisis, the United States Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or Act), one of the most significant pieces of legislation affecting the U.S. financial regulatory framework in many years. The Act includes many reforms to help strengthen the financial system and reduce the likelihood of future financial crises. For example, the legislation creates an interagency council to monitor and coordinate responses to emerging threats to the financial system; 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. These and other Dodd-Frank Act initiatives are described in greater detail below.

Changes to Banking Regulation and Supervision

The Dodd-Frank Act made a variety of changes to the laws designed to protect the safety and soundness of banking organizations that are administered by the agencies. For example, the Dodd-Frank Act: (i) enhances the limitations on transactions among a BHC, a subsidiary bank, and its affiliates;[2] (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;[3] (iii) incorporates financial stability considerations into the supervision of holding companies;[4] (iv) enhances the requirement for holding companies to be eligible to engage in expanded activities;[5] (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

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[2] Specifically, the Dodd-Frank Act 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. *See* Dodd-Frank Act sections 608 (124 Stat. 1608 and 12 U.S.C. 371c), 609 (124 Stat. 1611 and 12 U.S.C 371c (e)), and 615 (124 Stat. 1614 and 12 U.S.C. 1828 (z)).

[3] Sections 163 and 604 of the Dodd-Frank Act 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. *See* 12 U.S.C. 5363; 12 U.S.C. 1842(c); 12 U.S.C. 1843(j)(2)(A); 12 U.S.C. 1843(k)(6)(B); and 12 U.S.C. 1828(c)(5). Similarly, section 173 of the Dodd-Frank Act 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 United States. 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. 124 Stat. 1440; 12 U.S.C. 3105(d)(3) and (e)(1).

[4] *See* 124 Stat. 1600 and 1603; 12 U.S.C. 1844(c)(2); 12 U.S.C. 1467a(b).

[5] Section 606(a) of the Dodd-Frank Act 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. 12 U.S.C. 1843(l)(1). The Federal Reserve has clarified that these requirements also apply to SLHCs. See 76 Federal Register 56508, 56510 (September 13, 2011). 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. 12 U.S.C. 1843(k)(6)(B). Further, section 164 applies restrictions on management interlocks to designated nonbank financial companies supervised by the Federal Reserve. 12 U.S.C. 5364.

broker-dealer or insurance company;[6] (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;[7] (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;[8] 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.[9]

Other important Dodd-Frank changes and related regulatory initiatives that have significant impact on the framework for banking regulation and supervision are discussed below.

a. Financial Stability Oversight Council

Title I of the Dodd-Frank Act establishes a new Financial Stability Oversight Council (FSOC) charged with a number of important duties, including 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. *See* 12 U.S.C. 5321; 12 CFR 1310. The FSOC is composed of the Treasury Secretary (who is also chairperson of the FSOC); the heads of the three federal banking agencies; the heads of the Consumer Financial Protection Bureau, 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 Dodd-Frank Act instructs the FSOC to designate as systemically important large, interconnected nonbank financial firms (referred to in the Act as "nonbank financial companies supervised by the Board"). Once designated, these nonbank financial companies are subject to consolidated supervision by

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[6] *See* section 604 of the Dodd-Frank Act (124 Stat. 1599,12 U.S.C. 1844(c)). 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.

[7] *See* section 605 of the Dodd-Frank Act (124 Stat. 1604; 12 U.S.C. 1831c).

[8] *See* section 612 of the Dodd-Frank Act (124 Stat. 1612; 12 U.S.C. 214d).

[9] *See* section 610 of the Dodd-Frank Act, amending section 5200(b) of the Revised Statutes (12 U.S.C. 84(b)). "Securities financing transactions" mean repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions. *See* OCC implementing regulations at 12 CFR part 32 (78 FR 37930 (June 25, 2013).)

the Federal Reserve and enhanced prudential standards. *See* 12 U.S.C 5323 et seq. The FSOC has designated three nonbank financial companies: American International Group, Inc., General Electric Capital Corporation, Inc., and Prudential Financial, Inc. *See* http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx.

In addition, the Act authorizes the FSOC to designate a financial market utilities (FMUs) as systemically important if the FSOC determines that that the failure of or a disruption to the functioning of the FMU could pose a threat to U.S. financial stability. *See* 12 U.S.C. 5461 et seq. Designated FMUs are also subject heightened prudential and supervisory provisions of Title VIII of the Dodd-Frank Act, which promote robust risk management and safety and soundness, including providing that FMUs (i) conduct their operations in compliance with applicable risk-management standards, (ii) provide advance notice and review of changes to their rules, procedures, and operations that could materially affect the nature or level of their risks, and (iii) be subject to examinations. In 2012, the FSOC voted unanimously to designate eight FMUs as systemically important under Title VIII of the Dodd-Frank Act, including: 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; and The Options Clearing Corporation. *See* http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx. These designated FMUs perform important functions in their respective markets, including the clearance and settlement of cash, securities, and derivatives transactions.

The FSOC is also charged with facilitating information sharing and coordination among the member agencies regarding the development of financial policy, rulemaking, examinations, reporting requirements, and enforcement actions. *See Financial Stability Oversight Council Created Under the Dodd-Frank* Wall Street Reform and Consumer Protection Act: Frequently Asked Questions, U.S. DEP'T OF THE TREASURY, available at: http://www.treasury.gov/initiatives/Documents/FAQ%20-%20FinancialStabilityOversightCouncilOctober2010FINALv2.pdf.

In addition, the Dodd-Frank Act requires the FSOC to annually report to and testify before Congress on significant financial market and regulatory developments, potential emerging threats to U.S. financial stability, and recommendations for promoting market discipline and maintaining investor confidence. With the submission of the annual report to Congress, each voting member of the FSOC must either state that he or she believes the FSOC, the government, and the private sector are taking all reasonable steps to ensure financial stability and mitigate systemic risk, or identify what actions he or she believes need to be taken. 12 U.S.C. 5322(a)(2)(N). To assist the FSOC and its member agencies in their FSOC duties, the Dodd-Frank Act establishes a new Office of Financial Research (OFR) within the Treasury Department to collect, standardize, and analyze data for the FSOC and member agencies. 12 U.S.C. 5342 et seq. The OFR is headed by a director appointed by the President and confirmed by the Senate.

b. Systemic Designations and Enhanced Prudential Standards for Financial Firms

Section 165 of the Dodd-Frank Act requires the Federal Reserve to establish heightened prudential standards for designated nonbank financial companies supervised by the Federal Reserve and for BHCs with assets of $50 billion or more. *See* 12 U.S.C. 5365. These heightened standards must be more stringent than the standards that apply to other nonbank financial companies and BHCs that do not pose similar risks to the financial system. In particular, these heightened standards must include risk-based capital and leverage requirements, liquidity requirements, overall risk-management requirements, concentration limits, and "living will" and credit exposure reporting requirements. In addition to the mandatory heightened standards, the Federal Reserve may establish standards for designated nonbank financial companies and BHCs with assets of $50 billion or more relating to contingent capital, enhanced public disclosure, short-term debt limits, and such other prudential standards as deemed appropriate.

The Dodd-Frank Act 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 Dodd-Frank Act 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.

The Federal Reserve has implemented a final rule to establish a number of enhanced prudential standards under section 165 for large U.S. bank holding companies and foreign banking organizations to help increase the resiliency of their operations. These standards include liquidity, risk management, and capital. It also requires a foreign banking organization with a significant U.S. presence to establish an intermediate holding company over its U.S. subsidiaries, which will facilitate consistent supervision and regulation of the U.S. operations of the foreign bank. 12 CFR 252; 79 Federal Register 17240 (March 27, 2014).

For U.S. BHCs with total consolidated assets of $50 billion or more, the final rule incorporates the previously issued capital planning and stress testing requirements as an enhanced prudential standard. It also requires such a U.S. BHC to comply with enhanced risk-management and liquidity risk-management standards, conduct liquidity stress tests, and hold a buffer of highly liquid assets based on projected funding needs during a 30-day stress event. These requirements will help ensure that these firms can continue to lend to households and businesses even in times of financial stress. In addition, the final rule requires publicly traded U.S. BHCs with total consolidated assets of $10 billion or more to establish enterprise-wide risk committees. The new requirements for U.S. BHC complement the stress testing and resolution planning requirements for large BHCs. U.S. BHCs subject to the rule will need to comply by January 1, 2015.

For foreign financial institutions, the final rule recognizes that the U.S. operations of foreign banking organizations have become more complex, interconnected, and concentrated in recent years. The requirements in the final rule will bolster the capital and liquidity positions of the U.S. operations of foreign banking organizations and promote a level playing field among all banking firms operating in the United States. Foreign banking organizations with U.S. non-branch assets of $50 billion or more will 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 to help ensure that the foreign bank understands and manages the risks of its combined U.S. operations. In addition, these foreign banking organizations will be required to meet enhanced liquidity risk-management standards, conduct liquidity stress tests, and hold a buffer of highly liquid assets based on projected funding needs during a 30-day stress event.

Foreign banking organizations 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. In addition, the final rule implements stress testing requirements for foreign banking organizations with total consolidated assets of more than $10 billion and risk committee requirements for foreign banking organizations that meet the asset threshold and are publicly traded.

The final rule extends the initial compliance date for foreign banking organizations to July 1, 2016, a year later than originally proposed, and generally defers application of the leverage ratio to foreign-owned U.S. intermediate holding companies until 2018.

The Federal Reserve will apply enhanced prudential standards to designated nonbank financial companies supervised by the Federal Reserve through a subsequently issued order or rule following an evaluation of the business model, capital structure, and risk profile of each designated nonbank financial company.

c. Annual Stress Tests

Section 165 of the Dodd-Frank Act requires the Federal Reserve to conduct supervisory stress tests of FSOC designated nonbank financial companies and BHCs with $50 billion or more in assets and requires banks with more than $10 billion in total consolidated assets to conduct annual stress tests. *See* 12

U.S.C. 5363(i). FSOC designated nonbank financial companies and BHCs with $50 billion or more in assets are also required to conduct semiannual company-run stress tests.

On October 9, 2012, the federal banking agencies adopted final rules to implement the stress testing requirements of the Dodd-Frank Act. The Federal Reserve adopted two final rules: one implementing the supervisory stress test and semiannual company-run stress test requirements for covered companies (*see* 12 CFR 252; 77 Federal Register 62378), and a second implementing the annual company-run stress test requirements for BHCs with total consolidated assets of more than $10 billion but less than $50 billion as well as for state member banks and savings and loan holding companies (SLHCs) with total consolidated assets of more than $10 billion (*see* 12 CFR 252; 77 Federal Register 62396).[10] The OCC adopted final rules to require national banks and federal savings associations with total consolidated assets of more than $10 billion to conduct annual stress tests(s*ee* 12 CFR 46; 77 Federal Register 51638)[11]. The OCC rule sets out definitions and rules for scope of application, scenarios, reporting, and disclosure, and also states that the OCC will provide the required scenarios to the covered institutions by November 15 of each year[12]. The FDIC adopted rules to require state nonmember banks and FDIC-insured state-chartered savings associations with total consolidated assets of more than $10 billion to conduct annual stress tests. *See* 12 CFR 325, Subpart C.

In addition, on September 24, 2013, the Federal Reserve issued two interim final rules to clarify how companies should incorporate the Basel III regulatory capital reforms into their capital and business projections for capital plan submissions and their stress tests required under the Dodd-Frank Act. The first interim final rule applies to BHCs with $50 billion or more in total consolidated assets. *See* 12 CFR Parts 225 and 252; *See* 78 Federal Register 59779. The rule clarifies that for the 2013-14 capital planning and stress-testing cycle, these companies must incorporate the revised capital framework into their capital planning projections and into the stress tests required under the Dodd-Frank Act using the transition paths established in the Basel III final rule. This rule also clarifies that for the 2013-14 cycle, capital adequacy at large banking organizations would continue to be assessed against a minimum 5 percent tier 1 common ratio calculated in the same manner as under previous stress tests and capital plan submissions, ensuring consistency with those

[10] The Federal Reserve began conducting supervisory stress tests in the fall of 2012 for 19 BHCs that participated in the 2009 Supervisory Capital Assessment Program and subsequent Comprehensive Capital Analysis and Reviews. These companies and their state-member bank subsidiaries also conducted their own company-run stress tests in the fall of 2012. Other companies subject to the Federal Reserve's final rules for Dodd-Frank Act stress testing will be required to comply with the final rule beginning in October 2013. Companies with between $10 billion and $50 billion in total assets that begin conducting their first company-run stress test in in the fall of 2013 will not have to publicly disclose the results of that first stress test.

[11] Covered firms over $50 billion in total assets subject to the OCC stress test rule began conducting their own company-run stress tests in November 2012. Firms with between $10 and $50 billion began conducting their company-run stress test in November 2013.

[12] The OCC has issued proposed rule that would shift back the timing of the annual stress testing cycle by approximately 90 days. 79 Federal Register 37231.

previous exercises. The second interim final rule provides a one-year transition period for most banking organizations with between $10 billion and $50 billion in total consolidated assets to incorporate the Basel III capital reforms into their stress tests. *See* 12 CFR 252; 78 Federal Register 59791. These companies conducted their first company-run stress test under the Federal Reserve's rules implementing the Dodd-Frank Act during the fall of 2013. The interim final rule requires these companies to calculate their stress test projections in their 2013-14 stress tests using the Federal Reserve's then-current regulatory capital rules to allow the firms time to adjust their internal systems to the revised capital framework.

The current OCC stress testing rule requires covered institutions to estimate the impact of stress scenarios on "the covered institution's regulatory capital levels and ratios applicable to the covered institution under 12 CFR 3 (for national banks) or part 167 (for Federal savings associations), as applicable, and any other capital ratios specified by the OCC." On October 11, 2013, the OCC published revised risk-based and leverage capital requirements that implement the Basel III framework. In light of the issuance of the Basel III framework, the OCC issued a notice of proposed rulemaking on June 12, 2014 clarifying when covered institutions would be required to estimate their minimum regulatory capital ratios over the stress-test planning using the Basel III advance approaches methodology. 79 Federal Register 37231.

d. Regulatory Capital Framework

The Dodd-Frank Act establishes floors for regulatory capital requirements applied to domestic BHCs, SLHC, and designated nonbank financial companies supervised by the Federal Reserve. Specifically, the Dodd-Frank Act requires the minimum leverage and risk-based capital requirements for such institutions to be no lower than the requirements applied to insured depository institutions at any time in the future and not quantitatively lower than the requirements applied to insured depository institutions on July 21, 2010. *See* 12 U.S.C. 5371. Consistent with this provision, the agencies jointly adopted a final rule amending its capital framework to require a banking organization operating under the advanced approaches risk-based capital rules to meet the higher of the minimum requirements under the generally applicable capital requirements and the minimum requirements under the advanced approaches risk-based capital rules. *See* 76 Federal Register 37620 (June 28, 2011).

On June 12, 2012, the federal banking agencies approved a final rule to implement changes to the market risk capital rule, which requires institutions with significant trading activities to adjust their capital ratios to better account for the market risks of those activities. See 77 Federal Register 53060; 12 CFR part 3, appendix B (OCC), 12 CFR parts 208 and 225, appendix E (Federal Reserve), and 12 CFR part 325, appendix C (FDIC). The final market risk capital rule, applies to a BHC or bank with aggregate trading assets and liabilities equal to 10 percent of total assets, or $1 billion or more, implements certain revisions made by the BCBS to its market risk framework. The final rule is intended to enhance sensitivity to risks arising from trading activities,

reduce procyclicality in the market risk capital requirements, and increase transparency through enhanced disclosures. The final rule includes alternative standards of creditworthiness for determining specific risk capital requirements for certain debt and securitization positions.[13]

In addition, on June 12, 2012, the federal banking agencies invited comment on three notices of proposed rulemakings that would implement in the United States the Basel III regulatory capital reforms adopted by the BCBS and make other revisions to the agencies' regulatory capital requirements. The proposals would establish an integrated regulatory capital framework to address shortcomings in regulatory capital requirements that became apparent during the financial crisis. The proposed rules would be consistent with section 171 of the Dodd-Frank Act, which directs the Federal Reserve to establish minimum risk-based and leverage capital requirements for BHCs and SLHCs that are not less than the "generally applicable" capital requirements for insured depository institutions and not "quantitatively lower than" the "generally applicable" capital requirements in effect for insured depository institutions when the Dodd-Frank Act was enacted.

On July 2, 2013, the Federal Reserve and OCC jointly issued a final rule that revises its risk-based and leverage capital requirements to implement the Basel III regulatory capital reforms and integrate the Federal Reserve's capital rules into a comprehensive regulatory framework. (*See* 1212 CFR part 3; 12 CFR part 217). The FDIC published a substantively identical interim final rule. (*See* 12 CFR part 324). Under the final rule, minimum requirements increase for both the quantity and quality of capital held by all depository institutions, BHCs with total consolidated assets of $500 million or more, and SLHCs that are not substantially engaged in commercial or insurance underwriting activities (collectively, banking organizations). Consistent with the BCBS international standard, the rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent, raises the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations. In addition, the rule requires a banking organization to hold a capital conservation buffer of common equity tier 1 capital in an amount greater than 2.5 percent of total risk-weighted assets to avoid limitations on capital distributions and discretionary bonus payments to executive officers. The final rule also incorporates the new and revised minimum requirements into the agencies' prompt corrective action framework.

In addition, for advanced approaches banking organizations (generally, the largest, most complex banking organizations), the final rule includes a new 3 percent minimum supplementary leverage ratio based on the BCBS international leverage standard that takes into account off-balance-sheet exposures.

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[13] On December 6, 2013, the Federal issued a final rule that makes technical changes to the market risk capital rule to align it with the Basel III revised capital framework. The changes to the rule reflect modifications by the Organisation for Economic Co-operation and Development regarding country risk classifications and clarifies criteria for determining whether underlying assets are delinquent for certain traded securitization positions.

The rule also introduces a countercyclical capital buffer applicable to advanced approaches banking organizations to augment the capital conservation buffer during periods of excessive credit growth. The final rule enhances the quality of banking organizations' regulatory capital through the establishment of standards based on common equity tier 1 capital--the most loss-absorbing form of capital--and the implementation of strict eligibility criteria for regulatory capital instruments. The final rule also improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. The final rule also establishes transition periods designed to provide sufficient time for banking organizations to meet the new capital standards while supporting lending. Under the final rule, the phase-in period for smaller, less complex banking organizations and all covered SLHCs begins in January 2015. The phase-in period for larger banking organizations that are not SLHCs began in January 2014.

Consistent with the requirement of section 939A of the Dodd-Frank Act that all federal agencies remove from their regulations references to and requirements of reliance on credit ratings, the agencies final capital rules rule remove references to, and reliance on, credit ratings from the Federal Reserve's capital rules.

e. Savings and Loan Holding Companies and Thrifts

Title III of the Dodd-Frank Act 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 federal banking agencies. Pursuant to Title III of the Dodd-Frank Act, the Federal Reserve regulates SLHCs, the OCC regulates federally chartered savings associations, and the FDIC regulates state-chartered savings associations. The transfer of the OTS's authority to the federal banking agencies became effective on July 21, 2011, one year after the enactment of the Dodd-Frank Act. *See* 12 U.S.C. 5412. The agencies have untaken several initiatives to provide SLHCs with advance notice of how the agencies would supervise and regulate SLHCs and their thrift subsidiaries after the transfer date. Among other things, the agencies issued a joint report on January 25, 2011, regarding the agencies' plans to implement the transfer of OTS authorities on January 25, 2011. In addition, the Federal Reserve has issued regulations to effectuate the transfer of authority from the OTS; the regulations sets forth the changes necessary to accommodate the transfer of supervisory authority and the rules that govern SLHCs generally (*see* Regulation LL, 12 CFR 238) as well as SLHCs that are organized in mutual form (*see* Regulation MM, 12 CFR 239). 76 Fed. Reg. 56508. Similar regulations have been implemented with respect to the transfer of authority over savings association to the OCC and FDIC. *See* 76 Fed. Reg. 43549, and 12 CFR parts 4, 5, 7, 8, 28, and 34 (OCC); 76 Fed. Reg. 47651, and 12 CFR 390 and 391 (FDIC).

In addition, the Dodd-Frank Act contains several provisions designed to preserve the traditional separation of banking and commercial activities and support the Federal Reserve's supervision and regulation of SLHCs. First, as noted above, the act provides that an SLHC will be allowed to conduct

expanded activities permissible to an FHC, such as insurance underwriting, only if such SLHC satisfies the same capital, managerial, and Community Reinvestment Act criteria that govern whether a BHC qualifies as an FHC. In addition, the act instructs the Federal Reserve to issue regulations establishing criteria for determining when a grandfathered unitary SLHC that engages in commercial activities must form an intermediate holding company (IHC) through which to conduct its financial activities. Such IHCs would be subject to Federal Reserve supervision as an SLHC, and the Federal Reserve may promulgate regulations to restrict or limit transactions between the IHC and any affiliate.

f. Resolution Framework

The Dodd-Frank Act creates a special resolution process that allows the government to wind down a failing systemically important financial institution whose disorderly collapse would pose substantial risks to the financial system and the broader economy. Specifically, title II of the Dodd-Frank Act permits the FDIC to be appointed as receiver for a failing designated nonbank financial company. This optional resolution framework is triggered only by a recommendation of two-thirds of the Federal Reserve and the FDIC's board of directors and a determination by the Secretary of the Treasury, in consultation with the President, that (1) the company is in default or in danger of default, (2) the failure of the company and its resolution under otherwise applicable federal or state law would have serious adverse effects on financial stability in the United States, and (3) resolution under the new regime would avoid or mitigate these adverse effects. The SEC would substitute for the FDIC in the recommendation process if the firm or its largest subsidiary is a broker-dealer.

The Dodd-Frank Act vests in the FDIC, as receiver for the failed company, powers similar to those it has when acting as a receiver for a failed bank. Specifically, the FDIC may stabilize the company with loans or guarantees, sell assets or operations, and transfer assets and liabilities to a bridge company. The act requires the FDIC to ensure that creditors and shareholders of the failed company bear losses and that directors and management responsible for the company's failure are removed. The act also allows the FDIC to obtain temporary funding for a resolution by borrowing from the Treasury, subject to certain limits. Importantly, any borrowings from the Treasury must be repaid through proceeds from the sale of the failed company's operations. If such proceeds are insufficient to fully repay all borrowings from the Treasury, assessments would be made on certain creditors of the failed firm and, if necessary, on financial companies that have $50 billion or more in total assets.

In addition, section 165(d) requires BHCs with total consolidated assets of $50 billion or more and any designated nonbank financial company supervised by the Board (collectively, covered companies) to periodically submit to the Federal Reserve, the FDIC, and the FSOC a plan for such company's rapid and orderly resolution, under the U.S. Bankruptcy Code, in the event of material financial distress or failure. These resolution plans, or "living wills," will assist covered companies and regulators in conducting advance resolution planning for a covered company. On October 17, 2011, the Federal Reserve and

the FDIC issued a final rule requiring covered companies to annually submit resolution plans. Large, complex covered companies are required to submit a resolution plan that covers the entire organization. Smaller, less complex companies can file a streamlined resolution plan. See 12 CFR Parts 243 (Federal Reserve) and 381 (FDIC).

Under the final resolution plan regulation, a company's resolution plan must describe the company's strategy for rapid and orderly resolution in bankruptcy during a time of financial distress or failure of the company, and the plan must include information concerning the company's operations and funding. The plan must also include information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of nonbank subsidiaries of the company; detailed descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company; identification of the cross-guarantees tied to different securities; and a description of the governance and oversight process related to resolution planning.

Separately, the Dodd-Frank Act instructed the Federal Reserve to conduct two studies in consultation with the Administrative Office of the U.S. Courts regarding the resolution of financial companies: one regarding the resolution of domestic financial companies under the Bankruptcy Code, and one regarding international coordination relating to the resolution of systemic financial companies under the Bankruptcy Code and applicable foreign laws. The Federal Reserve issued both studies in July 2011. The studies are available on the Federal Reserve's website at www.federalreserve.gov/publications/other-reports/default.htm.

g. Incentive compensation

Section 956 of the Dodd-Frank Act requires the appropriate federal regulators, including the federal banking agencies, 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. 12 U.S.C. 5641. In addition, the regulations or guidance must require covered financial institutions, including holding companies and banks, to disclose to their appropriate federal regulator sufficient information concerning the structure of incentive-based compensation arrangements to monitor compliance with these restrictions. Section 956 complements the guidance the federal banking agencies issued on June 21, 2010, to ensure that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices. *See* 75 Federal Register 36395.

The agencies, along with other federal agencies, have proposed rules to implement section 956. *See* 76 Federal Register 21170 (April 14, 2011). In prohibiting incentive compensation arrangements that could encourage inappropriate risks, the proposal would require compensation practices at regulated

financial institutions to be consistent with three key principles--that incentive compensation arrangements should appropriately balance risk and financial rewards, be compatible with effective controls and risk management, and be supported by strong corporate governance. The proposed rule complements guidance previously issued by the agencies, including guidance on sound incentive compensation policies issued by the banking agencies last year.

The agencies are proposing that financial institutions with $1 billion or more in assets be required to have policies and procedures to ensure compliance with the requirements of the rule, and submit an annual report to their federal regulator describing the structure of their incentive compensation arrangements. The agencies are proposing that larger financial institutions, generally those with $50 billion or more in assets, defer at least 50 percent of the incentive compensation of certain officers for at least three years and that the amounts ultimately paid reflect losses or other aspects of performance over time. For purposes of credit unions, large financial institutions would be defined as those with $10 billion or more in assets. The FHFA has proposed that the income-deferral provisions apply to all entities it regulates, regardless of size.

h. Credit Ratings

Section 939A of the Dodd-Frank Act requires all federal agencies to review their regulations, including capital rules, and remove any reference to credit ratings. *See* 15 U.S.C. 78o-7. The Federal Reserve completed the required review of its regulations and issued a report to Congress on July 25, 2011. See *Report to the Congress on Credit Ratings*, www.federalreserve.gov/publications/other-reports/files/credit-ratings-report-201107.pdf. In accord with section 939A, the OCC and FDIC also reviewed their regulations and issued reports.

Section 939A also requires the agencies to remove any reference to, or requirements of reliance on, credit ratings in regulations that require the use of an assessment of creditworthiness of a security or money-market instrument. On June 13, 2012, the OCC finalized revisions to its regulations pertaining to permissible investment securities, securities offerings, and foreign bank capital equivalency deposits to replace references to credit ratings with non-ratings based standards of creditworthiness. *See* 77 Federal Register 35253. On the same day, the OCC published final guidance on due diligence requirements in determining whether securities are eligible for investment. *See* 77 Federal Register 35259.

On August 10, 2010, the agencies issued an advanced notice of proposed rulemaking regarding alternatives to the use of credit ratings in their risk-based capital rules. *See* 75 Federal Register 52283. The agencies also held a roundtable discussion with industry, academic, and other participants in November 2010 to hear views on how to develop alternatives to credit ratings. On December 7, 2011, the agencies issued a second notice of proposed rulemaking that would modify the agencies' market risk capital rules for banking organizations with significant trading activities. *See* 76 Federal Register 79379. The modified notice of proposed rulemaking included alternative standards of creditworthiness that would be used in place of credit ratings to determine the

capital requirements for certain debt and securitization positions covered by the market risk capital rules. The agencies finalized these revisions to the market risk capital rules on August 30, 2012. *See* 77 Federal Register 53060.

In 2013, the agencies finalized fundamental revisions to their respective regulatory capital rules. Among other changes, these revisions removed all remaining references to credit ratings. The Board and the OCC issued a final rule implementing these regulatory capital reforms on October 11, 2013. *See* 78 FR 62018. The FDIC adopted an interim final rule that was substantively identical to the OCC and Board rules in July 2013 and later issued a final rule on April 14, 2014, which also is substantively identical. *See* 79 FR 20754.

Other the Dodd-Frank Act Initiatives

a. The "Volcker Rule": Prohibitions against Proprietary Trading and Other Activities

Section 619 of the Dodd-Frank Act generally prohibits banking entities from engaging in proprietary trading or from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. *See* 124 Stat. 1620; 12 U.S.C. 1851. Proprietary trading does not include transactions entered into on behalf of customers or in connection with underwriting or market-making-related activities, risk-mitigating hedging activities, or investments in small business investment companies or other similar qualifying investments. The Act also provides that designated nonbank financial companies supervised by the Federal Reserve that engage in such activities or have such investments will be subject to additional capital requirements, quantitative limits, or other restrictions. These prohibitions and other provisions of section 619 are commonly known as the "Volcker Rule."

As required by the Dodd-Frank Act, on January 18, 2011, the FSOC issued a study and made recommendations on the implementation of the Volcker Rule. *See* http://www.treasury.gov/initiatives/documents/volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf. The federal banking agencies along with the CFTC and SEC are responsible for developing and adopting regulations to implement the prohibitions and restrictions of the Volcker Rule. The Federal Reserve alone is responsible for adopting rules to implement the conformance provisions of the Volcker Rule, which provide a banking entity or a designated nonbank financial company supervised by the Federal Reserve a period of time after the effective date of the Volcker Rule to bring its activities into compliance with the Volcker Rule and the agencies' implementing regulations. On February 9, 2011, the Federal Reserve issued a final rule implementing the conformance period. *See* 76 Federal Register 8265. On December 10, 2013, the Federal Reserve extended the conformance period until July 21, 2015, to ensure effective compliance with the rules. *See* 79 Federal Register 5536.

On December 10, 2013, the federal banking agencies along with the CFTC and SEC issued final rules to implement section 619. *See* 79 Federal Register 5536. The final rules prohibit banking entities from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures, and

options on these instruments for their own account. This prohibition is subject to exemptions for underwriting, market making-related activities, risk-mitigating hedging, activities of foreign banking entities solely outside the United States, and certain other activities.

The final rules also prohibit banking entities from acquiring or retaining an ownership interest in, or having certain relationships with, a hedge fund or private equity fund (covered fund), subject to exemptions for investments made in connection with organizing and offering a covered fund, including making and retaining *de minimis* investments in a covered fund, certain investments made on behalf of customers, activities of foreign banking entities solely outside the United States, and certain other activities.

The final rules require a banking entity to establish a compliance program designed to help ensure and monitor compliance with the prohibitions and restrictions of section 619 and the final rules. The compliance requirements vary based on the size of the banking entity and the size, scope, and complexity of activities conducted. The final rule requires banking entities with total assets greater than $10 billion and less than $50 billion to have a compliance program that includes six pillars (including written policies and procedures, internal controls, management framework and accountability, independent testing and audits, training, and recordkeeping). Banking entities with significant trading operations and banking entities with total assets of $50 billion or more will be required to establish a detailed compliance program, and their chief executive officers will be required to attest that the program is reasonably designed to achieve compliance with the final rule.

The final rules reduce the burden on smaller, less-complex institutions by limiting their compliance requirements. For a banking entity that has total assets of $10 billion or less that engages in some activity regulated under the final rule, the compliance program may be limited to appropriate references in existing compliance policies, appropriate to the activities, size, scope and complexity of the banking entity. A banking entity that does not engage in covered activities or investments (other than trading in certain government obligations) will not need to establish a compliance program.

b. Financial Sector Concentration Limit

Section 622 of the Dodd-Frank Act establishes a financial sector concentration limit that generally prohibits a financial company from merging or consolidating with, or acquiring, another company if the resulting company's consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies. See 124 Stat. 1632; 12 U.S.C. 1852. Financial companies subject to the concentration limit would include insured depository institutions, bank holding companies, savings and loan holding companies, foreign banking organizations, companies that control insured depository institutions, and nonbank financial companies designated FSOC for Federal Reserve supervision. As required by the Act, on January 18, 2011, the FSOC completed a study of the concentration limit's effect on financial stability and other factors and made recommendations

regarding modifications to the concentration limit that the FSOC believes would more effectively implement section 622. *See* http://www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf

The Federal Reserve is required to adopt regulations to implement the financial sector concentration limit that reflect, and are in accordance with, the FSOC's recommendations. The Federal Reserve proposed rules to implement section 622, which generally defines liabilities of a financial institution as the difference between its risk-weighted assets, as adjusted to reflect exposures deducted from regulatory capital, and its total regulatory capital. *See* 79 Federal Register 27801. Firms not subject to consolidated risk-based capital rules would measure liabilities using generally accepted accounting standards. The proposal would also provide that the Federal Reserve would measure and disclose the aggregate liabilities of financial companies annually, and would calculate aggregate liabilities as a two-year average. The proposal reflects recommendations made by the FSOC.

c. Regulation of Derivatives Markets and Products

The Dodd-Frank Act makes a number of significant changes to the regulation of derivatives, which it refers to as "swaps" and "security-based swaps," and participants in the derivatives markets. The Act divides the regulation of the derivatives markets between the SEC, which will regulate security-based swaps, and the CFTC, which will regulate all other swaps. The Act generally requires (1) all standardized derivatives to be centrally cleared and traded on an exchange or registered execution facility; (2) all derivatives to be reported to registered data repositories; (3) all derivatives dealers ((swap dealers)) and major market participants ((major swap participants)) to register with the SEC and/or the CFTC; and (4) the establishment of new, regulated organizations to support the derivatives market, including exchanges, clearing organizations, and data repositories. In general, the Dodd-Frank Act mandates that the SEC and CFTC consult with the Federal Reserve before issuing rules to implement the new regulatory regime applicable to derivatives.

In addition, the federal banking agencies are required to adopt joint rules that establish capital and margin requirements for banks, BHCs, SLHCs, foreign banks, foreign bank branches, and Edge Act and agreement corporations that are swap dealers or major swap participants.

The federal banking agencies issued a joint proposed rule with the Farm Credit Administration, and FHFA to establish margin and capital requirements for swap dealers, major swap participants, security-based swap dealers, and security-based swap participants (collectively, "swap entities"). *See* 76 Federal Register 27564. The proposed rule would require certain swap entities regulated by the five agencies to collect minimum amounts of initial margin and variation margin from counterparties to non-cleared swaps and non-cleared, security-based swaps. The amount of margin that would be required under the proposed rule would vary based on the relative risk of the counterparty and of the swap or security-based swap. A swap entity would not be required to collect margin from a commercial end user as long as its margin exposure is below an appropriate credit exposure limit established by the swap entity.

On April 9, 2013, the Federal Reserve, in consultation with the OCC and FDIC, adopted final rule that would set standards for banking organizations regulated by the Federal Reserve that engage in certain types of foreign exchange transactions with retail customers. *See* 12 CFR 240; 78 Federal Register 21019. The rule establishes requirements for risk disclosures to customers, recordkeeping, business conduct, and documentation for retail foreign exchange transactions. Regulated institutions engaging in such transactions will be required to notify the Federal Reserve and to be well capitalized. They will also be required to collect margin for retail foreign exchange transactions. The types of transactions covered by the rule include foreign exchange transactions that are futures or options on futures, over-the-counter options on foreign currency, and so-called rolling spot transactions. The rule covers entities regulated by the Federal Reserve including state-chartered banks that are members of the Federal Reserve System, bank and savings and loan holding companies, Edge Act and agreement corporations, and uninsured, state-licensed branches and agencies of foreign banks.

d. Derivatives "Push-Out"

Section 716 of the Dodd-Frank Act, commonly referred to as the derivatives "push-out" section, prohibits the provision of certain kinds of federal assistance to banks and other institutions with respect to their derivatives activities, except for derivatives activities related to hedging or other risk-mitigating activities and acting as a dealer for derivatives involving interest or other rates; derivatives that reference assets that are eligible for bank investment (including foreign exchange, gold, and silver; and cleared credit default swaps. 15 U.S.C. 8305. As a result, these institutions will push out all other derivatives activities, including derivatives on agricultural commodities, energy, and non-precious metals; equity derivatives; and uncleared credit default swaps to a separately capitalized affiliate. The federal banking agencies must establish a transition period of up to 24 months for institutions to bring their activities into compliance with the derivatives push-out restrictions.

On January 8, 2013, the OCC published in the Federal Register guidance applicable to insured federal depository institutions concerning procedures and conditions for requests for a transition period. 78 Federal Register 1306. The Federal Reserve adopted an interim final rule, effective as of June 5, 2013, clarifying that uninsured U.S. branches and agencies of foreign banks will be treated as insured depository institutions, and thus, they will be eligible to apply for a transition period and will be treated as insured depository institutions for purposes of the other provisions of section 716. *See* 12 CFR 237; 78 Federal Register 34545. Consistent with the Federal Reserve's interim final rule, the OCC notified uninsured U.S. branches and agencies of foreign banks on June 12, 2013 that they may request a transition period under the OCC's guidance. The Federal Reserve's interim final rule also establishes the process for state member banks and uninsured state branches or agencies of foreign banks to apply to the Federal Reserve for the transition period. The OCC and the Federal Reserve have granted a number of institutions' requests for a transition period.

e. Credit-Risk Retention Study and Regulations

Section 941(b) of the Dodd Frank Act imposes certain credit-risk retention obligations on securitizers or originators of assets securitized through the issuance of asset-backed securities. *See* 124 Stat. 1891; 15 U.S.C. 78a et seq. Section 941 also requires the Federal Reserve, in conjunction with other federal agencies, to jointly prescribe regulations implementing these credit-risk retention requirements. See 15 U.S.C. 78o-11. On October 19, 2010, the Federal Reserve issued a report on the effect of the new risk-retention requirements to be developed and implemented by the federal agencies, and of Statements of Financial Accounting Standards Nos. 166 and 167. *See* Board of Governors of the Federal Reserve System (2010), "Report to the Congress on Risk Retention" (October), available at: http://federalreserve.gov/boarddocs/rptcongress/securitization/riskrenttion.pdf. (highlighting the significant differences in market practices and performance across securitizations backed by different types of assets).

In 2013, the federal banking agencies along with other agencies issued a joint revised proposed rule that would require securitizers to retain risk through one of several options, which were designed to take into account market practices and securitization structures across different asset classes. Under the revised proposed rule, sponsors of ABS would be required to retain at least 5 percent of the credit risk of the assets underlying the securities, and securitizations of commercial loans, commercial mortgages, or automobile loans of low credit risk would not be subject to risk retention. Further, the rule would recognize the full guarantee on payments of principal and interest provided by Fannie Mae and Freddie Mac for their residential mortgage-backed securities as meeting the risk retention requirements while Fannie Mae and Freddie Mac are in conservatorship or receivership and have capital support from the U.S. government.

Ultimately, the proposal aims to ensure that the amount of credit risk retained by sponsors is meaningful, while taking into account market practices and reducing the potential for the rule to affect negatively the availability and cost of credit to consumers and businesses.

f. Payment, Settlement, and Clearing Activities and Utilities

As noted above, the Dodd-Frank gives the FSOC the authority to identify and designate as systemically important an FMU if the FSOC determines that failure of or a disruption to the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. In addition, the FSOC may designate payment, clearing, or settlement activities it determines are systemically important. On July 18, 2011, the FSOC adopted rules describing the criteria that will inform its processes and procedures for designating an FMU as systemically important. *See* 12 CFR 1320. Under the rule, which incorporates the Act's criteria, the FSOC will consider the aggregate monetary value of transactions processed by a FMU; the aggregate exposure of an FMU to its counterparties; the relationship,

interdependencies, or other interactions of a FMU with other FMUs; and the effect that the failure of or disruption to a FMU would have on critical markets, financial institutions, or the broader financial system.

In addition, title VIII of the Dodd-Frank Act establishes a new supervisory framework for systemically important FMUs and systemically important payment, clearing, and settlement activities conducted between financial institutions. Under the framework, the Board is authorized to prescribe risk-management standards governing the operations of FMUs that are designated as systemically important by the FSOC (other than a designated FMU that is registered with the CFTC as a derivatives clearing organization (DCO) or registered with the SEC as a clearing agency) as well as the conduct of payment, clearing, and settlement activities by financial institutions if such activities have been designated as systemically important by the FSOC.[14] *See* 12 U.S.C. 5464(a). The FSOC, as noted above, voted unanimously to designate eight FMUs as systemically important under the Dodd-Frank Act.

On July 30, 2012, the Federal Reserve approved a final rule to implement certain provisions of Title VIII of the Dodd-Frank Act. 12 CFR 234 (Regulation HH); 77 Federal Register 45907. The final rule creates risk-management standards governing the operations related to the payment, clearing, and settlement activities of FMUs designated as systemically important by the FSOC (other than registered DCOs or clearing agencies). The risk-management standards are based on the recognized international standards developed by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions that were incorporated previously into the Federal Reserve's Policy on Payment System Risk. Regulation HH also establishes requirements for advance notice of proposed material changes to the rules, procedures, or operations of a designated FMU for which the Federal Reserve is the supervisory agency as specified in Title VIII of the Dodd-Frank Act. The advance notice requirements set the threshold above which a proposed change would be considered material and thus require an advance notice to the Federal Reserve, and also include provisions on the length of the review period.

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[14] The framework also permits the Federal Reserve to: (i) examine and take enforcement action against designated FMUs for which it is the supervisory agency; (ii) consult on and participate in any examination of a designated FMU led by another supervisory agency and recommend the supervisory agency take enforcement action against the designated FMU; and (iii) require a designated FMU to submit reports and data in order to assess the safety and soundness of the utility and the systemic risk that the FMU's operations pose to the financial system. *See* 12 U.S.C. 5466; 12 U.S.C. 5468. In addition, the Federal Reserve may authorize a Reserve Bank to establish and maintain an account for and provide deposit and payment services to the designated FMU, and may, after consultation with the Secretary of the Treasury, authorize a Reserve Bank to provide discount and borrowing privileges to the designated FMU in unusual and exigent circumstances and when a designated FMU demonstrates that it is unable to secure adequate credit accommodations from other banking institutions. *See* 12 U.S.C. 5465(b).

In addition, as required by the Dodd-Frank Act, in July 2011 the Federal Reserve, CFTC, and SEC issued a joint report to Congress containing recommendations for promoting robust risk-management standards and consistency in the supervisory programs of the CFTC and SEC for designated clearing entities. *See Risk-Management Supervision of Designated Clearing Entities*, www.federalreserve.gov/publications/other-reports/files/risk-management-supervision-report-201107.pdf.

g. Debit Interchange

Section 1075 of the Dodd-Frank Act restricts the interchange fees that issuers may receive for electronic debit card transactions. 15 U.S.C. 1693o-2. Specifically, the interchange fee an issuer receives for a particular transaction must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The Dodd-Frank Act requires the Federal Reserve to set standards for determining whether an interchange fee is reasonable and proportional to the issuer's cost and permits the Federal Reserve to adjust the interchange fee to account for an issuer's fraud-prevention costs. It also authorizes the Federal Reserve to prescribe regulations in order to prevent circumvention or evasion of the interchange fee restrictions. The interchange fee restrictions do not apply to issuers that, together with affiliates, have less than $10 billion in assets, to debit cards issued pursuant to government-administered payment programs, or to certain general-use prepaid cards. In addition, the Dodd-Frank Act requires the Federal Reserve to prescribe rules prohibiting network exclusivity arrangements and routing restrictions in connection with electronic debit card transactions.

On June 29, 2011, the Federal Reserve issued final rules to establish standards for determining whether an interchange fee is reasonable and proportional to the issuer's cost. *See* 12 CFR 235 (Regulation II); 76 Federal Register 43394. Under the final rule, the maximum permissible interchange fee that an issuer may receive for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. In accordance with the statute, the final rule exempts issuers that, together with their affiliates, have assets of less than $10 billion from the debit card interchange fee standards. To facilitate implementation of the small issuer exemption, the Federal Reserve has published lists of institutions with consolidated assets above and below the $10 billion exemption threshold and plans to survey networks and publish annually the average interchange fees each network provides to its exempt and nonexempt issuers. In addition, the final rule prohibits all issuers and networks from restricting the number of networks over which electronic debit transactions may be processed to less than two unaffiliated networks. The rule also prohibits issuers and networks from inhibiting a merchant's ability to direct the routing of the electronic debit transaction over any network that the issuer has enabled to process them.

On July 27, 2012, the Federal Reserve approved a final rule that permits a debit card issuer subject to the interchange fee standards of Regulation II to receive a fraud-prevention adjustment. *See* 12 CFR 235; 77 Federal Register 46258. Under the fraud-prevention adjustment final rule, an issuer is eligible for an adjustment of no more than 1 cent per transaction (unchanged from the previous interim final rule) if it develops and implements policies and

procedures that are reasonably designed to take effective steps to reduce the occurrence of, and costs to all parties from, fraudulent debit card transactions. The final rule simplifies the elements required to be included in an issuer's fraud-prevention policies and procedures. To receive an adjustment, an issuer is required to review its fraud-prevention policies and procedures, and their implementation, at least annually. An issuer also is required to update its policies and procedures as necessary in light of their effectiveness and cost-effectiveness and, as previously required, in light of changes in the types of fraud and available methods of fraud prevention. The final rule retains and clarifies the requirement that an issuer that meets these standards and wishes to receive the adjustment must annually notify the payment card networks in which it participates of its eligibility to receive the adjustment. In addition, the final rule explicitly prohibits an issuer from receiving or charging a fraud-prevention adjustment if the issuer is substantially noncompliant with the Federal Reserve's fraud-prevention standards and sets forth a timeframe within which such an issuer must stop receiving or charging a fraud-prevention adjustment.

The Federal Reserve also has issued several reports regarding interchange fees, as required by the Dodd-Frank Act. On June 29, 2011, the Federal Reserve issued a report disclosing certain aggregate and summary information concerning transaction processing costs and interchange transaction fees charged or received in connection with electronic debit transactions. *See 2009 Interchange Revenue, Covered Issuer Cost, and Covered Issuer and Merchant Fraud Loss Related to Debit Card Transactions*, www.federalreserve.gov/paymentsystems/files/debitfees_costs.pdf. On July 21, 2011, the Federal Reserve issued a report on the use of prepaid cards by government-administered payment programs as well as the interchange and cardholder fees charged with respect to such prepaid cards. *See Report to the Congress on Government-Administered, General-Use Prepaid Cards*, www.federalreserve.gov/publications/other-reports/files/government-prepaid-report-201107.pdf.

h. Registration of Securities Holding Companies (SHCs)

Section 618 of the Dodd-Frank Act permits a company that one or more securities broker or dealer registered with the Securities and Exchange Commission (SEC), and that is required by a foreign regulator or provision of foreign law to be subject to comprehensive consolidated supervision, to register with the Federal Reserve as an SHC and become subject to supervision and regulation by the Federal Reserve. An SHC that registers with the Federal Reserve under section 618 is subject to the full examination, supervision, and enforcement regime applicable to a registered BHC, including capital requirements (although the statute allows the Federal Reserve to modify its capital rules to account for differences in activities and structure of SHCs).

On May 30, 2012, the Federal Reserve adopted a final rule to implement section 618 of the Dodd-Frank Act. 12 CFR 241; 77 Federal Register 32881. The final rule, which became effective July 20, 2012, specifies the information that an SHC must provide to the Federal Reserve as part of registration,

including information relating to organizational structure, capital, and financial condition. Under the final rule, an SHC's registration becomes effective no later than 45 days from the date the Federal Reserve receives all required information. Consistent with the Dodd-Frank Act, the restrictions on nonbanking activities in section 4 of the Bank Holding Company Act would not apply to a supervised SHC.

i. Consumer Financial Protection

Title X of the Dodd-Frank Act creates within the Federal Reserve an independent Consumer Financial Protection Bureau (CFPB) to ensure that consumers have access to financial markets and that such markets are fair, transparent, and competitive. The CFPB is led by a director selected by the President and confirmed by the Senate and has assumed rulemaking authority for most federal consumer protection statutes. It also has exclusive authority to conduct examinations, require reports, and take enforcement actions regarding the federal consumer protection laws with respect to nondepository institutions that are engaged in certain markets, such as the mortgage business, or that are otherwise larger participants in the consumer financial services industry. With respect to large depository institutions (with $10 billion or more in total assets), the CFPB has authority to conduct examinations and require reports and has primary authority to take enforcement actions with respect to the federal consumer financial protection laws as defined in the Dodd-Frank Act. Consumer compliance examination authority for smaller entities remains with the applicable federal banking agency. 12 U.S.C. 5516.

The Dodd-Frank Act also made other enhancements to consumer financial protection, which the agencies have worked to implement. For instance, the Dodd-Frank Act amends the Truth in Lending Act (TILA) and Consumer Leasing Act (CLA) to extend the protections of those laws to consumer credit transactions and consumer leases of higher dollar amounts. Before the Dodd-Frank Act, TILA and CLA applied to consumer credit transactions and consumer leases, respectively, of $25,000 or less. The Dodd-Frank Act increased this limit to $50,000 for each statute. On March 25, 2011, the Federal Reserve issued a final rule amending Regulation Z (Truth in Lending) and Regulation M (Consumer Leasing) to reflect these higher thresholds.

The Dodd-Frank Act further amends TILA with respect to home mortgage lending. On February 23, 2011, the Federal Reserve issued a final rule to increase the annual percentage rate threshold used to determine whether a mortgage lender is required to establish an escrow account for property taxes and insurance for first-lien jumbo mortgages. Also on February 23, the Federal Reserve proposed a rule that would expand the minimum period for mandatory escrow accounts for first-lien, higher-priced mortgage loans from one to five years, and longer under certain circumstances. The proposed rule would provide an exemption from the escrow requirement for certain creditors that operate in rural or underserved communities. It also contains new disclosure requirements mandated by the Dodd-Frank Act. The proposed rule was transferred to the CFPB on the transfer date.

In addition, the Dodd-Frank Act generally prohibits lenders from making residential mortgage loans unless the consumer has a reasonable ability to repay the loan. On April 19, 2011, the Federal Reserve proposed a rule to implement this provision. Under the Federal Reserve's proposal, a lender could comply with the ability-to-repay requirement by considering and verifying specified underwriting factors, making certain types of qualified mortgages, or refinancing a non-standard mortgage into a more stable standard mortgage. The proposed rule also would implement the Dodd-Frank Act's limits on prepayment penalties. This proposed rule also was transferred to the CFPB on the transfer date.

Further, the Dodd-Frank Act amends the Fair Credit Reporting Act to require a creditor to disclose credit scores and related information to a consumer when the creditor uses the consumer's credit score in setting material terms of credit or in taking adverse action. On July 6, 2011, the Federal Reserve and the Federal Trade Commission issued final rules to implement this provision. *See* 76 Federal Register 41590; 12 CFR 202 and 76 Federal Register 41602; 12 CFR 222. The final rules revise the content requirements for risk-based pricing notices and add related model forms that reflect the new credit score disclosure requirements. The final rules were transferred to the CFPB on the transfer date.

On May 12, 2011, the Federal Reserve issued a proposed rule to create protections for consumers who send remittance transfers to recipients located in a foreign country. *See* 76 Federal Register 29902. Consistent with section 1073 of the Dodd-Frank Act, the Federal Reserve proposed to amend Regulation E to require disclosure of information about fees, exchange rates, and amount of currency to be received by the recipient of a remittance transfer. The proposed rule, which was transferred to the CFPB on the transfer date, would also provide error resolution and cancellation rights for senders of remittance transfers. In addition, on July 19, 2011, the Federal Reserve issued a report to Congress on the status of automated clearinghouse expansion for remittance transfers to foreign countries. *See Report to the Congress on the Use of the Automated Clearinghouse System for Remittance Transfers to Foreign Countries*, www.federalreserve.gov/boarddocs/rptcongress/ACH_report_201107.pdf.

On August 15, 2012, the federal banking agencies, CFPB, FHFA, and NCUA proposed a rule to implement section 129H of the Truth in Lending Act (TILA), added by the Dodd-Frank Act, which requires a creditor to obtain an appraisal before issuing a "higher-risk mortgage." 77 Federal Register 54722. Under the Dodd-Frank Act, mortgage loans are higher-risk if they are secured by a consumer's home and have interest rates above a certain threshold.

For higher-risk mortgage loans, the proposed rule would require creditors to use a licensed or certified appraiser who prepares a written appraisal report based on a physical inspection of the interior of the property. The proposed rule also would require creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report. Creditors would have to obtain an additional appraisal at no cost to the consumer for a home-purchase higher-risk mortgage loan if the seller acquired the property for a lower price during the past six months. This

requirement would address fraudulent property flipping by seeking to ensure that the value of the property being used as collateral for the loan legitimately increased.

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.[15] 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.[16]

EC1	**Principle 1: Responsibilities, objectives and powers**
Criterion	The responsibilities and objectives of each of the authorities involved in banking supervision[17] 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.
Legal Framework/ **Practices and Procedures**	Federal law and the laws of each of the states provide for the establishment of banks and address their permissible activities. *See* 12 U.S.C. § 21 (providing for the formation of national banks). There are a number of different banking supervisors in the United States, each with specific powers and responsibilities. The three federal banking agencies are the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC). In addition, each state has its own banking authority. Each federal and state banking agency operates pursuant to an express statutory grant of authority and has clearly defined objectives and responsibilities. *See, e.g.*, 12 U.S.C. § 1 *et seq.* (OCC); 12 U.S.C. § 221 *et seq*. (Federal Reserve); 12 U.S.C. § 1811 *et seq.* (FDIC). For the U.S. federal banking agencies, the organizing statutes, implementing regulations, guidelines, and other resources are (and are required to be) made publicly available, including on the website of each agency. *See* 5 U.S.C. § 552(a).

[15] 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.
[16] The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.
[17] Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

	The lines of responsibility for banking regulation and supervision are clear. Under the U.S. "dual banking system," a depository institution may choose to be chartered by a federal or state banking agency. Federal bank charters are issued by the OCC and federally chartered banks are referred to as national banks. These entities are supervised by the OCC. A bank chartered by a state banking authority is referred to as a state-chartered bank, and is supervised by the state agency that chartered it and by a federal agency. The Federal Reserve is the primary federal banking supervisor for state-chartered banks that are members of the Federal Reserve System. The FDIC is the primary federal banking supervisor for all other state-chartered banks. Another type of depository institution, a savings association, may be licensed by the OCC or a state banking agency, but federally chartered savings associations are supervised by the OCC and state-chartered savings associations are supervised by the appropriate state banking authority and the FDIC. A foreign bank may choose to establish a branch or agency in the United States that is federally licensed and supervised by the OCC or state-licensed and supervised by the banking authority in the state in which the office is located. The FDIC is the primary Federal bank supervisor of state-nonmember banks and state savings associations. The Federal Reserve also regulates and supervises companies that control one or more banks or savings associations (bank holding companies, financial holding companies, and savings and loan holding companies) and certain entities and facilities engaged in international business (including so-called Edge Act and agreement corporations). The Federal Reserve also has responsibility for supervising nonbank financial companies designated by the Financial Stability Oversight Council (FSOC). *See* 12 U.S.C. § 5323. The Consumer Financial Protection Bureau (CFPB) supervises both large depository institutions and their affiliates and certain nonbank consumer financial services firms with respect to their compliance with Federal consumer financial law. The objective of all prudential banking agencies is to promote safe and sound banking practices in the United States and maintain stability and public confidence in the banking system. The Federal Reserve has the added 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 also has an additional objective of minimizing the disruptive effects that can occur within the financial system when bank or nonbank financial firms fail. Although not a prudential regulator, the CFPB has the objective of ensuring that consumers have access to markets for consumer financial products and services that are fair, transparent, and competitive.

EC2	**Principle 1: Responsibilities, objectives and powers**
Criterion	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.
Legal Framework/ **Practices and Procedures**	The federal banking agencies 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. In addition, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the federal banking agencies 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. *See* 12 U.S.C. § 5301 et seq.

EC3	Principle 1: Responsibilities, objectives and powers
Criterion	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[18] and systemic importance.[19]
Legal Framework/ Practices and Procedures	Together, the banking statutes, regulations, guidelines, policy statements, interpretations and supervisory guidance and manuals establish a framework of minimum prudential standards that banks must meet. The standards address 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, AML/CFT/anti-fraud measures, among others. The federal banking agencies can issue regulations and 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. In addition, certain large bank holding companies, including foreign banking organizations and systemically significant nonbank financial companies are subject to enhanced prudential standards. The Dodd-Frank Act 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 to U.S. financial stability. *See* 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. *See* 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. *See* 12 U.S.C. § 5365; 12 CFR part 252. Federal statutes provide clear bases for the imposition of prudential standards. *See, e.g.*, 12 U.S.C. §§ 1464(t),1831o(c) and 3907, 3909 (capital standards); 84, 1464(u) (single borrower lending limits); 371c and 371c-1, 1467a(d), 1468(a), 1828a, 1828(j)(1) (affiliate transactions); 375, 375a, 375b, 1468(b), 1828(j)(2) (related party transactions), 1831p-1 (safety and soundness standards, including operational and managerial measures, asset quality and underwriting standards, earnings, and stock valuation standards, and compensation standards); 5365 (enhanced prudential standards).

EC4	Principle 1: Responsibilities, objectives and powers

[18] In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

[19] 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.

Criterion	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.
Legal Framework/ **Practices and Procedures**	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 U.S. federal banking agencies to review their regulations at regular intervals to ensure that they remain relevant and effective and to reduce the burden on regulated entities. *See, e.g.*, 12 U.S.C. §§ 611a, 1817(a)(11), and 3311(a). These reviews are conducted through a process that allows for widespread public (including industry) participation in developing more efficient and relevant rules. The CFPB also must conduct an assessment of its significant regulations on a periodic basis. See 12 U.S.C. § 5512(d). In many instances, regulations are adopted or amended to implement specific legislative initiatives or requirements passed by Congress. These statutory provisions may have been adopted by Congress in response to specific crises or market failures, industry concerns or recommendations, or to update the nation's banking laws to address changes in the marketplace. Changes also may be made in response to judicial decisions. In some cases, the U.S. federal banking agencies 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. *See, e.g.*, Interagency "Supervisory Guidance on Implementing Dodd-Frank Act Company Run Stress Tests for Banking Organizations with Total Consolidated Assets of More than $10 Billion but Less than $50 Billion" *79 Fed. Reg. 14153;* "Interagency Guidance on Leveraged Lending" *78 Fed.Reg 17766*.

EC5	**Principle 1: Responsibilities, objectives and powers**
Criterion	The supervisor has the power to: (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.
Legal Framework/	As discussed in detail under Principles 8, 10, and 28, the U.S. federal banking agencies 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. *See, e.g.*, 12 U.S.C. §§ 93a, 161(a) and (c), 324-26, 481, 483, 484, 602, 625, 1464(d) and (v), 1467(h), and 1467a(b)(2), 1817(a),

Practices and Procedures	1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 1867, 3105(c) and 3108. The CFPB has similar powers with respect to supervision of matters under its jurisdiction for bank and nonbank firms. *See* 12 U.S.C. §§ 5514 and 5515. Banks and their affiliates must provide supervisors with full and complete access to their books, records, and employees; failure to do so can result in the imposition of administrative sanctions. Specifically, bank records related to anti-money-laundering must be made available to a U.S. federal banking agency within 120 hours of a request. *See* 31 U.S.C. § 5318(k)(2). These duties extend to the foreign operations of banks and their affiliates; however, note that the laws of foreign host countries may restrict U.S. banks in such countries from sharing certain information with the U.S. banking agencies. Also, the agencies have full and complete access to the workpapers, reports, and other relevant materials of external auditors responsible for conducting an external audit of the banks. Institutions are subject potentially to 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. *See, e.g.*, 12 U.S.C. §§ 164, 1464(v), 1467a(r), and 1817(c)(4); 18 U.S.C. §§ 1001, 1007, 1517, and 1519. Banks and holding companies are required to file consolidated reports of condition with their primary federal supervisor on a quarterly basis. With limited exceptions, the content of these reports is made publicly available on a timely basis following submission, including through the FFIEC's website. The agencies require the periodic submission of a host of additional information on banks and their affiliates. A list of required reports, along with a description of the report contents and instructions for completion, is available on the FFIEC's website (http://www.ffiec.gov/forms031.htm). As discussed in detail under Principle 12, as an essential component of consolidated supervision, the Federal Reserve has and maintains a current 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 is the supervisor of bank holding companies, savings and loan holding companies, and nonbank financial companies designated by the FSOC. 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. As discussed in detail under Principle 13, 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 (IBA), 12 U.S.C. § 3101 *et seq.*, and its implementing regulations. *See* 12 CFR part 211, subpart B (Federal Reserve); 12 CFR part 28, subpart B (OCC); 12 CFR part 347, subpart B (FDIC).

EC6	**Principle 1: Responsibilities, objectives and powers**
Criterion	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: (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.
Legal Framework/ **Practices and Procedures**	As discussed at length under Principle 11 (on remedial powers of supervisors), the U.S. federal banking agencies have broad authority to take (or require the bank to take) remedial measures when, in their judgment, a bank or holding company is not complying with laws or regulations or is likely to be engaged or is 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, revoking or recommending the revocation of the banking license, and issuing monetary fines against institutions and individuals. In general, remedial measures are imposed according to the extent and severity of the problem being addressed. The CFPB has broad remedial authority with respect to violations of consumer protection laws, including the authority to obtain restitution and damages for consumers, limiting activities and functions of institutions and individuals, and the assessment of civil penalties.

EC7	**Principle 1: Responsibilities, objectives and powers**
Criterion	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 the bank and the banking group.
Legal Framework/ **Practices and Procedures**	As discussed in detail under Principle 12, as an essential component of consolidated supervision, the Federal Reserve has and maintains a current 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	Compliant

Comments	

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. (Reference documents:)

EC1	Principle 2: Independence, accountability, resourcing and legal protection for supervisors
Criterion	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.
Legal Framework/ **Practices and Procedures**	Each federal banking agency operates pursuant to an express statutory grant of authority and has clearly defined objectives and responsibilities. *See, e.g.,* 12 U.S.C. § 1 *et seq.* (OCC); 12 U.S.C. § 221 *et seq*. (Federal Reserve); 12 U.S.C. § 5491 *et seq.* (CFPB);and 12 U.S.C. § 1811 *et seq.* (FDIC). As discussed in Principle 11, 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. The agencies may take prompt remedial action and impose penalties. In practice, the range of tools is applied in accordance with the extent and severity of the problem being addressed. The U.S. federal banking agencies strive to promptly address deficiencies, problems, or violations of law or regulation at their respective supervised banks and holding companies. Federal statutes also provide for the operational independence of each federal banking agency. For the U.S. federal banking agencies, the organizing statutes, implementing regulations, guidelines, and other resources are (and are required to be) made publicly available, including on the website of each agency. *See* 5 U.S.C. § 552(a).

EC2	Principle 2: Independence, accountability, resourcing and legal protection for supervisors
Criterion	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.
Legal Framework/ **Practices and Procedures**	The heads of the U.S. federal banking agencies are appointed by the President with the advice and consent of the Senate to a set term in office. The Comptroller of the Currency is appointed to a five-year term. During his/her tenure he/she also serves as a director of the FDIC. In addition to the Comptroller and the Director of the Consumer Financial Protection Bureau, the FDIC's three remaining directors are appointed 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. On appointment by the President and with the advice and consent of the Senate, 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 agency 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); 12 U.S.C. § 1812 (FDIC) and 12 U.S.C. § 5491 (CFPB).

EC3	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.[20]
Legal Framework/ **Practices and Procedures**	Each of the U.S. federal banking agencies 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. Together, these requirements provide tangible and transparent measures of agency performance against statutory and stated performance targets.

EC4	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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.

[20] Please refer to Principle 1, Essential Criterion 1.

Legal Framework/ **Practices and Procedures**	As discussed in detail under EC5 of Principle 2, the U.S. federal banking agencies insist 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 federal banking agencies, help to ensure that these standards are met.

EC5	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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.
Legal Framework/ **Practices and Procedures**	The U.S. federal banking agencies insist 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 federal banking agencies, 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 the 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), 242, 244 (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. The Consumer Financial Protection Bureau has implemented additional ethical restrictions by regulation that further limit their employees. *See* 5 C.F.R. § 9401. Senior examination staff of the agencies generally are subject to a one year post-employment "cooling off" period with respect to entities they supervised. *See, e.g.*, 12 U.S.C. § 1820(k); 12 CFR 4, subpart E; "One-Year Restrictions on Post-Employment Activities of Senior Examiners" (OCC). 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. *See* 18 USC § 213. 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. U.S. federal banking agencies have administrative policies to ensure that appropriate codes of conduct are being followed. The agencies' 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. *See* Federal Reserve (*Federal Reserve Administrative Manual*, FRAM 5-041 and 5-035), OCC (OCC's Ethics Bulletin Board), and FDIC (FDIC Directive 2410.6 Standards of Ethical Conduct for Employees).

	Each agency has general requirements related to the initial appointment of an examiner, and promotion to commissioned examiner. In general, the guidance specifies standard information required for initial examiner appointments, such as professional qualifications, citizenship, and potential conflicts with banks, holding companies or other affiliates (*i.e.*, the prospective employee's completed conflicts of interest form), and outlines general requirements to be considered for appointment of an assistant examiner to commissioned examiners status, including proficiency tests that must be completed as well as practical supervisory work. The rigorous commissioning process for examiners promotes high standards of performance. References: Federal Reserve (FRAM 5-040), OCC (*Policies and Procedures Manual* (PPM 5400-7 Rev)), FDIC (Examiner Training and Development Policy, July 2007).

EC6	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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: (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 independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (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 (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).
Legal Framework/ **Practices and Procedures**	Each of the U.S. federal banking agencies is self-funding and, thus, is not subject to the congressional budget process or congressional appropriations.

EC7	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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.

Legal Framework/ Practices and Procedures	Each of the U.S. federal banking agencies undertakes an internal evaluation process to ensure its staff meets its supervisory need. This includes evaluation of hiring and retention programs to attract and retain staffs that have the necessary critical skills. In addition, the agencies approve annual training budgets and insist that staff undergo adequate and relevant training.

EC8	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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.
Legal Framework/ Practices and Procedures	By statute, 12 U.S.C. § 1820(d), the agencies, 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 eighteen months for banks that meet certain asset size thresholds and supervisory rating criteria. *See* 12 U.S.C. § 1820(d)(4). The U.S. federal banking agencies utilize a risk-based supervisory approach, and this is extensively detailed in supervisory guidance (*see, e.g.*, Federal Reserve SR letter 97-24, "Risk-Focused Framework for Supervision of Large Complex Institutions," and Federal Reserve SR letter 97-25, "Risk-Focused Framework for the Supervision of Community Banks") and examination manuals (*see, e.g.*, OCC Comptroller's Handbook on *Bank Supervision Process*, *Large Bank Supervision*, and *Community Bank Supervision*; Federal Reserve's *Commercial Bank Examination Manual (*section 1000.1); FDIC *Risk Management Manual of Examination Practices*. Special examinations are performed for certain bank operations such as trust operations (*see, e.g.*, FDIC's *Trust Examination Manual*.) As part of this approach, they apply supervisory programs that are appropriate to the geographic scope and degree of specialization, sophistication, risk, size, and complexity of the activities and organization of banks. Each program is staffed by supervisory personnel with training and experience applicable to the entities covered. In general, those entities presenting the greatest risk receive the most intense, frequent, and comprehensive scrutiny. All of the supervisory programs consider the best approaches available to mitigate risks.

EC9	**Principle 2: Independence, accountability, resourcing and legal protection for supervisors**
Criterion	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.
Legal Framework/Practices and Procedures	The federal banking agencies 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 federal banking agencies' heads and staff from liability for the violation of an individual's federal Constitutional rights in connection with employees' performance of discretionary functions, as long as the employees' conduct does not clearly violate established statutory or Constitutional rights.

	Lawsuits are permitted against federal banking agencies' employees for acts and/or omissions that cause injuries while acting within the scope of their employment pursuant to the Federal Tort Claims Act, 28 U.S.C. § 2679. In such a case, the United States 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 at the time of the incident giving rise to the tort claim. *See* 28 U.S.C. § 2679(d)(2). Moreover, an exception to the act protects employees from lawsuits involving the execution of a statute or regulation or the exercise or performance or the failure to exercise or perform a discretionary function or duty, whether or not the employee abused the discretion involved. *See* 28 U.S.C.§ 2680(a).

Assessment of Principle 2	Compliant
Comments	

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.[21]

EC 1	Principle 3: Cooperation and collaboration
Criterion	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.
Legal Framework	Unless authorized by law, it is a crime for an employee of the U.S. federal government to divulge, disclose, or make known in any manner trade secrets or other confidential business information collected in the course of employment or official duties. *See* 18

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

EC 1	Principle 3: Cooperation and collaboration
	U.S.C. § 1905. However, the U.S. federal banking agencies have broad statutory powers that allow them to share information with other domestic banking supervisors. *See, e.g.*, 12 U.S.C §§ 1817(a)(2)(A) and (C) (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) (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 agencies, the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Federal Trade Commission (FTC), and the Bureau of Consumer Financial Protection). The importance and necessity of maintaining the confidentiality of the information is highlighted in several statutory and regulatory provisions, as is the requirement that the information be used for lawful supervisory purposes. Each of the U.S. federal banking agencies has promulgated rules and policies implementing the civil and criminal statutes relating to the treatment of confidential supervisory and bank information. *See, e.g.*, 12 CFR part 4 (OCC); 12 CFR part 261 (Federal Reserve); 12 CFR 309.6 (FDIC) and 12 CFR part 1070 (CFPB).
Practices and Procedures	U.S. federal banking agencies have in place a number of formal and informal mechanisms for information sharing, which, among other things, are an integral part of supervisory programs providing for the comprehensive consolidated supervision of banks and holding companies. Domestically, the U.S. federal banking agencies 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 agencies, as appropriate. The agencies refer suspected criminal violations to the law enforcement authorities. The U.S. federal banking agencies exchange 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. The U.S. federal banking agencies 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 having significant insurance operations[22]. 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 banking agencies make information about bank subsidiaries of holding companies

[22] In 2000, the OCC and the National Association of Insurance Commissioners (NAIC) agreed to a model Memorandum of Understanding that provides for the sharing of insurance-related supervisory and enforcement information and the sharing of consumer complaints. This model agreement implements the functional regulation requirements in Gramm-Leach-Bliley Act and further increases cooperative efforts, supervisory coordination, and information sharing between the OCC and state insurance departments. As of June 2014, the OCC has executed these insurance information-sharing agreements with the insurance departments of 49 states, the District of Columbia, and Puerto Rico. U.S. federal banking agencies maintain ongoing communication with the states through periodic meetings with the NAIC, whose members consist of the state insurance regulators.

EC 1	Principle 3: Cooperation and collaboration
	available to the Federal Reserve and to each other. Other functional regulators also provide information to the banking agencies concerning regulated entities within U.S. banking groups that may have an adverse effect on the banks within the group. Such sharing is an integral part of the U.S. supervisory process. The arrangements are effective in practice. The FSOC, established by the DFA, 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. It facilitates regulatory coordination and information sharing among the member agencies, among other responsibilities. The Federal Reserve, OCC, CFPB and FDIC are members of the FSOC and fully participate at the staff level.

EC 2	Principle 3: Cooperation and collaboration
Criterion	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.
Legal Framework	As noted above, unless authorized by law, it is a crime for an employee of the U.S. federal government to divulge, disclose, or make known in any manner trade secrets or other confidential business information collected in the course of employment or official duties. *See* 18 U.S.C. § 1905. However, the U.S. federal banking agencies have broad statutory powers that allow them to share information with other foreign banking supervisors. The U.S. federal banking agencies, other than the Consumer Financial Protection Bureau, 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 sharing 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 also provide for on-site examinations by home authorities of cross-border operations in the host jurisdiction. All parties agree to maintain the confidentiality of information received. These memoranda of understanding and statements of cooperation have facilitated timely information sharing between the U.S. federal banking agencies and their foreign counterparts. The U.S. federal banking agencies have 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. Section 15 of the International Banking Act (12 U.S.C. § 3109) authorizes the U.S. federal banking agencies to disclose information obtained in the course of exercising their supervisory or examination authority to any foreign bank regulatory or supervisory authority. The disclosure must be appropriate and it cannot prejudice the interests of the United States. The U.S. federal banking agencies also have authority under section 8(v) of the Federal Deposit Insurance Act (12 U.S.C. 1818(v)(2)(C)) to assist foreign banking supervisors by investigating and collecting information and evidence. Such assistance may be provided only when 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 relating to banking matters or currency transactions administered or enforced by the requesting authority. The U.S. federal banking

EC 2	Principle 3: Cooperation and collaboration
	agencies also have authority to share information with others in appropriate cases. *See, e.g.*, 12 U.S.C § 326; 12 U.S.C. § 1817(a)(2)(C); 12 CFR part 4, subpart C; 12 CFR §309.6(b)(3). In addition, each U.S. federal banking agency has regulations governing disclosure of non-public information, including supervisory information. *See, e.g.*, 12 CFR part 4 (OCC); 12 CFR 211.27 and 12 CFR part 261 (Federal Reserve); and 12 CFR 309.6 and 12 CFR 347.207 (FDIC).
Practices and Procedures	Pursuant to the authorities outlined above, the U.S. federal banking agencies have entered into a number of memoranda of understanding, statements of cooperation, and other arrangements establishing frameworks for cooperation and the exchange of information in connection with their respective supervisory, resolution, and other responsibilities with foreign authorities. U.S. federal banking agencies are authorized to share relevant supervisory information with foreign banking supervisors even in the absence of a formal arrangement such as a memorandum of understanding, and in practice the U.S. federal banking agencies share significant information with foreign supervisors whether the U.S. federal banking agencies 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.

EC 3	Principle 3: Cooperation and collaboration
Criterion	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.
Legal Framework	As noted above, the U.S. federal banking agencies are subject to a general statutory prohibition on disclosing certain types of confidential financial information unless such sharing is specifically authorized by law. In addition, each agency's regulations, which have the force of law, require confidential treatment of a broad range of non-public supervisory information. The U.S. federal banking agencies are authorized by statute and regulation to share supervisory information with domestic and foreign banking and financial supervisors. *See, e.g.*, 12 U.S.C § 326; 12 U.S.C. § 1817(a)(2)(A) and (C); 12 U.S.C. § 1818(v)(2)(C); 12 U.S.C. § 3109; 12 CFR part 4; 12 CFR 211.27; 12 CFR part 261; 12 CFR 309.6; 12 CFR 347.207. In general, prior to engaging in information sharing, the U.S. federal banking agencies require assurances that the information will be used only for lawful supervisory purposes and will be kept confidential. Under the International Banking Act provision that specifically authorizes sharing with foreign banking supervisors, the U.S. federal banking agencies must determine that disclosure is appropriate and would not prejudice the interest of the United States. 12 U.S.C. § 3109(a). In addition, the U.S. federal banking agencies must obtain, to the extent necessary, the recipient's agreement to keep the information confidential to the "extent possible under applicable law." 12 U.S.C. § 3109(b).

EC 3	Principle 3: Cooperation and collaboration
Practices and Procedures	Memoranda of understanding and statements of cooperation between the U.S. federal banking agencies and foreign regulatory counterparts contain a number of requisite provisions to govern the confidentiality of information. These conditions normally include sharing to the extent reasonable, subject to relevant statutes, and grounds for denial; restricting usage to lawful supervisory purposes while holding information confidential; requesting prior consent before sharing with third parties; reacting to disclosures required by statute or legal process; and consenting to onward sharing with stated authorities per lawful supervisory responsibilities.

EC 4	Principle 3: Cooperation and collaboration
Criterion	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 (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.
Legal Framework/ Practices and Procedures	As noted above, the U.S. federal banking agencies are subject to a general statutory prohibition on disclosing certain types of confidential financial information unless such sharing is specifically authorized by law. In addition, each agency has implemented regulations and policies that restrict disclosure of confidential information. In the exercise of their supervisory responsibilities, the U.S. federal banking agencies generally share information with each other and with state banking authorities, as well as with other regulatory agencies such as securities and insurance regulators. In addition, as part of their supervisory responsibilities, the U.S. federal banking agencies notify and provide information to U.S. law enforcement authorities if information comes to their attention that indicates a possible violation of criminal law. The U.S federal banking agencies are able to deny demands for confidential information in their possession except in limited situations in which the U.S. federal banking agencies can be legally compelled to disclose otherwise confidential information. Such information may be subpoenaed by a court, a grand jury, or a committee of the U.S. Congress. If the agencies receive a subpoena from a litigant, an agency, or Congress for confidential supervisory information and decline to produce the information, the party that obtained the subpoena may go to court to enforce it. 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 U.S. federal banking agencies also must notify and provide information to U.S. law enforcement authorities if information comes to their attention that indicates a possible violation of criminal law. Each agency has implemented regulations and policies that restrict disclosure of confidential information. *See, e.g.*, 12 CFR part 4 (OCC); 12 CFR part 261 (Federal Reserve); 12 CFR 1070 (CFPB) and 12 CFR 309.6 (FDIC). Under the International Banking Act,

EC 4	Principle 3: Cooperation and collaboration
	confidential material provided by a foreign supervisor will have broad protection from compelled onward disclosure if certain conditions are met. The information must have been obtained from the foreign supervisor through procedures used in connection with the administration and enforcement of U.S. federal banking laws or pursuant to a memorandum of understanding or similar arrangement between a U.S. federal banking agency and the foreign supervisor. In addition, the foreign supervisor must in good faith determine and make a written representation to the U.S. federal banking agency that public disclosure of the information would violate the laws applicable to the foreign supervisor. If the requirements of the statute are met, the U.S. federal banking agencies could not be compelled to disclose such information except to duly authorized committees of the Congress or to comply with an order of a court of the United States in an action commenced by the United States or the U.S. federal banking agency. 12 U.S.C. § 3109(c). Disclosure may also be required under certain statutes that provide for notification and disclosure to other agencies in specific circumstances. *See, e.g.*, 12 U.S.C. § 1831m-1; 12 U.S.C. § 1831*l*; 31 U.S.C. § 714

EC 5	Principle 3: Cooperation and collaboration
Criterion	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.
Legal Framework	As noted above, the U.S. federal banking agencies have broad statutory authority to share information with other domestic and foreign financial authorities, which 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. Confidential supervisory information regarding recovery and resolution planning may be provided on a bilateral basis under existing memoranda of understanding (or similar arrangements) or in response to specific requests. Recovery and resolution planning also takes place in the crisis management groups (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.
Practices and Procedures	The U.S. federal banking agencies 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. federal banking agencies also participate as home and host authorities in supervisory colleges established for numerous banking institutions at which recovery plans created by those institutions are reviewed.

Assessment of Principle 3	Compliant
Comments	

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.

(Reference documents:

EC 1	Principle 4: Permissible activities
Criterion	The term "bank" is clearly defined in laws or regulations.
Legal Framework/ Practices and Procedures	State and federal 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 under either state or federal 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 and/or federal authorities.[23] State and federal laws also provide for the establishment of specialized institutions that engage in some activities also permitted to banks, but that generally are not called "banks". These include "savings associations," which provide "for the deposit of funds and for the extension of credit for homes and other goods and services." 12 U.S.C. 1464(a). They provide many of the services that banks provide and are supervised similarly.[24]

EC 2	Principle 4: Permissible activities
Criterion	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.
Legal Framework/ Practices and Procedures	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 (HOLA), and implementing regulations specify the permissible activities and transactions of national banks and federal savings associations. For national banks, see 12 U.S.C. §§ 24 (corporate powers), 24a (financial subsidiaries), 29 (power to hold real property), 92 (acting as insurance broker), and 92a (trust powers); 12 CFR parts 1

[23] For the purposes of this principle, the nomenclature for banks and holding companies described in the introduction does not apply.

[24] Because of the similarity in the regulation and supervision of savings associations, the federal banking agencies agreed to include them in the scope of this self-assessment. This self-assessment does not address several more specialized institutions that may engage in some traditional banking activities, including industrial loan companies, trust companies, credit unions, and single purpose banks. Collectively, these specialized institutions comprise only a small percentage of the U.S. banking market.

EC 2	Principle 4: Permissible activities
	(investment securities activities), 2 (sales of credit life insurance), 5 (initial and expanded activities), 7 (bank activities and operations), 9 (fiduciary activities), and 23 (leasing). For federal savings associations, *see* 12 U.S.C. §§ 1464(b) (deposits and related powers), 1464(c) (loans and investments), 1464(l) (retirement accounts) and 1464(n) (trust powers) and 12 CFR parts150 (fiduciary activities), 157 (deposit taking and related powers), 159 (subordinate organizations), and 160 (lending and investments).[25] The state laws under which state banks and state savings associations are chartered and authorized to operate specify (by statute and regulation) the permissible activities of the state banks and state savings associations. Federal law provides an "overlay" to the states' authority to determine the permissible activities and transactions of state chartered banks and savings associations. *See* 12 U.S.C. §§ 321-339a and 1828; 12 CFR parts 208, 303 and 362 (banks); 12 U.S.C. §§ 1463(c) and 1831e (savings associations). 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 and the banks or savings associations is in compliance with certain capital requirements. *See* 12 U.S.C. §§ 335, 371-378, 1831a (banks); 12 U.S.C. § 1831e (savings associations).

EC 3	Principle 4: Permissible activities
Criterion	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.
Legal Framework/ Practices and Procedures	No entity may operate as a "bank" and engage in banking operations in the United States without a charter from a state or federal banking agency. Federal law 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. *See* 12 U.S.C. § 378. In addition, states generally prohibit corporations from using the word "bank" in the corporation's name unless the corporation has a bank charter. Federal law also makes it a crime for an entity that engages in banking operations to make unauthorized use of those terms (*e.g.*, "national", "Federal", "United States", "reserve", or "Deposit Insurance") that indicate the entity has a federal banking charter, membership in the Federal Reserve, or federal deposit insurance.

EC 4	Principle 4: Permissible activities
Criterion	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.[26]

[25] The OCC has proposed to combine 12 CFR part 159 and certain sections of 12 CFR parts 150 and 160 with 12 CFR part 5. See 79 FR 33260 (June 10, 2014).
[26] The Committee recognizes the presence in some countries of nonbanking 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.

EC 4	Principle 4: Permissible activities
Legal Framework/ Practices and Procedures	All persons or entities engaged in demand deposit-taking are required to be subject to some degree of regulation, supervision, or oversight by state or federal authorities. *See* 12 U.S.C. § 378. Persons violating this requirement are subject to criminal penalties, including fines and imprisonment. In practice, most entities engaged in retail deposit-taking are licensed and subject to supervision as banks or savings associations.

EC 5	Principle 4: Permissible activities
Criterion	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.
Legal Framework/ Practices and Procedures	Collectively (through the Federal Financial Institutions Examination Council—or FFIEC) and separately, the U.S. federal banking agencies publish and regularly update information on banks and holding companies (domestic and foreign) subject to their jurisdiction. Data accessible through the FFIEC's National Information Center (NIC) includes detailed financial information (including detailed information on capital ratios) on all banks, savings associations, bank holding companies, and savings and loan holding companies, organizational charts for banks, bank holding companies and savings and loan holding companies, detailing all of their direct and indirect bank and nonbank subsidiaries; U.S. offices and bank subsidiaries of foreign banks; foreign branches and direct and indirect foreign bank and nonbank subsidiaries, and Edge and agreement corporation subsidiaries of U.S. banks; limited historical structural data; and functionality and data for conducting peer analyses for individual banks and holding companies. The financial information is populated by data obtained from regulatory reports (primarily, the Call Report) that are filed by banks and holding companies with the appropriate agencies quarterly and/or annually. The organizational structure data generally is updated on an event-generated basis. The website for each federal banking agency includes a link to the FFIEC website. Additional relevant data is published directly by the individual agencies. For the OCC, *see* Weekly Bulletin for National Banks[27] and FSA Bulletin for FSAs.[28] *See also, e.g.*, Quarterly Report of Structure and Share Data for U.S. Banking Offices of Foreign Entities[29] and the FDIC Quarterly.[30]

Assessment of Principle 4	Compliant

[27] http://www.occ.gov/topics/licensing/corporate-activities-weekly-bulletin/weekly-bulletin-2014.html
[28] http://www.occ.gov/topics/licensing/corporate-activities-weekly-bulletin/FSA-Bulletin-Guide-1.pdf
[29] http://www.federalreserve.gov/releases/iba/
[30] http://www.fdic.gov/bank/analytical/quarterly/

Comments	

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[31]) 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 organisation is a foreign bank, the prior consent of its home supervisor is obtained.

(Reference documents:

EC 1	Principle 5: Licensing criteria
Criterion	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.
Legal Framework/ Practices and Procedures	Banks, whether organized under federal or state law, are regulated and supervised by their licensing authority. They also typically are 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.*, for a license, federal deposit insurance, membership in the Federal Reserve) from more than one agency. Under well-established practices and procedures, the licensing and other banking authorities communicate and coordinate actions with respect to supervised entities. *See* Principle 3 (EC 1) for further information on information-sharing arrangements. This extends to decisions taken on related applications for licensing, deposit insurance, and Federal Reserve membership. Consultations among the U.S. federal banking agencies are required by law (statute or regulation) in some instances, and statutory provisions authorize the

[31] This document refers to a governance structure composed of a board and senior management. The Committee recognises 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.

EC 1	Principle 5: Licensing criteria
	sharing of relevant confidential information among supervisors. Often, the licensing authorities and the FDIC will conduct joint investigations on related licensing and deposit insurance applications. The licensing agencies generally have the authority to impose prudential conditions or limitations on newly licensed banks, as appropriate. *See*, e.g., 12 CFR 5.20 (OCC licensing procedures and requirements).

EC 2	Principle 5: Licensing criteria
Criterion	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.
Legal Framework/ Practices and Procedures	The authority to license banks is conferred by statute, and the criteria to be considered are set forth in statutes and/or regulations. The authority for licensing national banks is conferred on the OCC by statute, *see* 12 U.S.C. § 21 et seq. while the criteria to be considered and procedures to be followed are set forth in regulations issued by the OCC, *see* 12 CFR 5.20. By statute, the OCC is authorized to license federal savings associations and must make certain findings in order to approve a licensing application. *See* 12 U.S.C. § 1464(e). Procedures and additional factors to be considered in licensing federal savings associations are prescribed by OCC regulations. See 12 CFR part 116.[32] A State chartered institution, whether member or nonmember, is chartered by its respective state of jurisdiction. Under state statute, each of the states has the authority to license banks headquartered and operating within its jurisdiction of authority. Typically, the OCC and the states condition licensing approvals on the receipt of deposit insurance coverage by de novo banks. The factors to be considered by the FDIC in authorizing deposit insurance coverage are established by statute, 12 U.S.C. § 1816. The application and authorization procedures are set forth in FDIC regulation, *see* 12 CFR part 303, subpart B. Authority to establish and operate a bank is a privilege, not a right. Accordingly, each licensing agency has the authority to deny an application if the agency determines that the applicants have not met the established criteria or if the information provided is inadequate. Merely presenting evidence of compliance with each of the qualifying criteria is not sufficient for approval. The licensing agencies must evaluate the evidence and, in this respect, may conduct investigations and exercise independent judgment based on all of the information presented and collected in determining whether the qualifying criteria are adequately met in particular circumstances.

[32] The OCC has proposed to combine 12 CFR part 116 with 12 CFR part 5. *See* 79 FR 33260 (June 10, 2014).

EC 2	Principle 5: Licensing criteria
	Providing false or misleading information can provide a basis for civil, administrative, and criminal liability, and the penalties can include license revocation. *See* 12 U.S.C. § 93(a); *see also* 12 U.S.C. § 327 (forfeiture of Federal Reserve membership). In filing an application to establish a de novo bank, the organizers must certify that the information contained in the application has been examined carefully and that it is true, correct, and complete as of the date submitted. They also acknowledge that any misrepresentations or omissions of material facts with respect to the application may be grounds for denial or nullification of the license. Similar certifications are made on applications for federal deposit insurance coverage and for membership in the Federal Reserve.

EC 3	Principle 5: Licensing criteria
Criterion	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Legal Framework/ Practices and Procedures	Although not expressly required by statute, the criteria for issuing licenses are generally consistent with those applied in ongoing supervision. For example, in evaluating an application for approval to establish a national bank, OCC considers whether the proposed 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 also considers other factors, including the convenience and needs of the community to be served, the risk to the Deposit Insurance Fund, and whether the proposed bank's corporate powers are consistent with the purposes of the FDI Act and the National Bank Act. The U.S. federal banking agencies evaluate these same factors and others, sometimes in much greater detail, in the course of ongoing supervision.

EC 4	Principle 5: Licensing criteria
Criterion	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.[33] The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Legal Framework/ Practices and Procedures	Developing a complete understanding of the proposed legal, managerial, operational, and ownership structures of a bank, on both a solo and consolidated basis, is an essential component of the licensing process. Each banking agency is responsible for protecting the safety and soundness of banks. In order to fulfill this responsibility agencies 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

[33] Please refer to Principle 14, Essential Criterion 8.

EC 4	Principle 5: Licensing criteria
	supervision) the impact that those structures may have on the integrity of a bank. *See* "Joint Agency Statement on Parallel-Owned Banking Organizations" (April 23, 2002) (emphasizing the importance of structural assessments to safety-and-soundness evaluations). 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.

EC 5	Principle 5: Licensing criteria
Criterion	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.
Legal Framework/ Practices and Procedures	As part of the licensing process, applicants are required to identify prospective shareholders and key policymakers, including ultimate beneficial owners. The federal banking agencies may require each prospective principal shareholder (generally, those owning or controlling 10 percent or more of a class of a bank's shares) and key policymakers of a bank or holding company subject to federal supervision to complete an "Interagency Biographical and Financial Report," detailing information on their current and past work experiences and financial holdings. The appropriate agency 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. Assessments regarding principal shareholders primarily consider whether they have the ability to provide financial support to the proposed bank. A necessary part of this evaluation is identifying the sources of initial capital and ensuring transparency of ownership structures.

EC 6	Principle 5: Licensing criteria
Criterion	A minimum initial capital amount is stipulated for all banks.
Legal Framework/ Practices and Procedures	In general, a de novo bank must have a minimum amount of initial capital. For federal savings associations, this amount is at least $2 million, net of pre-opening expenses charged to capital after the institution commences business. *See* 12 CFR 1431.3(b).[34] Although the OCC does not stipulate a minimum dollar amount, *see* 12 CFR 5.20(h)(4), it requires that the de novo bank have sufficient net initial capital to support the projected volume and type of business to be conducted. Generally, the OCC and the

[34] The OCC has proposed to combine 12 CFR 143.3(b) with 12 CFR 5.20. *See* 79 FR 33260 (June 10, 2014).

EC 6	Principle 5: Licensing criteria
	FDIC require that the de novo bank have sufficient initial capital to provide for a tier 1 leverage capital ratio of no less than 8 percent throughout the first three years of operation, based on a realistic business plan. In most cases, newly insured banks require initial capital in an amount significantly higher than $2 million in order to enable the bank to reach a size and scale that enables it to operate and compete in its identified geographic market(s). Separately, the FDIC through its insurance authority to grant deposit insurance also requires a minimum amount of capital for all insured banks. Banks must retain a minimum stated amount of paid–in-capital funds as a condition of continuing deposit insurance coverage. For state nonmember institutions, the FDIC requires a minimum tier 1 leverage capital ratio of 8 percent 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 tier 1 leverage capital ratio requirement in excess of 8 percent. Prior to issuing a license and allowing a bank to commence operations, the licensing agency will ensure that the bank has the appropriate capitalization as proposed in the application and that the capital is available and ready to be deployed. Typically, the licensing agency will do this by verifying that the capital funds are fully available and on deposit with the institution's correspondent bank.

EC 7	Principle 5: Licensing criteria
Criterion	The licensing authority, at authorisation, 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.[35] 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.
Legal Framework/ Practices and Procedures	The licensing agencies carefully evaluate proposed directors and senior management with respect to expertise, integrity, and any potential for conflicts of interest. The agencies generally consider 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; (d) reputation for honesty and integrity; and (e) familiarity with the economy, financial needs, and 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,

[35] Please refer to Principle 14, Essential Criterion 8.

EC 7	Principle 5: Licensing criteria
	taking into account the circumstances and plans of the organization. Officers must show their ability to perform their proposed duties successfully. In conducting their evaluations, the licensing agencies rely on diverse sources of information, including (a) statements in the application regarding qualifications and expertise and all positions and offices currently held or to be held with the bank and its holding company and affiliates, if applicable; (b) organizational charts, business plans, and proposed policies and procedures in an effort to understand the role and expectations of directors and officers; (c) completed "Interagency Biographical and Financial Reports," including details on educational and professional experience and financial resources and dealings; and (d) completed fingerprint cards and background checks by law enforcement to determine if the individual has any criminal convictions and to verify financial condition and professional positions.

EC 8	Principle 5: Licensing criteria
Criterion	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.[36]
Legal Framework/ Practices and Procedures	As part of the licensing process, applicants are required to submit and the licensing agencies evaluate information on applicants' proposed business plan and financial projections. *See* 12 CFR 5.20(h) and 116.20.[37] 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. To evaluate corporate governance structures, the agencies must 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. They specifically determine how a bank's board of directors will approve, oversee, and communicate the bank's strategic objectives and otherwise exercise its fiduciary responsibilities.

[36] Please refer to Principle 29.
[37] The OCC has proposed to combine 12 CFR 116.20 with 12 CFR part 5. *See* 79 FR 33260 (June 10, 2014).

EC 8	Principle 5: Licensing criteria
	Board members are expected to exercise the duties of loyalty and care, and this requires directors and officers to act as prudent and diligent business persons in conducting the affairs of the bank. Directors are responsible for (a) selecting, monitoring, and evaluating competent management; (b) establishing business strategies and policies; (c) monitoring and assessing the progress of business operations; (d) establishing and monitoring adherence to policies and procedures required by statute, regulation, and principles of safety and soundness; and (e) making business decisions based on fully informed and meaningful deliberation. Also, in evaluating the effectiveness of corporate governance systems, the agencies consider the relationship between the proposed bank (its affiliates and holding company, if applicable) and any related parties, including directors, officers, organizers, agents, and principal shareholders. This extends to evaluating (a) potential conflicts of interest; (b) the terms and conditions of any transactions, contracts, or business relationships, and (c) the terms of compensation (including stock-based) plans. With respect to risk-management systems and policies, applicants must develop appropriate written investment, loan, funds management, and liquidity policies. They also must 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 bank. Similarly, additional documentation is required where markets to be entered are intensely competitive or economic conditions are marginal.

EC 9	Principle 5: Licensing criteria
Criterion	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.
Legal Framework/ Practices and Procedures	An evaluation of the inherent risks of the applicant's business model and reasonableness of the financial projections is paramount to the licensing process since a proposed de novo bank has no financial history on which to base a financial analysis. Also critical is an assessment of the adequacy of financial strength, including capital levels, to support the proposed strategic plan. The licensing agencies require estimates to be fully documented, supported, and based on established growth patterns in the applicant's specific

EC 9	Principle 5: Licensing criteria
	market area. They also evaluate 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. With respect to asset growth projections, the agencies generally review 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 licensing authority may require stress tests to show that the bank can maintain required minimum capital ratios and adequate profitability under adverse market conditions. In addition, with respect to financial projections the applicant must demonstrate that the proposed bank can achieve stabilized operations and be operated profitably. The applicant must demonstrate, through realistic and supportable estimates that the earnings of the applicant will be sufficient to generate an adequate profit within a reasonable period of time (typically, three years). As previously noted, the licensing agencies assess the suitability of principal shareholders (generally defined as those owning or controlling ten percent or more of a class of a bank's shares). This includes consideration of whether these shareholders have the ability to provide financial support to the proposed bank.

EC 10	Principle 5: Licensing criteria
Criterion	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.
Legal Framework/ Practices and Procedures	Foreign banks establishing a branch, agency, or a subsidiary bank in the U.S. must obtain approval both from the licensing authority (the OCC in the case of federal branches and agencies and national banks or the state banking authority in the case of state branches or agencies) 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 Federal Reserve and the licensing authority 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 Federal Reserve and the licensing authority 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).

EC 10	Principle 5: Licensing criteria
	A foreign entity that is not a BHC must obtain Federal Reserve approval before establishing or acquiring a subsidiary savings association in the United States. 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.

EC 11	Principle 5: Licensing criteria
Criterion	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Legal Framework/ Practices and Procedures	The U.S. federal banking agencies monitor the progress of all banks in meeting their business plans and strategic plans through on-site and off-site reviews. Due to their inherent risks, heightened attention is paid to de novo institutions and their progress in meeting their business plans and the 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, to the appropriate FDIC office 60 days 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.

Assessment of Principle 5	Compliant
Comments	

Principle 6: Transfer of significant ownership

The supervisor[38] 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.

(Reference documents[39]: *Parallel-owned banking structures*, January 2003; and *Shell banks and booking offices*, January 2003.)

EC 1	**Principle 6: Transfer of significant ownership**
Criterion	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest".
Legal Framework/ Practices and Procedures	Four federal statutes (and their implementing regulations) define significant ownership and controlling interest. They address proposed changes in ownership, control, or structure of banks. In each instance, the circumstances triggering the need for authorization are clear. The U.S. federal banking agencies have statutory authority under the Change in Bank Control Act (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. In general, prior authorization by the appropriate federal banking agency 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 centum or more of any class of voting securities of an insured depository institution." Id. §1817(j)(8)(B). Under limited circumstances a rebuttable presumption of control arises when a person, as a result of a proposed transaction, would own, control, or hold with the power to vote 10 percent or more of any class of voting securities. 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. The agency processing the notice is required by statute to consult with the appropriate state banking agency when the proposal involves a state-chartered bank. The agencies have authority to reject, or impose conditions on, proposed acquisitions based upon criteria enumerated in the CIBC Act. In general, prior authorization of the Federal Reserve is 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

[38] While the term "supervisor" is used throughout Principle 6, the Committee recognises that in a few countries these issues might be addressed by a separate licensing authority.
[39] Unless otherwise noted, all reference documents are BCBS documents.

EC 1	Principle 6: Transfer of significant ownership
	request for authorization. *See* 12 U.S.C. § 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. 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). 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). Acquisitions of a bank resulting from a merger transaction fall under the Bank Merger Act (BMA), 12 U.S.C. § 1828(c). The BMA requires prior approval of the appropriate U.S. federal banking agency before any bank can merge with an insured or an uninsured institution. The agency must consider the views of the U.S. Department of Justice regarding the competitive aspects of any proposed bank merger involving unaffiliated insured depository institutions. An agency may deny a merger application based upon the factors enumerated in the BMA, which include failure to meet the convenience and needs of the communities to be served, potential monopolies, the substantial lessening of competition, and financial and managerial resources, among other items. *See also* OCC rules regarding mergers at 12 CFR 5.33 (mergers involving national banks), 12 CFR part 146 (federal mutual savings associations), and 12 CFR 152.13, 152.14, and 152.15 (Federal stock savings associations).[40] Mergers of BHCs are acted upon under the BHC Act, and mergers of SLHCs are acted upon under the HOLA.

EC 2	Principle 6: Transfer of significant ownership
Criterion	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.
Legal Framework/ Practices and Procedures	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 required, but the CIBC Act exempts various categories of transactions from this requirement or requires 90-days after-the-fact notice for other categories of transactions. 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

[40] The OCC has proposed to combine 12 CFR parts 146 and 152 with 12 CFR part 5. *See* 79 FR 33260 (June 10, 2014).

EC 2	Principle 6: Transfer of significant ownership
	circumstances. *See* 12 CFR part 225, subpart B, and 12 CFR part 238, subpart B 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).[41]

EC 3	Principle 6: Transfer of significant ownership
Criterion	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.
Legal Framework/ Practices and Procedures	The federal banking agencies 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 federal banking 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, tend to create a monopoly, 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. In addition, criteria vary under the applicable statutes, such as the Bank Merger Act, Change in Bank Control Act, Bank Holding Company Act, and Home Owners' Loan Act, but the applicable 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, under these statutes the federal banking agencies generally must 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 Community Reinvestment Act. 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.

[41] The OCC has proposed to combine 12 CFR 163.22 with 12 CFR part 5. *See* 79 FR 33260 (June 10, 2014).

EC 3	Principle 6: Transfer of significant ownership
	If a change in significant ownership was based on false information, the federal banking agencies have various authorities 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).

EC 4	Principle 6: Transfer of significant ownership
Criterion	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.
Legal Framework/ Practices and Procedures	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. On-site or off-site examinations may include review of the ownership of significant shareholders.

EC 5	Principle 6: Transfer of significant ownership
Criterion	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.
Legal Framework/ Practices and Procedures	The agencies can and, as appropriate, do 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 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.

EC 6	Principle 6: Transfer of significant ownership
Criterion	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.

EC 6	Principle 6: Transfer of significant ownership
Legal Framework/ Practices and Procedures	The agencies expect controlling shareholders, or the bank(s) with which they are affiliated, to provide the agencies with timely notice of any material information that would impact the shareholders' continued suitability.[42] Federal statutes provide for sanctions if an institution submits false or misleading report or information to an agency. *See e.g.*, 12 U.S.C. § 164(a)(1)(B). A failure to disclose material information regarding a controlling shareholder when providing information to an agency could trigger these provisions. Also, federal banking agency supervisors meet with and, in that connection, generally assess the competence and integrity of officers and directors during on-site reviews. At times, these meetings and evaluations include principal shareholders. Nevertheless, these evaluations do not impact the affirmative disclosure obligation noted above. Further, section 19 of the FDIA, 12 U.S.C. § 1829, prohibits a person who has been convicted of any criminal offense involving dishonesty or a breach of trust, or money laundering, or has agreed to enter into a pre-trial diversion or similar program in connection with a prosecution for such offense, from becoming, or continuing as, an institution-affiliated party with respect to a bank or holding company; from owning or controlling, directly or indirectly, any bank; or otherwise participating, directly or indirectly, in the conduct of the affairs of any bank. Section 19(b) of the FDIA, 12 U.S.C. §1829(b), states that whoever knowingly violates the statute shall be fined not more than $1,000,000 for each day the prohibition is violated or imprisoned for not more than five years, or both.

Assessment of Principle 6	Compliant
Comments	

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.

(Reference documents):

[42]However, for the OCC, there is no formal licensing process to notify the supervisor of material changes in an existing major shareholder, unless a change in control notice is required.

EC 1	Principle 7: Major acquisitions
Criterion	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (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.
Legal Framework/ Practices and Procedures	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 established regulatory criteria for prior approval of major acquisitions or investments of banks and other investors (*e.g.*, Edge and agreement corporations). 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). 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. (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. With respect to federal savings associations, the OCC's regulations for federal savings associations on Lending and Investment, 12 CFR part 160, and Subordinate Organizations, 12 CFR part 159, [43] apply to both domestic and foreign activities and investments. The Bank Holding Company Act and section 10 of the Home Owners' Loan 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. *See* 12 CFR part 238. For both BHCs and SLHCs, there are clear regulatory directions as to when an application for prior supervisory approval is necessary (*See* 12 CFR 225.11; 12 CFR 225.24; 12 CFR 238.11) or when post-notice is sufficient for an acquisition (*See* 12 CFR 225.12; 12 CFR 225.22(a); 12 CFR 238.12).

EC 2	Principle 7: Major acquisitions
Criterion	Laws or regulations provide criteria by which to judge individual proposals.

[43] The OCC has proposed to combine 12 CFR part 159 with 12 CFR part 5. *See* 79 FR 33260 (June 10, 2014).

EC 2	Principle 7: Major acquisitions
Legal Framework/ Practices and Procedures	Major acquisitions and business combinations are subject to approval by federal authorities. 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, Change in Bank Control Act, Bank Holding Company Act, and Home Owners' Loan 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, Community Reinvestment Act compliance, anti-money laundering compliance, the impact of the proposal on the risk to the stability of the United States 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). Where acquisitions by a holding company of a bank require agency approval, applicable statutes and regulations provide review criteria. Federal banking agencies' regulations set forth preconditions for foreign activities and investments. The federal banking agencies 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.[44] 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.

EC 3	Principle 7: Major acquisitions
Criterion	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.[45] 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.
Legal Framework/ Practices and Procedures	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, including analysis of the host country supervision. When evaluating proposals by organizations to establish foreign operations (including an office or subsidiary), the federal banking agencies require the applicants to show, and the federal banking agencies must determine, that the laws or regulations of the foreign jurisdiction would not prohibit the federal banking agencies from obtaining information needed to determine and enforce compliance with U.S. banking laws. The federal banking agencies have the authority to deny a request for

[44] A small number of "grandfathered" SLHCs are not subject to this limitation.
[45] 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.

EC 3	Principle 7: Major acquisitions
	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).

EC 4	Principle 7: Major acquisitions
Criterion	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organisational resources to handle the acquisition/investment.
Legal Framework/ Practices and Procedures	For those proposals requiring authorization, the federal banking agencies consider whether the bank or holding company has the financial 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 to ensure compliance with BSA/AML requirements). 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*.[46]

EC 5	Principle 7: Major acquisitions
Criterion	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.
Legal Framework/ Practices and Procedures	The federal banking agencies are aware of the risks that nonbanking activities can pose to a bank and holding company. Significant nonbanking activities must be approved in advance by the applicable federal banking agencies. *See, e.g.*, OCC's Licensing Manual*: Investment in Subsidiaries and Equities and Subordinate Organizations booklets*.[47] 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. *See* 12 U.S.C. § 1843(c); 12 CFR part 225 subpart C; 12 CFR part 238 subpart F. There are statutory provisions designed to protect against a bank suffering losses in transactions with affiliates. *See* Principle 20 for further information. During examinations, federal supervisors 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, as appropriate, can take actions, formal and informal, to ensure that corrective action is taken and that the bank is protected. The federal banking agencies 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.

[46] http://www.occ.gov/publications/publications-by-type/licensing-manuals/index-licensing-manuals.html
[47] http://www.occ.gov/publications/publications-by-type/licensing-manuals/opsubs.pdf

EC 6	Principle 7: Major acquisitions
Additional Criterion	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. Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.
Legal Framework/ Practices and Procedures	The federal banking agencies 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.

Assessment of Principle 7	Compliant
Comments	

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; they also 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.

Overview: The U.S. federal banking agencies[48] are vested by the banking laws with broad authority to regulate and supervise banking organizations subject to their jurisdiction. This authority includes the power to examine banks and holding companies (including BHCs and

[48] The OCC is currently in the process of integrating its rules, policies and handbooks applicable to national banks and Federal savings associations. At this time not all rules, policies and handbooks have been updated; however, throughout this Principle, where appropriate in the context, references to banks, with regard to national banks should be construed to be generally applicable to Federal savings associations.

Principle 8: Supervisory approach

SLHCs) and their affiliates and to obtain information necessary for proper examination. The federal banking agencies employ a broad array of information from banking organizations, including financial data and information on their activities, operations, structure, corporate governance, risk management, and any other details necessary to determine and enforce compliance with applicable laws and ensure the risk-based supervisory approach focused on evaluating risk, identifying material and emerging problems, and ensuring that corrective action is taken before problems compromise the safety and soundness of the bank or holding company. *See* 12 U.S.C. §§ 93a, 161(a) and (c), 324-26, 481, 483, 602, 625, 1464(d) and (v), 1467(h) and 1467a(b)(2), 1817(a), 1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 3105(c), and 3108. Banks and holding companies must provide supervisors with full and complete access to their books and records; failure to do so can result in the imposition of administrative sanctions. Under the agencies' statutory examination authority, supervisors may review all books and records maintained by a banking organization subject to the agencies' supervision. This includes access to the banks' and holding companies' employees involved in a matter under review. These duties extend to the foreign operations of banks; however, it should be noted that the laws of foreign host countries may restrict U.S. banks and holding companies operating in such countries from sharing certain information with the U.S. banking agencies.

U.S. federal banking supervisors utilize their authorities to develop and maintain a thorough understanding of the operations of individual banks and holding companies, to evaluate and ensure the safety and soundness and compliance of individual banks and holding companies with applicable laws and regulations, and to monitor the stability of the banking and financial system. This includes a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance, and the ability to identify, assess, and address risks emanating from banks and the banking system as a whole. The supervisors 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.

With the passage of the Dodd-Frank Act (DFA), the federal banking agencies' supervisory authority over banking organizations has increased and become broader. Additionally, the agencies have promulgated rules to implement the DFA and initiated new supervisory programs to help in their oversight of banking institutions.

Forward-looking assessments of risk are a significant part of the supervisory approach. Such assessments take into account institutions' systemic importance. The Federal Reserve issued a Capital Plan Rule in November 2011 that requires all U.S.-domiciled, top-tier BHCs 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." *See* 76 Fed. Reg. 74631 (Dec. 1, 2011); "Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice," available at www.federalreserve.gov/bankinforeg/bcreg20130819a1.pdf. The OCC issued Bulletin OCC 2012-16, Guidance for Evaluating Capital Planning and Adequacy, on June 7, 2012, to provide details regarding expectations for national banks and federal savings associations regarding capital adequacy and provides guidance on capital planning. This bulletin also discusses the OCC's processes for evaluating a bank's capital planning and adequacy and, as appropriate, the various actions the OCC may take to ensure a bank's capital planning process and capital level remain adequate for its complexity and overall risks.

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 federal banking agencies 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. *See* http://www.federalreserve.gov/bankinforeg/bcreg20090424a1.pdf. 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. *See* http://www.federalreserve.gov/bankinforeg/ccar.htm. 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. Additionally, the DFA 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. *See* 12 U.S.C. § 5365(i). The federal banking agencies issued the annual company-run stress testing rules for banks and savings associations in October of 2012. See 77 Fed. Reg. 62378 and 62396 (Federal Reserve); 77 Fed. Reg. 62417 (FDIC); and 77 Fed. Reg. 61238. 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. *See* 79 Fed. Reg. 14153 (Mar. 13, 2014). The OCC also issued Bulletin OCC 2012-33 on October 18, 2012, to provide guidance to national banks and Federal savings associations with $10 billion or less in total assets on using test results to identify and quantify risk in loan portfolios and help establish effective strategic and capital planning processes.

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 microprudential supervision and regulation and macroprudential supervisory considerations to reduce potential threats to the financial system. *See* Supervisory Letter SR 12-17 (Dec. 17, 2012), *available at* http://www.federalreserve.gov/bankinforeg/srletters/sr1217.htm. 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 macroprudential supervisory approaches to address risk to financial stability. The guidance covers firms supervised by the Federal Reserve's Large Institution Supervision Coordinating Committee (LISCC),[49] also known as "LISCC firms." It also covers Large Banking Organizations (LBOs), which include domestic bank and savings and loan holding companies with consolidated assets of $50 billion or more that are not included in the LISCC portfolio. Additionally, the guidance covers Large Foreign Banking Organizations (Large FBOs) with combined assets of U.S. operations of $50 billion or more that are not included in the LISCC portfolio. The supervisory guidance embodied in SR 12-17 does not apply to regional or community banking organizations—regional organizations have total consolidated assets between $50 billion and $10 billion and community banking organizations have total consolidated assets of $10 billion or less.

[49] The LISCC was created to reorient its supervisory program in response to lessons learned from the financial crisis. In addition, the LISCC approach fulfills the DFA requirement that the Federal Reserve supervise systemically important financial institutions, the U.S. operations of foreign banking organizations, and nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve. The LISCC is a multidisciplinary body that oversees the supervision and evaluates the condition of supervised firms. The Operating Committee (OC) of the LISCC also develops cross-firm perspectives and monitors interconnectedness and common practices that could lead to greater systemic risk. *See* http://www.federalreserve.gov/bankinforeg/large-institution-supervision.htm.

Principle 8: Supervisory approach

Under the DFA, the Financial Stability Oversight Council (FSOC) was created to identify risks to financial stability, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system. The heads of the U.S. federal banking agencies are among the 10 voting members of the FSOC. The FSOC has the authority to designate nonbank financial companies for Federal Reserve supervision, and may also issue recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies. The FSOC may also make recommendations to the Federal Reserve regarding the establishment of prudential standards, including those for designated nonbank financial companies. *See* 12 U.S.C. §§ 5322, 5323, 5325, 5330, 5365, and 5366.

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. *See* 12 U.S.C. 1831*o*; 12 CFR parts 6 (OCC), 208 (Federal Reserve), and 324 and 325 (FDIC). 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. 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. *See* 12 U.S.C. §§ 5325(a), 5365(d); 12 CFR part 381. The DFA also provides for the orderly liquidation of covered financial companies. *See* 12 U.S.C. §§ 5384 -5386. Thus, the U.S. supervisory approach also includes a framework for early intervention and resolution of banking organizations if they become non-viable. *See* EC6 below for a discussion of resolution authority and planning requirements.

U.S. federal banking supervisors utilize the authorities discussed herein to develop and maintain a thorough 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 annually report 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. *See* 12 U.S.C. §§ 5330.

EC 1	**Principle 8: Supervisory approach**
Criterion	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (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. 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.

EC 1	Principle 8: Supervisory approach
Legal Framework	*See* Overview section above
Practices and Procedures	During each supervisory cycle, the U.S. federal banking agencies 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. The U.S. federal banking agencies maintain continuous off-site monitoring programs to determine and assess on an ongoing 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. The DFA-required supervisory stress tests and the Federal Reserve's Capital Plan Rule are the primary tools for identifying and assessing risk to capital at large BHCs. Further, newly implemented requirements for all institutions regulated by the Federal Reserve, the FDIC, and the OCC with total consolidated assets greater than $10 billion provides important information in the supervisory assessment of risks for these institutions. The Federal Reserve utilizes a ratings system known as RFI to assign supervisory ratings for BHCs on a consolidated basis. The R rating component provides a framework for assessing and assigning risk ratings across BHCs. In addition, 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 foreign banking organizations. Each agency has additional tools and systems, such as horizontal examinations of a group of banks that it uses to supplement these interagency tools. *See* EC 2 for additional information on quarterly monitoring practices. Also *see* 12 U.S.C. § 1831m(b)(2)(B)(i), addressing the annual management attestation of internal controls framework.

EC 2	Principle 8: Supervisory approach
Criterion	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.
Legal Framework	*See* Overview section above.
Practices and Procedures	Please see discussion in the overview of this Principle of Federal Reserve guidance provided under SR 12-17 that responds to this EC's expectations regarding a "well-defined methodology to establish a forward-looking view of the profile." U.S. federal banking agencies use their authority to conduct 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). 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* Federal Reserve's BHC Inspection Program). The Consumer Financial Protection Bureau (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 it is responsible for confirming that these organizations appropriately manage their consumer compliance and programs for these laws. The Federal Reserve, FDIC, and OCC have primary supervisory and enforcement authority with respect to (a) these same federal consumer financial protection laws as applied to banking organizations with assets of $10 billion or less and (b) 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. 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 ongoing cash needs, and sensitivity of a banking organization's earnings and capital position to market risk. For many larger banks and holding companies, 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.[50] 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.

[50] Formal ratings are assigned to BHCs per SR 04-18 and indicative ratings are assigned to SLHCs per SR 13-08.

EC 2	Principle 8: Supervisory approach
	During the period of time in between full-scope, on-site examinations, the agencies maintain 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. For additional information on the agencies' off-site surveillance procedures and analytical tools, *see* Federal Reserve SR letters 06-2 and 95-43; and OCC *Community Bank Supervision* and *Large Bank Supervision Handbooks*, and PPM 5000-34. For example, the OCC uses a variety of monitoring tools, including the Canary Early Warning System; monitoring of foreign exposures; stress testing under different scenarios; quarterly reports obtained from large banks that provide granular, loan level detail on various loan portfolios such as residential mortgages; and annual underwriting surveys. The risk assessment system (RAS), which is a foundational element of the OCC's risk-based supervisory approach, provides a structured process for defining and evaluating the eight categories of risk inherent in the business of banking: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. The RAS supports the assessment of a national bank's or Federal savings association's risk profile, and it provides a consistent means of measuring risk and assessing the quality of risk management practices. OCC examiners use the risk assessment to set strategy and the scope of their activities, to inform the Statistical CAMELS ratings, and to communicate areas of supervisory concern. The FDIC maintains several monitoring systems such as Large Institution Risk Review, Real Estate Stress Test, and Growth Monitoring System. *See* EC5 for more information.

EC 3	Principle 8: Supervisory approach
Criterion	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Legal Framework	*See* Overview section above
Practices and Procedures	During regular on-site examinations, the U.S. federal banking agencies and the CFPB complete a series of testing procedures, contained in the agencies' examination and inspection manuals, to confirm banks' and holding companies' compliance with

EC 3	Principle 8: Supervisory approach
	prudential regulations and other legal requirements. In addition, compliance with some rules is monitored on an ongoing 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. federal banking agencies 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.

EC 4	Principle 8: Supervisory approach
Criterion	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.
Legal Framework	*See* Overview section above.
Practices and Procedures	The Federal Reserve expects large complex BHCs to hold sufficient capital to continue lending to support real economic activity, even under adverse economic conditions. Stress testing is one tool that helps bank supervisors' measure whether a BHC has enough capital to support its operations throughout periods of stress. The Federal Reserve conducts annual supervisory stress tests of large complex BHCs to evaluate whether these institutions maintain capital, on a total consolidated basis, sufficient to absorb losses and continue operations by maintaining ready access to funding, meeting its obligations to creditors and other counterparties, and to continue to serve as a credit intermediary under adverse economic and financial conditions. The Federal Reserve previously highlighted the use of stress tests as a means of assessing capital sufficiency under stress during the 2009 Supervisory Capital Assessment Program (SCAP) and the annual Comprehensive Capital Analysis and Review (CCAR) exercise beginning in 2011. The Federal Reserve is required to conduct an annual supervisory stress test on all large BHCs and nonbank financial companies designated by the Financial Stability Oversight Council (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. In addition to the annual supervisory-run stress tests conducted by the Federal Reserve at HCs with total consolidated assets of more than $50 billion, the FDIC, the OCC, and the Federal Reserve require an annual company-run stress test to be conducted at

	the bank and HC level for certain large financial institutions (with total consolidated assets of more than $10 billion). Further, for HCs with total consolidated assets of $50 billion or more, 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. On an ongoing basis, U.S. federal banking agencies 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 utilize the submitted financial data to identify emerging problems in supervised banks and holding companies, are also used to monitor banking industry trends. *See* Principle10 for details on Supervisory Reporting requirements. 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 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 Financial Stability Oversight Council, 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 participate at the staff level. The agencies also consult regularly with the supervisors of major non-bank organizations in the United States, including the Securities and Exchange Commission (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.
EC 5	**Principle 8: Supervisory approach**
Criterion	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.

Legal Framework	*See* Overview section above
Practices and Procedures	Each of the U.S. federal banking agencies employs well defined 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, the details of which are available through each agency. Through their ongoing 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 which evaluate whether the direction of a bank's risk profile is increasing, decreasing, or stable. 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. The Financial Stability Oversight Council (FSOC), established by the DFA, 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. It facilitates regulatory coordination and information sharing among the member agencies, among other responsibilities. The Federal Reserve, OCC, CFPB and FDIC are members of the FSOC and fully participate at the staff level.

EC 6	**Principle 8: Supervisory approach**
Criterion	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 ongoing business.
Legal Framework	*See* Overview section above

EC 6	Principle 8: Supervisory approach
Practices and Procedures	As discussed in the Overview, 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. 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. *See* 12 U.S.C. §§ 5325(a), 5365(d); 12 CFR Part 381. The DFA also provides for the orderly liquidation of covered financial companies. See 12 U.S.C. §§ 5384 -5386. To implement the DFA's requirement for resolution plans for certain banking organizations, *see* 12 U.S.C. § 5365(d), the Federal Reserve and FDIC issued regulations in November 2011. The regulations require all domestic bank holding companies and foreign banking organizations (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. *See* 12 CFR part 381. 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. 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.

EC 7	Principle 8: Supervisory approach
Criterion	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.
Legal Framework	*See* Overview section above

EC 7	Principle 8: Supervisory approach
Practices and Procedures	See EC6 above.

EC 8	Principle 8: Supervisory approach
Criterion	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.
Legal Framework	When bank-like activities are performed outside the regulatory perimeter, the federal banking agencies 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. 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.
Practices and Procedures	The U.S. federal banking agencies 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. U.S. federal banking agencies 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). 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

EC 8	Principle 8: Supervisory approach
	deviations or material changes from the plan. Further, U.S. federal banking agencies may impose notification requirements formally or informally as determined by supervisors.

Assessment of Principle 8	Compliant
Comments	

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.

Overview

The U.S. federal banking agencies have deployed resources on a proportionate basis in satisfaction of this Principle. The agencies have segmented the banking organizations under their respective jurisdictions, taking into account risk profiles and systemic importance. Each agency has dedicated resources proportionately to the size and complexity of the supervised organization.

The OCC staff is guided primarily by three supervision based *Comptroller's Handbook* booklets, and other booklets on specific topics, as applicable. The *Bank Supervision Process* (9/07), *Larger Bank Supervision (1/10)*, and *Community Bank Supervision* (1/10) booklets serve as the basis for providing supervisory guidance.

Since the financial crisis, the Federal Reserve created the Large Institution Supervision Coordinating Committee (LISCC)[51] to oversee the supervision of the largest, most systemically important financial institutions in the United States. 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 supervision is supported by the Quantitative Surveillance (QS)

[51] The LISCC is composed of senior officers throughout the Federal Reserve System who represent various functions at the Federal Reserve and at the Federal Reserve Banks.

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 utilizes horizontal examinations among LISCC firms and a high degree of consultation and coordination among supervisors from the Federal Reserve System of LISCC firms.

An example of heightened supervisory scrutiny that takes account of the risk profile and systemic importance of banks can be found in the tailoring of stress testing. *See* Principle 8 for a description of the agencies' stress testing framework.

Supervisory Authorities and On-site and Off-site Supervision

Pursuant to the authorities cited in the overview to Principle 8, the U.S. federal banking agencies complement regulatory standards designed to ensure the safe and sound operation of banks and holding companies with a risk-focused supervisory approach. 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. *See* 12 U.S.C. §§ 481, 1463(a)(1), and 1820(d). Smaller banks that satisfy certain qualifying criteria, including having less than $500 million in total assets, may be examined on an 18-month cycle. *See* 12 U.S.C. § 1820(d)(4). The OCC maintains a supervision strategy for each of its nationally chartered banks and federal savings associations, and each of the U.S. federal banking agencies retains authority to examine a bank as frequently as it deems necessary. For example, the FDIC would conduct annual examination of problem institutions less than $500 million, and depending on the nature of the problems, conduct more frequent visitations. *See* 12 U.S.C. 1820(d)(4).

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. *See* 12 U.S.C. § 1467a(b)(4). In addition to examining national banks and their affiliates, the OCC examines federal branches and federal agencies of foreign banks. *See* 12 U.S.C. §§ 3102(b). The Federal Reserve alternates with state regulators in examining state licensed branches and agencies of foreign banks. *See* 12 U.S.C. §§ 1867 and 3105(c)(1)C). All of the U.S. federal banking agencies examine bank service companies. *See* 12 U.S.C. §§ 1464(d)(7) and 1867.

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 forth in sections 23A and 23B of the Federal Reserve Act. *See* 12 U.S.C. §§ 371c and 371c-1; *see also* 12 C.F.R. part 223 (Regulation W).

The primary federal banking supervisor makes risk assessments with respect to the bank's operations. For larger banks and holding companies, 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. As discussed more fully in Principle 11, 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. *See* 12 U.S.C. §§ 1813(q) and (u), and 1818.

The primary federal banking agencies generally have the authority to examine affiliates of the bank under their supervision. *See, e.g.,* 12 U.S.C. §§ 338 (examinations of affiliates of state member banks); 481 (examinations of affiliates of national banks); 1464(d)(1)(B) (examinations of affiliates of savings associations); 1820(b)(4) (examinations of affiliates of state nonmember banks)); 1467a(b)(4) (subsidiaries of SLHCs); 1844(c)(2) (subsidiaries of BHC s). 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.[52] The Federal Reserve has the authority to examine bank subsidiaries of BHCs; 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 SLHCs 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 federal banking agencies 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. *See* 12 U.S.C. §§ 1831v and 1844(c)(4).

With respect to insured depository institutions with total assets greater than $10 billion and any affiliates thereof, and insured credit unions with total assets of more than $10 billion and any affiliates therefore, the Consumer Financial Protection Bureau (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. *See* 12 U.S.C. §§ 5515(a) and (b)(1). The U.S. federal banking agencies 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

[52] The OCC is currently updating all the Comptroller's Handbook booklets. The Bank Supervision Process booklet has not been updated yet to reflect DFA changes, including Federal savings associations.

action, take into consideration concerns, if any, raised by the other agency in its comments. *See* 12 U.S.C. §§ 5515(b)(2) and (e)(1). 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.

The U.S. federal banking agencies 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. *See* 12 U.S.C. § 1831m-1.

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, 12 U.S.C. § 1820(b)(3) gives the FDIC 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.

As required by Section 165(i) of the Dodd-Frank Act, the agencies have adopted rules requiring various bank holding company 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 ongoing 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.

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. *See* 12 U.S.C. § 5365(i); 12 CFR part 46 (OCC); 12 CFR part 325, subpart C (FDIC); 12 CFR part 252 (Federal Reserve).

See Principle 8 "Overview" for citations to statutes granting the U.S. federal banking agencies authority to receive from banks, holding companies, and certain nonbank organizations, reports on the institutions' condition and finances and to submit to the institutions reports of examination.

EC 1	Principle 9: Supervisory techniques and tools
Criterion	The supervisor employs an appropriate mix of on-site[53] and off-site[54] 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.
Legal Framework	*See* Overview.
Practices and Procedures	The U.S. federal banking agencies apply a risk-based supervisory approach that focuses on evaluating risks, identifying material and emerging problems, and ensuring that these banks and holding companies take corrective action before problems compromise their safety and soundness. The agencies accomplish this through a mix of both on- and off-site supervisory activities. As described in the Overview, under U.S. law, the agencies conduct full-scope on-site examinations of banks and banking groups 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) to evaluate the condition of banks, their inherent risk, and the corrective measures necessary to address supervisory concerns. The federal banking agencies and the Consumer Financial Protection Bureau (CFPB) also conduct regular Consumer Compliance examinations of banks to confirm that the organization is appropriately managing its compliance risk and complying with U.S. consumer protection laws and regulations. The CFPB has supervisory authority and primary enforcement authority with respect to federal consumer financial protection laws as applied to banking organizations with assets greater than $10 billion. The FRB, FDIC, and OCC have primary supervisory and enforcement authority with respect to these same federal consumer financial protection laws as applied to banking organizations with assets of $10 billion or less. At the conclusion of each full scope exam and/or annual supervisory cycle, the board of directors receives from a federal banking agency a Report of Examination (ROE) that conveys the overall condition and risk profile, provides conclusions on the assigned supervisory ratings, discusses significant deficiencies, violations, and excessive risks, and details corrective action to which the board or management has committed. In its supervisory role, the CFPB issues a supervisory letter for each target review it conducts and an ROE with a compliance rating for each point-in-time examination or roll up of several target reviews. Supervisory letters and ROEs, as applicable, discuss significant deficiencies, violations, and significant risks, and detail corrective action to which the board or management has committed. In its role as holding company supervisor, the Federal Reserve conducts inspections and makes risk assessments of holding companies' operations. *See* 12 U.S.C. § 1844(c) (Federal Reserve). While most banks and holding companies agree to promptly address criticisms or

[53] 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.

[54] 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.

EC 1	Principle 9: Supervisory techniques and tools
	deficiencies that arise through the examination process, the agencies also have a variety of informal and formal enforcement tools that they can use to effect corrective actions. *See* Principle 11 for information on corrective and sanctioning powers of supervisors. During the period between on-site examinations, the agencies conduct ongoing off-site surveillance of each supervised bank and holding company and may follow up with additional on-site work and testing. Generally, the balance between on- and off-site supervisory activities is dictated by the condition and size of the subject bank or holding company, with more on-site examination work being conducted at larger or more problematic banks and holding companies. At the largest and most systemically critical banks and holding companies, the agencies' Central Point of Contact (CPC) or Examiner-in-Charge (EIC) teams provide for an ongoing, on-site presence and continuous monitoring program. For other banks and holding companies, portfolio managers are assigned responsibility for developing and executing examination strategies. The agencies monitor the success of their on- and off-site supervisory efforts in promptly identifying and addressing deteriorating banks and holding companies on a continuous basis and make adjustments to off-site surveillance programs and supervisory approaches as needed to improve their effectiveness. *See* Federal Reserve SR letters 06-2 and 97-24; OCC *Bank Supervision Process* booklet and PPM 5000-34 (REV) relating to the Canary System.

EC 2	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	*See* Overview.
Practices and Procedures	Each of the U.S. federal banking agencies 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. *See* Federal Reserve SR letter 06-2 (Feb. 2, 2006); OCC *Bank Supervision Process* booklet; FDIC RMMEP section 1.1: FDIC Case Managers Procedures Manual section 13, and CFPB Examination Manual, section Part 1.

EC 3	Principle 9: Supervisory techniques and tools
Criterion	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 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 reliable[55] and obtains, as necessary, additional information on the banks and their related entities.
Legal Framework	*See* Overview. *See also* statutory references in Principle 8.
Practices and Procedures	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 ongoing 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. Continuous monitoring is also an important supervisory tool at the largest U.S. banking 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. 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. For banks over $1 billion, section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (*see* 12 U.S.C. § 1831m(b)) 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. Section 404 of the Sarbanes-Oxley Act, 15 U.S.C. § 7262(b), 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. The CFPB reviews, among other things, books and records, compliance policies and procedures, and transaction files for a specified period. 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.

[55] Please refer to Principle 10.

EC 3	Principle 9: Supervisory techniques and tools
	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 plan accordingly. *See* Principle 11 for details on corrective and sanctioning powers of supervisors.

EC 4	Principle 9: Supervisory techniques and tools
Criterion	The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as: (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. The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.
Legal Framework	*See* Overview. *See also* statutory references in Principle 8.
Practices and Procedures	As part of formal, off-site monitoring programs, the U.S. federal banking agencies 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. Examination staffs also use 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

EC 4	Principle 9: Supervisory techniques and tools
	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. The supervisors use a range of supervisory activities to maintain a comprehensive understanding and assessment of each firm, including: 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, see the Overview and EC5. 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 foreign banking organizations) 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 of a firm's failure or material weakness.

EC 4	Principle 9: Supervisory techniques and tools
	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.

EC 5	Principle 9: Supervisory techniques and tools
Criterion	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate 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 vulnerabilities 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.
Legal Framework	*See* Overview. *See also* statutory references in Principle 8.
Practices and Procedures	In addition to the supervisory actions described in EC 4, above, the supervisory agencies use analysis from their own staff economists and financial analysts, who monitor trends in domestic US 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 in the Fall. 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 Community Affairs Letters, Handbooks and Examination Manual updates are all utilized. 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 ongoing 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

EC 5	Principle 9: Supervisory techniques and tools
	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. In addition to the supervisory-run stress tests conducted by the Federal Reserve, the FDIC, the OCC, and the Federal Reserve require an annual company-run stress test to be conducted at the bank level for certain large financial institutions (with total consolidated assets of more than $10 billion). 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.

EC 6	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	*See* Overview.
Practices and Procedures	The U.S. federal banking agencies 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 audit function.

EC 7	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	*See* Overview.
Practices and Procedures	Throughout the supervisory process, the U.S. federal banking agencies and the CFPB 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 provides the bank's or holding company's board of directors a written ROE for review by all directors and senior officers. The ROE 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; and addresses compliance with consumer financial protection laws and regulations and the Community Reinvestment Act. The ROE also discusses significant deficiencies, violations, and excessive risks, and details corrective action to which the board or management has committed. The CFPB issues a supervisory letter for each target review it conducts and an ROE with a compliance rating for each point-in-time examination or roll up of several target reviews. Supervisory letters and ROEs, as applicable, discuss significant deficiencies, violations, and significant risks, and details corrective action to which the board or management has committed. The CFPB uses the FFIEC Uniform Consumer Compliance Rating System. Under this system, after an examination a supervised entity is assigned a confidential consumer compliance rating based upon an evaluation of its present compliance with Federal consumer financial protection law and the adequacy of its systems designed to ensure compliance on a continuing basis. The rating system is based upon a scale of 1 through 5 in increasing order of supervisory concern 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 ongoing, on-site presence to enable monitoring by CPC and EIC teams.

EC 8	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	At the conclusion of regularly scheduled on-site examinations, federal banking supervisors meet with senior management and the board of directors to discuss findings of the examinations and communicate supervisory ratings assigned.
Practices and Procedures	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 examination cycle. For more information on the agencies' communication of examination findings. *See* Federal Reserve SR letter 13-13/CA letter 13-10 and the OCC *Bank Supervision Process* Handbook. The CFPB 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.[56] 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. *See* Principle 11 for a more detailed description of corrective and sanctioning powers of supervisors. 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. *See* Interagency Policy Statement on Examination Coordination and Implementation Guidelines.

EC 9	Principle 9: Supervisory techniques and tools
Criterion	The supervisor undertakes appropriate and timely follow-up to verify 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.
Legal Framework	*See* Overview.
Practices and Procedures	U.S. supervisory authorities undertake appropriate and timely 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.

[56] Formal ratings are assigned to BHCs per SR 04-18 and indicative ratings are assigned to SLHCs per SR 13-08.

EC 9	Principle 9: Supervisory techniques and tools
	For instance, through the supervision process, including onsite and off-site examination activities, staff may identify Matters Requiring Attention (MRAs) and Matters Requiring Immediate Attention (MRIAs) for institutions supervised by the Federal Reserve) by banks and holding companies. MRAs/MRIAs are detailed in ROEs and/or other communications to management and as warranted, boards of directors. Depending on the significance of the MRAs/MRIAs identified, an informal or formal enforcement action may be issued. MRAs/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* Principle 11. U.S. supervisory authorities conduct periodic (*e.g.*, quarterly, semi-annual) onsite reviews or utilize ongoing monitoring to ensure that banks and holding companies correct any weaknesses identified in the supervisory process in an effective and timely manner.

EC 10	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	*See* Overview.
Practices and Procedures	U.S. federal banking agencies require banks to notify them 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. 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 ongoing communication between supervisors and institutions described under EC 4, above, institutions are expected to promptly notify supervisors of material adverse developments. Periodic review of management reports by supervisors helps to ensure that communications of these events occurs on a timely basis. 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 Federal Reserve Board's Regulation Y, 12 CFR Part 225, which addresses changes in ownership and control of financial and bank holding companies as well as banks supervised by the Federal Reserve. Regulation Y also contains restrictions on, and reporting requirements for, non-bank activities of a bank holding company and/or its subsidiaries as well as non-bank activities of foreign banks doing business in the United States. Regulation Y also contains the requirements for large bank holding companies to submit annual capital plans for review. Regulation H, 12 CFR part 208, contains the requirements for state member

EC 10	Principle 9: Supervisory techniques and tools
	banks, activities they may engage in, prompt corrective action for institutions where capital is inadequate, and financial record keeping and reporting requirements. National Bank permissible activities are discussed in "Activities Permissible for a National Bank, Cumulative," an OCC publication that summarizes permissible activities and provides references to the underlying enabling legislation for the activity *available at* http://www.occ.gov/publications/publications-by-type/other-publications-reports/bankact.pdf. 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. *See, e.g.*, 12 U.S.C. § 36 and 12 C.F.R. § 5.30 (branching) and 12 U.S.C. §92a and 12 C.F.R. § 5.26 and part 9 (fiduciary activities). Similar requirements exist under most state laws for state-chartered banks. The FDIC publishes similar regulations for state-chartered banks that are not members of the Federal Reserve System. In addition to statutory requirements for reporting or approving new businesses, 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.

EC 11	Principle 9: Supervisory techniques and tools
Criterion	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.
Legal Framework	The supervisors perform supervisory activities themselves and sometimes rely on the examination reports of other federal banking agencies. *See* Overview.
Practices and Procedures	U.S. federal banking agencies do not utilize independent third parties, such as auditors, to conduct their prudential supervisory activities of banks and holding companies.

EC 12	Principle 9: Supervisory techniques and tools
Criterion	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Legal Framework	*See* Overview to this Principle and Overview to Principle 8.
Practices and Procedures	U.S. federal banking agencies utilize 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 Center (NIC) database that contains financial, regulatory, and structure report data for supervised domestic financial companies and foreign financial institutions with a presence in the United States, as well as their subsidiaries and branches around the world. In addition, the Federal Reserve uses C-SCAPE (Consolidated Supervision, Comparative Analysis, Planning and Execution) which 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 The OCC uses several tools to support ongoing 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 utilizes a combination of applications, including the Large Bank Institutional Database (LBID), eDocs and 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, ongoing 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.

EC 12	Principle 9: Supervisory techniques and tools
Additional Criterion	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.
Legal Framework	The Government Accountability Office is authorized to conduct periodic audits of the US 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. *See* 12 U.S.C. § 3910(a). Additionally, the Office of Inspector General (OIG) for each of the U.S. federal banking agencies 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. *See* 5 U.S.C. app. 3, § 2. The OIG for the Federal Reserve has audit and investigative authority with respect to the CFPB. 5 U.S.C. app. 3.
Practices and Procedures	The U.S. federal agencies have a framework for periodic independent review of the adequacy and effectiveness of the range of its available supervisory tools and their use, and make changes as appropriate. In October 2013, at the request of the Comptroller of the Currency, a group of international regulators conducted an independent review of the OCC's supervision of large and midsize banks. The review provided key recommendations in both process and policy related areas for the OCC to consider. Beginning in February 2014, the OCC began its peer review project to address the recommendations. The project team is in process of developing implementation plans. The report, An International Review of OCC's Supervision of Large and Midsize Institutions (12/4/2013), can be located on the OCC website. As part of their membership in the Financial Stability Board and the Basel Committee on Banking Supervision, U.S. Federal Agencies have taken part in FSB peer reviews which focus on the implementation and effectiveness of international financial standards developed by standard-setting bodies (SSBs) and of policies agreed within the FSB. The objectives of the reviews are to encourage consistent cross-country and cross-sector implementation; to evaluate (where possible) the extent to which standards and policies have had their intended results; and to identify gaps and weaknesses in reviewed areas and to make recommendations for potential follow-up (including via the development of new standards) by FSB members. Country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector policies in achieving the desired outcomes in a specific FSB member jurisdiction. They examine the steps taken or planned by national authorities to address IMF-World Bank Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSCs) recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or

EC 12	Principle 9: Supervisory techniques and tools
	other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership.

Assessment of Principle 9	Compliant
Comments	

Principle 10: Supervisory reporting

The supervisor collects, reviews and analyses prudential reports and statistical returns[57] 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.
(Reference documents):

Overview

As noted in the overview to Principle 9, off-site surveillance is a key component of the U.S. federal banking agencies' risk-focused supervisory approach. A major part of this surveillance consists of the collection, review, and analysis of regulatory reports required to be submitted to the agencies on a periodic basis by banks and savings associations (collectively, "banks") and bank and savings and loan holding companies (collectively, "holding companies"). These reports capture an array of data, including financial, operational, prudential, activities, and structural information. As previously noted, the agencies' authority to require the submission of information is broad, extending to affiliates of a bank or holding company and including information on a bank's and holding company's domestic and foreign activities and operations. It includes the authority, as appropriate, to require the submission of reports necessary for the effective supervision of the particular bank or holding company or groups of organizations with similar operations and/or risks. *See* 12 U.S.C. §§ 161 (national banks), 324 (state member banks, 1464(v) (savings associations), 1467a(b) (savings and loan holding companies), 1817 (state nonmember banks), and 1844 (bank holding companies).

The authority to collect information from banks and holding companies is limited by the Paperwork Reduction Act (PRA), which requires federal agencies to obtain approval from the Office of Management and Budget (OMB) prior to collecting certain information. Information may be collected: from fewer than 10 banks or holding companies in any manner; and from any number of banks or holding companies within the framework of an examination, as a result of an action regarding a particular bank, or holding company; through a public hearing or meeting, or as a brief certification without obtaining OMB approval. The approval process for new collections of information and changes to existing collections of information, such as

[57] 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.

the Consolidated Reports of Condition and Income (Call Report), requires publication of two *Federal Register* Notices and a submission to OMB. *See* 44 U.S.C. § 3501 *et seq.*

In addition, as discussed in detail under Principle 27, banks exceeding a certain asset size threshold are required to have their financial statements audited at least annually by an external independent public accountant meeting certain qualifying criteria. The external audit reports are required to be provided to the FDIC and the appropriate federal banking agency.

EC 1	Principle 10: Supervisory reporting
Criterion	The supervisor has the power[58] 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.
Legal Framework	Under the authorities cited in the overview to Principle 20, the U.S. federal banking agencies have the power to require banks and holding companies to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, at regular intervals and on demand. 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.
Practices and Procedures	The U.S. federal banking agencies have a robust regulatory reporting framework and have the power to request information needed for supervisory purposes at regular intervals and upon demand. Title III of the Dodd-Frank Act transferred all former Office of Thrift Supervision (OTS) authorities (including rulemaking) related to savings and loan holding companies (SLHCs) and their non-depository subsidiaries to the Board of Governors of the Federal Reserve System on July 21, 2011. *See* 12 U.S.C. § 5412(b). Consequently, the Board became responsible for the consolidated supervision of SLHCs beginning July 21, 2011. Among the information collections transferred to the Federal Reserve was the *Savings Association Holding Company Report* (H-(b)11) known as the *Annual/Current Report*. In connection with this transfer, the Federal Reserve proposed for public comment and subsequently adopted regulatory reporting requirements for SLHCs. In addition, Title III of the Dodd-Frank Act transferred to the OCC all functions of the former OTS authorities (including rulemaking and information collection) related to federal savings associations, and all functions of the OTS relating to state-chartered savings associations (other than rulemaking) were transferred to the FDIC. *See* 12 U.S.C. §§ 5412(b)(2)(B) and (C), respectively. In connection with this transfer, the U.S. federal banking agencies determined after careful review that having common financial

[58] Please refer to Principle 2.

EC 1	Principle 10: Supervisory reporting
	reports and reporting processes among all FDIC-insured banks and savings associations would be more efficient and would lead to more uniform comparisons of financial condition, performance, and trends among institutions regulated by the agencies. For these reasons, the federal banking agencies proposed to eliminate the regulatory report for savings associations (the Thrift Financial Report), and subsequently required savings associations to adopt the regulatory reporting routines and processes required of FDIC-insured banks beginning as of the March 31, 2012, report date, with early adoption allowed as of the September 30 or December 31, 2011, report date. *See* 76 Fed. Reg. 7082 (February 28, 2011) and 76 Fed. Reg. 39981 (July 7, 2011), respectively. On December 10, 2013, the five financial services regulatory agencies -- the Federal Reserve, OCC, FDIC, SEC, and CFTC -- issued final rules developed jointly to implement section 619 of the Dodd-Frank Act (the "Volcker Rule"). *See* 12 U.S.C. § 1851; *see also* 79 Fed. Reg. 5536 (January 31, 2014). The final rule prohibit insured depository institutions and companies affiliated with insured depository institutions ("banking entities") from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures, and options on these instruments for their own account. The final rules also impose limits on banking entities' investments in, and other relationships with, hedge funds or private equity funds. The final rules require banking entities with significant trading operations to report certain quantitative measurements designed to monitor certain trading activities. The reporting requirements are being phased in based on the type and size of the entity's trading activities. The final rule requires certain banking entities to calculate and report metrics of their trading activity, by trading desk, to allow the agencies to assess whether such trading activity is consistent with permitted trading activities in scope, type, and profile. Banking entities that engage in significant trading activity and meet the relevant size thresholds must collect and report metrics for all trading desks engaged in covered trading activity beginning on the dates established in final rule. Specifically, banking entities with trading assets and liabilities of $50 billion and over must begin to measure and record metrics on June 30, 2014. Banking entities with less than $50 billion and greater than or equal to $25 billion in trading assets and liabilities and banking entities with less than $25 billion and greater than or equal to $10 billion in trading assets and liabilities also would be required to record metrics beginning in 2016. *See* 12 CFR. § 44.20(d)(1) – (2) (OCC), 12 CFR 248.20(d)(1) – (2) (Federal Reserve) and 12 CFR 351.20(d)(1) – (2) (FDIC). A banking entity must furnish the following metrics for each of its trading desks engaged in covered trading activity: risk and position limits and usage; risk factor sensitivities; value-at-risk (VaR) and stress VaR; comprehensive profit and loss attribution; inventory turnover; inventory aging; and customer facing trade ratio. *See* 12 CFR 44.20(d) and App. A (OCC), 12 CFR 248.20(d) and App. A (Federal Reserve) and 12 CFR 351.20(d) and App.A (FDIC). A banking entity must calculate any applicable metric for each trading day and report the desk-wide metrics to each agency that has authority under the Volcker Rule over any of the affiliated entities that compose the trading desk. Banking entities with $50 billion or greater in trading assets and liabilities must report the

EC 1	Principle 10: Supervisory reporting
	metrics on a monthly basis, and other banking entities that must report metrics are required to do so on a quarterly basis. *See* 12 CFR 44.20(d)(3) (OCC), 12 CFR 248.20(d)(3) (Federal Reserve) and 12 CFR. 351.20(d)(3) (FDIC). The final rule provides a standardized description and method of calculating each metric to promote reporting of sufficiently uniform information across different banking entities so as to permit comparisons of the quantitative profile of trading desks across firms. The agencies expect to evaluate the data collected during the compliance period for its usefulness as a barometer of impermissible trading activity and excessive risk-taking. As described more fully in Principle 27, banks and holding companies are subject to reporting requirements that include financial and other information. Individual banks must submit reports on an entity-specific basis, while holding companies with assets of $500 million or more and SLHCs of all sizes must submit financial and supervisory information on a consolidated basis. Banks must submit financial and supervisory information to the appropriate federal banking agency, and each bank must submit reports on an entity-specific (solo) basis (but with its subsidiaries, if any, included 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. Information reported in regulatory reports is used to create performance measures for analysis, including funding and liquidity, capital adequacy, asset quality and concentrations, earnings, and sensitivity to changes in market prices. The 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 (FR Y-8) 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 thresholds. Many performance measures are derived from information reported by banks and holding companies, and are included in the Uniform Bank Performance Report (UBPR) and the Bank Holding Company Performance Report (BHCPR). U.S. federal banking agencies collaborate on an interagency basis to maintain regulatory reports under the Federal Financial Institutions Examination Council (FFIEC). *See* 12 U.S.C. § 3305(c). Reports maintained on an interagency basis by the FFIEC can be found at the following website: www.ffiec.gov/ffiec_report_forms.htm. A subset of these reports include: FFIEC 030 – Foreign Branch Report of Condition – reported quarterly or annually, depending on size and nature of the branch FFIEC 031 - Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices – reported quarterly FFIEC 041 - Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only – reported quarterly FFIEC 002 – Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks – reported quarterly FFIEC 009 – Country Exposure Report – reported quarterly

EC 1	Principle 10: Supervisory reporting
	FFIEC 101 –- Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework – reported Quarterly The information included in the FFIEC 031 and the FFIEC 041 reports is used to derive various performance measures and ratios that are included in the FFIEC's UBPRs. The Federal Reserve also maintains many regulatory reports submitted by holding companies and their subsidiaries other than U.S. banks. These reports can be found at the following website: www.federalreserve.gov/reportforms. A subset of these reports, which reflect the breadth of regulatory reports at the consolidated and individual levels, include: FR Y-9C – Consolidated Financial Statements for Holding Companies – reported quarterly FR Y-9LP – Parent Company Only Financial Statements for Large Holding Companies – reported quarterly FR Y-9SP – Parent Company Only Financial Statements for Small Holding Companies – reported semiannually FR Y-11 – Financial Statements of U.S. Nonbank Subsidiaries of U.S. Holding Companies – reported quarterly or annually, depending on the size and nature of the subsidiary FR 2314 – Financial Statements of Foreign Subsidiaries of U.S. Banking Organizations – reported quarterly or annually, depending on size and nature of subsidiary FR Y-6 - Annual Report of Holding Companies – reported annually FR Y-7 – Annual Report of Foreign Banking Organizations – reported annually FR Y-7N – Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations – reported quarterly FR Y-8 - The Holding Company Report of Insured Depository Institutions' Section 23A Transactions with Affiliates – reported quarterly. FR 2886b – Consolidated Report of Condition and Income for Edge and Agreement Corporations – reported quarterly FR 2320 Quarterly Savings Association Holding Company Report-reported quarterly FR H-(b)11-Savings and Loan Holding Company Report-reported quarterly

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	In addition to filing either FFIEC 031 or 041, each national bank is required to file with the OCC an Annual Report on Operating Subsidiaries (see http://www.gpo.gov/fdsys/pkg/CFR-2010-title12-vol1/pdf/CFR-2010-title12-vol1-sec5-34.pdf) containing a variety of information including the lines of business in which the operating subsidiary is doing business directly with consumers. *See* 12 CFR 5.34(e)(7).[59] The OCC also collects performance data on first lien residential mortgages from a group of national banks and federal savings associations with the largest mortgage servicing portfolios and publishes the data in the OCC Mortgage Metrics Report, *available at* http://www.occ.gov/publications/publications-by-type/other-publications-reports/index-mortgage-metrics.html. Further, banks are required to report public loan data for the Home Mortgage Disclosure Act (HMDA) that help supervisors in determining whether banks are serving the housing needs in their markets, distributing public-sector investments to attract private investment where needed, and identifying possible discriminatory lending patterns. *See* 12 U.S.C. § 2803 and 12 CFR part 1003. Additionally, those banks subject to the Community Reinvestment Act's (CRA) Large Bank Evaluations must report data associated with small business and small farm loans. *See* 12 U.S.C. §§ 2903 and 2905 and 12 CFR 25.24. Finally, all FDIC-insured banks that operate a main office and one or more branch locations are required to file the annual Summary of Deposits (SOD) survey as of June 30 each year. Such banks are required to report the deposits assigned to each office location in the United States, Puerto Rico, and U.S. territories and possessions. The data reported in the SOD is used for analyzing deposit trends and measuring market concentrations at the national and local levels.

EC 2	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	By statute, banks and holding companies are required to apply accounting principles that are uniform and consistent with U.S. generally accepted accounting principles (U.S. GAAP) in preparing and submitting financial reports or statements required to be filed with the U.S. federal banking agencies. Annual financial statements must be prepared in accordance with U.S. GAAP. *See* 12 U.S.C. § 1831n(a)(2)(A) and 1831m(b)(1). If a particular U.S. GAAP principle does not meet certain specified objectives, the U.S. federal banking agencies may prescribe an alternative accounting principle, provided the alternative is no less stringent than GAAP. *See* 12 U.S.C. § 1381n(a)(2)(B). The FFIEC has generally adopted U.S. GAAP for the Consolidated Reports of Condition and Income. This requirement is reiterated in the general instructions to relevant regulatory reports. *See* "Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 031 and 041)," at p. 11, *available at* http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201403_i.pdf; and "Instructions for Preparation of Consolidated Financial Statements for Bank Holding Companies" (Reporting Form FR Y–9C), at p. GEN-3, *available at* http://www.federalreserve.gov/reportforms/forms/FR_Y-9C20140331_i.pdf. *See also* the reporting instructions for Form FR H-

[59] The OCC has issued a proposal that would apply this requirement to federal savings associations. *See* 79 Fed. Reg. 33260 (June 10, 2014).

EC 2	Principle 10: Supervisory reporting
	(b)11, Annual/Current Report for SLHCs at the following website: http://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDbs1SoeyO9k0SirkbxuA6wO.
Practices and Procedures	The U.S. federal banking agencies provide instructions for each report that must be submitted by banks and holding companies. The reporting instructions describe the accounting standards required in the preparation of regulatory reports. Many of the reports require the use of U.S. GAAP, while other reports such as the FR Y-7 report, and, in certain instances, the FR 2314 report, allow the option of U.S. GAAP, International Financial Reporting Standards (IFRS), or national accounting standards, depending on the nature of the report being filed and the domicile of the reporting entity. Furthermore, the accounting principles applicable to the regulatory reports filed by banks on forms FFIEC 031 and 041 (referred to as the Call Report) are required by statute to be uniform and consistent with U.S. GAAP (or, in certain situations, no less stringent than U.S. GAAP), and the FFIEC has generally adopted U.S. GAAP for the Call Report. *See* 12 U.S.C. §§ 1831n(a)(2)(A) and (B).

EC 3	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	*See* Overview.
Practices and Procedures	Model risk management begins with robust model development, implementation, and use. The U.S. federal banking agencies ensure that institutions develop and maintain a strong governance framework, policies and controls that ensure the effectiveness of methodologies that produce valuations. The U.S. federal banking agencies ensure reliability of the data by verifying that institutions maintain ongoing robust validation processes commensurate with the model risk and that the validation process is comprehensive, rigorous and effective. In situations where the validation process is deemed unacceptable, the supervisor will require adjustments to the reported amounts. The federal banking agencies review the effectiveness of the internal audit function and verify that the institution's board annually reviews and approves model risk management policies. As described in EC 2, the U.S. federal banking agencies generally require banks and holding companies to use U.S. GAAP, which apply various measurement models to different categories of assets and liabilities. Under the relevant accounting standards, 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) are 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, discussed below, is elected), whereas trading assets and liabilities are measured at fair value with changes in fair value included in earnings.

FASB Accounting Standards Codification (ASC), Topic 820, *Fair Value Measurement* (ASC 820) (formerly Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*), was originally issued in September 2006 and subsequently amended in May 2011 by FASB Accounting Standards Update No. 2011-04 (ASU 2011-4) to achieve converged fair value measurement and disclosure requirements with IFRS 13, *Fair Value Measurement*. ASC 820 (1) defines fair value, (2) establishes a framework for measuring the fair value of assets and liabilities based on a three-level hierarchy, and (3) expands disclosures about fair value measurements.

Banks and holding companies must apply ASC 820 for regulatory reporting purposes. The FASB's three-level fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs)

- Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date (e.g., the reporting date).
- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

According to ASC 820, observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the reporting entity. In contrast, unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available under the circumstances.

In May 2011, the Boards issued new guidance that harmonized fair value measurement and disclosure requirements internationally. The guidance was set out in IFRS 13, *Fair Value Measurement*, and ASU 2011-4. Many of the changes to ASC Topic 820 were clarifications of existing guidance or wording changes to align with IFRS 13. While ASU 2011-4 broadly aligned U.S GAAP and IFRSs for fair value measurement, certain differences do remain such as the treatment of "day one" gains. The transition period for the update to ASC Topic 820 is complete and all banks and holding companies must apply the updated provisions of this topic for regulatory reporting purposes.

FASB ASC Topic 825, *Financial* Instruments (ASC 825) (formerly Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*), originally issued in February 2007 and subsequently amended by ASU 2011-4, allows banks and holding companies to report certain financial assets and liabilities at fair value with the changes in fair value included in earnings. In general, a bank or holding company may elect the fair value option for an eligible financial asset or liability when it first recognizes the instrument on its balance sheet or enters into an eligible firm commitment. A bank or holding

EC 3	Principle 10: Supervisory reporting
	company was permitted to elect the fair value option for eligible items that existed beginning in 2007 or 2008, depending on a bank's adoption date for the standard. The decision to elect the fair value option for an eligible item is irrevocable. 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 that will be accounted for at fair value under the option. While a fair value option is also permitted under IFRS, there are certain eligibility requirements that differ from those in U.S. GAAP. The current use of the fair value option under IFRS and U.S. GAAP is generally limited to larger, more complex banks and holding companies.

EC 4	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	*See* Overview to this Principle and Overview to Principle 9.
Practices and Procedures	The U.S. federal banking agencies collect and analyze information quarterly from all banks; bank holding companies with consolidated assets of $500 million or more; and SHLCs of all sizes. If the BHC is below the $500 million threshold, then it submits a parent-only report on a semiannual basis. In addition, reports from other subsidiaries, such as nonbank subsidiaries, in the BHC are required to be submitted either quarterly or annually, depending of the size and nature of the subsidiary. *See* EC 1 for a listing of reports and reporting frequency. At large banks or holding companies where the agencies have on-site examination teams, supervisors receive frequent risk management reports that allow them to monitor the bank's or holding company's condition and trends in key portfolios and risk segments. Similarly, the agencies 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.

EC 5	Principle 10: Supervisory reporting
Criterion	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).

EC 5	Principle 10: Supervisory reporting
Legal Framework	*See* Overview to this Principle, Overview to Principle 9 and EC 2 to this Principle.
Practices and Procedures	The U.S. federal banking agencies collect reports on the same dates for all banks on a quarterly basis and for all entities in the consolidated holding company, which are made public after clearing edit checks. While the frequency may differ given the size 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. Examiners review these reports periodically to ensure accuracy. As descried more fully in EC 8, for insured depository institutions with total assets of $1 billion or more, independent external auditors attest to internal controls over financial reporting, including regulatory reporting. *See* 12 CFR 363.3(b). As described more fully in EC 1, under the auspices of the FFIEC, the agencies meet during the year to determine what revisions, if any, need to be made to regulatory reports, based on the needs of supervisors, changes in risk profiles, changes in accounting standards, or other factors. Revisions are usually made during the first calendar quarter of the following year. For example, revisions to the 2014 reporting requirements for regulatory capital and capital ratios, in response to the U.S. adoption of Basel III, were determined during 2013, and implemented as of the first calendar quarter end for 2014 (*i.e.*, March 31, 2014) for advanced approach banks and holding companies and will be effective for all other banks and holding companies as of the first calendar quarter end for 2015. However, implementation of new reporting requirements is sometimes staggered to lessen the reporting burden to banks and holding companies. The agencies also 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, revisions to supplemental reports for other entities (for example, a nonbank subsidiary report) are driven by changes made to the bank report and the consolidated holding company report, which helps ensure that comparable information is reported across the holding company. *See* EC 1 for a listing of reports.

EC 6	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	As noted in the overview to Principle 8, the U.S. federal banking agencies have broad statutory authority to obtain a broad array of information from supervised banks and holding companies, including financial data and information on their activities, operations, structure, corporate governance, risk management, and any other details necessary to determine and enforce compliance with

EC 6	Principle 10: Supervisory reporting
	applicable laws and ensure the safety and soundness of banks and holding companies. *See* 12 U.S.C. §§ 93a, 161(a) and (c), 324-26, 481, 483, 602, 625, 1464(d) and(v), 1467(d) and (h), 1467a(b)(2) and (4), 1467a(g), 1817(a), 1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 3105(c), and 3108. Banks and holding companies must provide supervisors with full and complete access to their books, records, and employees; failure to do so can result in the imposition of administrative sanctions. These requirements extend to the foreign operations of banks and holding companies; however, it should be noted that the laws of foreign host countries may restrict U.S. banks and holding companies operating in such countries from sharing certain information with the U.S. banking agencies. Under these statutory authorities, U.S. federal banking agencies 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. (For example, for national banks, *see* 12 U.S.C. § 161(a) and (c)). However, as discussed in greater detail in the overview to Principle 9, this authority is limited by the requirement that the federal banking agencies must rely to the fullest extent possible on the functional supervisors of the securities and insurance subsidiaries and any other subsidiary that is subject to functional supervision by a federal or state authority. *See* 12 U.S.C. §§ 1831v and 1844(c)(2)(E). Additionally, the agencies have the authority to request more frequent and supplemental reports.
Practices and Procedures	U.S. federal banking agencies have the power and authority to request any relevant information from banks and holding companies that is deemed necessary for supervisory purposes. Even affiliates of banks and holding companies that may generally be exempt from reporting certain information can be required to do so by their U.S. federal banking agency. U.S. federal banking supervisors can request and obtain internal management information. In addition, an agency may request information from the functional supervisor for entities it does not supervise (for example, an insurance underwriting subsidiary that is functionally regulated by an insurance supervisor).

EC 7	Principle 10: Supervisory reporting
Criterion	The supervisor has the power to access[60] 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.
Legal Framework	Under the authorities cited in EC 6, the U.S. federal banking agencies have the power of full access to all bank and holding company records for the furtherance of supervisory work. The agencies also have similar access to the bank or holding company's board, management, and staff, when required.
Practices and Procedures	U.S. federal banking agencies 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 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

[60] Please refer to Principle 1, Essential Criterion 5.

EC 7	Principle 10: Supervisory reporting
	any information if there is a supervisory need, even when a particular bank or holding company would not be otherwise required to submit such information.

EC 8	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	As discussed under EC 6, banks and holding companies are required by statute to comply with reporting requirements and information disclosure requests of federal banking agencies. As discussed more fully in Principle 11, a failure to comply (including by submitting an untimely report or for misreporting or persistent errors) can provide the basis for informal or formal enforcement measures, including cease-and-desist (C&D) proceedings and the imposition of a civil monetary penalty (CMP) 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 remedial provisions are structured to be appropriate to the severity of the violation. These measures help ensure compliance with the requirement that information be submitted on a timely and accurate basis. As described more fully in Principle 27, public companies, including holding companies that are required to file reports with the SEC and banks that are required to file reports with their primary federal banking agency, are required by the Sarbanes-Oxley Act of 2002[61] to obtain an annual audit of their financial statements and, if they are "accelerated filers" for federal securities law purposes, 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. As described more fully in EC 10 and EC 11, for banks with assets of $1 billion or more, the FDIC requires that the bank's management annually prepare and submit to the FDIC, the appropriate federal banking agency (if other than the FDIC), 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 such fiscal year; and (3) an assessment by management of the effectiveness of such internal control structure and procedures as of the end of such fiscal year, including the disclosure of any material weaknesses that it has identified that have not been remediated prior to the insured depository institution's fiscal year-end. 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. In addition, the management of banks with assets of $500 million or more must provide to the regulators any written communication from the bank's independent external auditor of significant deficiencies and material weaknesses in internal control required by the AICPA's or the PCAOB's auditing standards.

[61] Pub. L. 107-204 (July 30, 2002), 116 Stat. 745.

EC 8	Principle 10: Supervisory reporting
Practices and Procedures	As discussed more fully in Principle 11, the U.S. federal banking agencies can impose CMPs, negotiate memoranda of understanding (MOU), and issue C&D orders to banks and holding companies if information is not reported on a timely basis or on an accurate basis. The agencies can and do require banks and holding companies to amend previously filed reports when material errors have occurred. The consolidated regulatory reports for banks and holding companies must be signed by the CFO (or the individual performing the equivalent function), who must attest that the report has been prepared in conformance with the instructions and the information contained therein is true and correct to the best of his/her knowledge and belief. The bank-level regulatory reports must also be signed by three members of the bank's board of directors (two members of the board if the bank is a state nonmember bank), who must attest that the report has been prepared in conformance with the instructions and the information contained therein is believed to be true and correct. *See* legal authority cited in Overview; *see* also general instructions to relevant regulatory reports, "Instructions for Preparation of Consolidated Reports of Conditions and Income" (FFIEC 031 and 041), at pp. 5-6, available at http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201406_i.pdf; *See* also 12 U.S.C. § 1831 m(b) and 12 CFR 363.2(b) and (c).

EC 9	Principle 10: Supervisory reporting
Criterion	The supervisor utilises policies and procedures to determine the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.[62]
Legal Framework	See the discussion in EC 9 "Practices and Procedures" below.
Practices and Procedures	U.S. federal banking supervisors review and verify regulatory reports during the course of on-site examinations of banks and holding companies. For example, an area of significant regulatory interest and scrutiny is the accuracy of the reported allowance for loan and lease losses (ALLL). Comprehensive examination procedures are used to evaluate the appropriateness of the reported amount of the ALLL. In addition, the U.S. federal banking agencies utilize extensive off-site automated programs that provide validity and quality checks ("edits") against the regulatory reports submitted by banks and holding companies. Some edits check the mathematical accuracy of certain areas of the regulatory reports (so-called "validity edits") while other edits review relationships between various aspects of the reports and certain qualitative measures (called "quality edits"). All edit exceptions must either be corrected or explained. If an edit explanation provided by the reporting bank or holding company is found to be unacceptable by the federal banking agency, additional investigative work is performed with the reporting bank or holding company until the edit exception is resolved (sometimes resulting in amended reports). There cannot be any validity edits exceptions on the regulatory reports and all quality edit exceptions must be considered reasonable by the federal banking agency before the report is accepted by the federal banking agency.

[62]May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

EC 9	Principle 10: Supervisory reporting
	All edit explanations are documented and reviewed during the reports submission process. The agencies can require banks and holding companies to submit amended reports when supervisors identify material errors in information submitted to the agencies. For consumer compliance examinations, supervisors verify the accuracy of data submitted pursuant to Home Mortgage Disclosure Act (HMDA) (*see* 12 U.S.C. § 2803 and 12 C.F.R. part 1003 (national banks and Federal savings associations)) and Community Reinvestment Act (CRA) (*see* 12 C.F.R. §§ 25.42 (national banks) and 195.42 (Federal savings associations)) and will require corrections if necessary.

EC 10	Principle 10: Supervisory reporting
Criterion	The supervisor clearly defines and documents the roles and responsibilities of external experts,[63] 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.
Legal Framework	See the discussion in EC 10 "Practices and Procedures" below.
Practices and Procedures	The banking agencies 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 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.

EC 11	Principle 10: Supervisory reporting
Criterion	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.
Legal Framework	See the discussion in EC 11 "Practices and Procedures" below.

[63] May be 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.

EC 11	Principle 10: Supervisory reporting
Practices and Procedures	When banking agencies engage consultants or external experts (*see* EC 10), such experts and consultants are under the direct supervision of on-site agency personnel and, as a result, their findings are reported to the agencies.

EC 12	Principle 10: Supervisory reporting
Criterion	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Legal Framework	See the discussion in EC 12 "Practices and Procedures" below. In addition, Section 604 of the Financial Services Regulatory Relief Act of 2006 requires the U.S. federal banking agencies to review "the information and schedules that are required to be filed by an insured depository institution" in its Call Report every five years beginning in 2007. After completing this review, the agencies are required to "reduce or eliminate any requirement to file information or schedules" if the agencies determine "that the continued collection of such information or schedules is no longer necessary or appropriate." *See* 12 U.S.C. 1817(a)(11).
Practices and Procedures	The U.S. federal banking agencies review all FFIEC reports for relevancy 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. The U.S. federal banking agencies, under the auspices of the Task Force on Reports, conducted their most recent review of the data collected in the Call Report, as required by Section 604 of the Financial Services Regulatory Relief Act of 2006, 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 PRA. In addition, pursuant to section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) (12 U.S.C. § 3311) the FFIEC, the OCC, the FDIC, and the Federal Reserve 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 Agencies must conduct this review at least once every 10 years, and the next EGRPRA review must be completed by December 31, 2016.

Assessment of Principle 10	Compliant

Comments	

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.
(Reference documents: *Parallel-owned banking structures*, January 2003.)

Overview

If a U.S. federal banking agency determines that a bank or holding company has problems that may affect safety and soundness or is not in compliance with laws and regulations, it may take supervisory action to ensure that the bank or holding company undertakes corrective measures. Typically, weaknesses and deficiencies are communicated to the management and directors of a bank or holding company through the examination process and in a written report. Management and directors are then asked to address all identified problems and to take measures to ensure that the problems are corrected and will not recur.

While most problems are resolved promptly after they are brought to the attention of a bank's or holding company's management and directors, in some situations, the appropriate agency may need to take supervisory action, requesting that a bank or holding company adopt an informal or formal enforcement action to address the problem. In practice, the type of enforcement action pursued should be commensurate with the severity of weaknesses and deficiencies identified at the bank or holding company, with informal enforcement actions being the least severe and revocation of banking license, revocation of membership in the Federal Reserve, or termination of deposit insurance being more severe. Informal enforcement actions include board resolutions and memorandums of understanding.

If necessary, the appropriate agency may take formal enforcement actions to compel the management and directors of a bank or holding company, or persons associated with it, to address the bank's or holding company's problems. For example, if a bank or holding company has significant deficiencies or fails to comply with an informal action, the agency may enter into a written agreement with the bank or holding company or may issue a cease-and-desist order against the bank or holding company or against an individual associated with it, such as an officer or director. The agency may also assess a fine (a civil monetary penalty or CMP), remove an officer or director from office and permanently bar him or her from the banking industry, or both. CMPs are tiered and applied in accordance with the severity of the violation at issue. All final formal enforcement orders issued and written agreements executed by the agencies are published on the agencies' public websites.

Special statutes and regulations apply to banks when the bank has a capital deficiency. Under the Prompt Corrective Action (PCA) regime, the agencies and banks are required to take certain actions promptly to resolve capital deficiencies. The PCA statute, 12 U.S.C. § 1831*o*, establishes mandatory and discretionary restrictions on any bank that fails to remain at least adequately capitalized. By regulation, the agencies have defined the capital categories and the restrictions each triggers. *See* 12 CFR 208.43 (Federal Reserve), 12 CFR parts 3, 6, 165, and 167 (OCC), and

12 CFR 324.403 and 325.103 (FDIC). Also see revisions to Regulatory Capital Rules at 78 Fed. Reg. 62018 (October 11, 2013) (OCC and Federal Reserve), and 78 Fed. Reg. 55340 (September 10, 2013) and 79 Fed. Reg. 20754 (April 14, 2014) (FDIC). The primary federal banking supervisor for a bank may take a range of mandatory and discretionary actions if a bank's capital falls below the minimum level for any relevant capital category. The severity of the supervisory action depends on the severity of the capital shortfall.

In addition to the remedies discussed above, there are also other actions to penalize banks and holding companies and their management for violating rules and regulations and failing to correct safety and soundness concerns. These actions can include restricting new activities or acquisitions and, in the most serious instances, revoking the charter of the bank and terminating Federal Reserve membership or federal deposit insurance.

Moreover, the Federal Reserve may require a holding company to terminate an activity or control of an entity where it is believed that the holding company's activity or control of an entity constitutes a serious risk to financial safety, soundness, or stability of the holding company or its banking subsidiary. *See* 12 U.S.C. § 1844(e); 12 CFR 225.4. The Dodd-Frank Act has also codified into law the Federal Reserve's source of strength doctrine and confirms its ability to compel holding companies to serve as a source of financial strength to their subsidiary banks. *See* 12 U.S.C. § 1831*o*-1.

Further, the Dodd-Frank Act established a framework through which the federal banking agencies are able to ensure consistent safety and soundness oversight of the bank permissible activities of nonbanking subsidiaries of holding companies consistent with the safety and soundness of the subsidiary bank(s), including through necessary enforcement actions. 12 U.S.C. § 1831c.

EC 1	**Principle 11: Corrective and sanctioning powers of supervisors**
Criterion	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.
Legal Framework/ Practices and Procedures	Generally, U.S. federal banking agencies identify problems or deficiencies at a bank or holding company during on-site examinations, which are authorized by various federal statutes. Most problems or deficiencies are resolved informally during the course of the examination through discussions with the bank's or holding company's management and directors in which 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 Bank Secrecy Act; and addresses compliance with consumer laws and regulations[64], information technology, and the Community Reinvestment Act. *See* the Interagency "Uniform Financial Institutions Rating System" as described in Principle 8. The narrative of

[64] The Consumer Financial Protection Bureau, created by the Dodd-Frank Act, has supervisory and enforcement authority concerning consumer compliance laws and regulations for banks with more than $10 billion in assets.

EC 1	Principle 11: Corrective and sanctioning powers of supervisors
	the ROE also calls attention to matters that need attention. One example of a U.S. federal banking agency policy on communication of examination findings is the Federal Reserve's 2013 supervisory letter "Supervisory Considerations for the Communication of Supervisory Findings" at fedweb.frb.gov/fedweb/bsr/srltrs/sr1313.pdf Similarly, the OCC's policy on communication can be found in the *Bank Supervision Process*, *Community Bank Supervision*, and *Large Bank Supervision* booklets of the OCC Comptroller's Handbook[65], and the FDIC's communication policy can be found at Basic Examination Concepts and Guidelines, available at: www.fdic.gov/regulations/safety/manual/section1-1.pdf Similar reports are issued after the inspection of a holding company. Holding company rating systems, which are somewhat different from those of banks, are described in connection with Principle 16. Some problems or deficiencies may not be satisfactorily addressed through discussion with the bank's or holding company's management, especially if the problems or deficiencies are serious, pervasive, or repeated. In such cases, the agencies may take supervisory actions, which are described in detail in the responses to EC 2, 3, and 4 of this Principle. Generally, supervisory actions require a bank or holding company to take certain affirmative actions and make periodic (monthly or quarterly) reports to the relevant federal banking agency(ies) on the progress that the bank or holding company has made to address the deficiencies identified in the examination. Detailed policies and action plans with specific 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. *See also* Overview above.

EC 2	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	The supervisor[66] has available 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.
Legal Framework/ Practices and Procedures	As described in the Overview to this Principle, U.S. federal banking agencies have a range of supervisory options when, in the supervisors' judgment, a bank or holding company is not complying with laws, regulations, or supervisory actions, or is engaged in an unsafe or unsound practice. The agencies may take prompt remedial action and impose penalties, including the divestiture of activities or control of an entity. In practice, the range of tools is applied in accordance with the gravity of a situation. *See* 12 U.S.C. § 1818 for a description of many of the types of formal enforcement actions that the agencies are authorized to take, and the PCA statute at 12 U.S.C. § 1831*o*. Also, *see* 12 USC 1831-p for a description of the Safety and Soundness plan/order process. U.S. federal banking agencies have a broad range of supervisory tools to address problems or deficiencies at the banks and holding companies they supervise. Supervisory actions are generally remedial and are intended to provide the bank or holding company with guidance on how to fix the problems or deficiencies identified at the examination. Informal, non-public supervisory action is usually

[65] www.occ.gov/handbook/ Please see the following booklets: *Bank Supervision Process*, *Community Bank Supervision*, and *Large Bank Supervision*.

[66] Please refer to Principle 1.

EC 2	Principle 11: Corrective and sanctioning powers of supervisors
	sufficient to resolve most deficiencies. 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 individual minimum capital ratios established by the agencies (applicable to banks only), or execute a memorandum of understanding with the supervisor. In the event that the problems, deficiencies or violations of law are pervasive, repeated, unresolved by management, or otherwise of serious concern, the agencies may exercise their statutory enforcement authority by taking a formal enforcement action against a bank or holding company. Formal enforcement actions against banks and holding companies include (i) Formal or Written Agreements (Agreements); (ii) Cease and Desist Orders (C&D); (iii) Safety and Soundness Orders; (iv) Capital Directives; (v) PCA Directives (applicable to banks only); and (vi) Civil Money Penalty Assessments (CMP). Federal banking agencies 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 agencies. Formal enforcement action often requires affirmative action by the bank or holding company and may include restitution or reimbursement. In determining whether a formal enforcement action is appropriate, the agency staffs consider all relevant factors, including the nature, severity, and duration of the problem, the risks presented at the particular bank or holding company, the anticipated resources and actions necessary to resolve the problem, and the responsiveness of the directors and management. Under certain circumstances, such as the failure of a bank to establish or correct problems with an anti-money laundering compliance program, the federal enforcement statutes require formal enforcement action, rather than giving the agency discretion to pursue a formal action. *See* 12 U.S.C. § 1818(s)(3). Formal enforcement actions are legally enforceable, remain in effect until modified or terminated, and must be publicly disclosed by the appropriate agency. *See* 12 U.S.C. §1818(u). For specific examples, links to the agencies' enforcement actions public websites are Federal Reserve: www.federalreserve.gov/apps/enforcementactions/search.aspx OCC: http://apps.occ.gov/EnforcementActions/ FDIC: www5.fdic.gov/EDO/index.html CMPs may also be assessed by the agencies under various federal banking laws. *See, e.g.*, 12 U.S.C. § 1818(i). The bases for such assessments may include violations of law or regulation, non-compliance with a formal enforcement action, engaging in unsafe or unsound practices, or failure to meet regulatory reporting requirements. Assessments are based on an analysis of the facts and circumstances of the case and consideration of the mitigating factors that are required to be taken into account by statute, such as the financial resources of the bank, holding company, or individual; good faith; gravity of the violation; history of previous violations; and other mitigating factors. All informal supervisory actions are entered into with the consent of the bank or holding company. Formal enforcement actions, including C&D orders and CMP assessments, are generally issued with the consent of the bank or holding company. However, in the event that a bank or holding company declines to consent to a formal enforcement action, the agency may initiate a contested judicial proceeding to impose the formal action upon the bank or holding company.

EC 2	Principle 11: Corrective and sanctioning powers of supervisors
	In cases where there is (i) an immediate threat to the viability of the bank or holding company or to the depositors' interests, due to violations of law, regulation, or ongoing unsafe or unsound practices or (ii) the institution's books and records are so incomplete or inaccurate that the agency is unable to determine the financial condition of the institution or the details or purpose of transactions that may have a material effect on the financial condition of the institution, an agency may take immediate action by issuing a temporary order to cease and desist. Such an order is effective upon service and may be issued with or without the bank's or holding company's consent. The provisions are narrowly focused to address the cause of immediate harm to the bank or holding company. The temporary order to cease and desist remains in place until either the bank or holding company consents to a C&D order or the conclusion of a contested proceeding to impose a C&D order. As more fully described in the response to EC 3, the agencies are also required by statute to take action to promptly address capital deficiencies at banks.

EC 3	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	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.
Legal Framework/ Practices and Procedures	As discussed in the Overview to this Principle and Principle 16 (on capital adequacy), a PCA regime applies to those instances in which a bank's capital ratios fall below the minimum ratios. The regime encourages intervention at an early stage to resolve issues and prevent further deterioration. In addition, under 12 U.S.C. § 3907, the federal banking agencies are required to "cause banking institutions to achieve and maintain adequate capital" by, among other things, establishing minimum capital levels. If a bank or holding company fails to maintain capital at or above its minimum level, the statute specifically provides that the appropriate federal banking agency may deem the failure an unsafe or unsound practice within the meaning of 12 U.S.C. § 1818 and issue a capital directive – enforceable to the same extent as a C&D – that requires the bank or holding company to submit a capital plan to achieve its required capital level. The federal banking agencies have issued implementing regulations. See, e.g., 12 CFR 263.80, et seq. (Federal Reserve), 12 CFR parts 324 and 325 (FDIC), and 12 CFR 3.1 et seq. and 12 CFR part 167 et seq. (OCC). The PCA statute and accompanying regulations, described in the Overview to this Principle, were enacted to promptly resolve capital deficiencies at banks and thereby reduce bank failures by imposing mandatory and discretionary restrictions on a bank that fails to remain at least adequately capitalized. For example, any bank that is less than adequately capitalized cannot pay dividends and must submit a capital restoration plan that is acceptable to the supervisor. Capital category definitions, which are uniform among the U.S. federal banking agencies, can be found at www.ecfr.gov/cgi-bin/text-idx?SID=e342dac9e00a00605309dbd482ffd86e&node=12:2.0.1.1.9.4.3.5&rgn=div8 Additional mandatory restrictions apply to significantly and critically undercapitalized banks, such as limitations on growth. The agencies may also take several discretionary actions when the bank is less than adequately capitalized. These restrictions are

EC 3	Principle 11: Corrective and sanctioning powers of supervisors
	imposed by an agency's issuance of a PCA Directive, with or without the consent of the bank. For a bank that is critically undercapitalized, the statute generally requires that the bank be recapitalized, sold, merged, liquidated, or placed into receivership or conservatorship within 90 days. It should be noted that the agencies intervene at even earlier stages to address capital weaknesses through the types of supervisory actions described in the response to EC 2 of this Principle. PCA examples: Federal Reserve Prompt Corrective Action Directive against NBRS Financial Bank, Rising Sun, Maryland: dated April 7, 2014, requires the sale or merger of the bank within 60 days. www.federalreserve.gov/newsevents/press/enforcement/20140410a.htm OCC Prompt Corrective Action Directive against One Bank & Trust, National Association, Little Rock, AR: dated September 28, 2012, requires the board to, among other things, dismiss an individual from the positions of chief executive officer, president, chairman of the board, and director and sever ties with him, ensure competent management, and ensure the bank's books and records are maintained in compliance with Generally Accepted Accounting Principles. www.occ.gov/static/enforcement-actions/ea2012-220.pdf FDIC Prompt Corrective Action Directive against Columbia Savings Bank: dated March 13, 2014, required the bank to recapitalize, sell, or merge. https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=9bb0b41e-ebe6-44a5-83c2-5fb7d493d2b3

EC 4	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in EC 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; revoking or recommending the revocation of the banking license; revoking membership in the Federal Reserve; and terminating deposit insurance.
Legal Framework/ Practices and Procedures	The U.S. federal banking agencies have available a broad range of possible measures to address the scenarios described above in EC 2. Together, statutes, regulations, guidelines, and guidance contain clear prudential objectives and set out the actions to be taken. 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; restricting asset transfers; barring individuals from banking; replacing or restricting the powers of managers, directors, or controlling owners; facilitating a takeover by, or merger with, a healthier bank or holding company, providing for the interim management of the

EC 4	Principle 11: Corrective and sanctioning powers of supervisors
	bank or holding company; revoking or recommending the revocation of the banking license; revoking membership in the Federal Reserve; and terminating deposit insurance. As specifically authorized by statute, the U.S. federal banking agencies may, through formal supervisory action, require the bank or holding company to cease and desist from violations of law or regulation or unsafe or unsound practices or take other affirmative actions. Among the actions specifically enumerated in the statute, an agency may restrict the bank's or holding company's growth; require the bank or holding company to dispose of any loan or asset involved in the violation or unsafe or unsound practice; require the bank or holding company to employ qualified officers and employees; and take any other action that the agency deems appropriate. Formal enforcement actions generally include provisions that specifically address the bank's or holding company's problems, deficiencies, violations, or unsafe or unsound practices. The provisions may require the bank or holding company to stop certain actions or to take affirmative actions. Some provisions may require a bank or holding company to submit specific plans, policies, or procedures that are acceptable to the federal banking agency. Common provisions for formal enforcement actions require the bank or holding company to cure specified violations, correct risk management or board of directors oversight weaknesses, submit an acceptable plan to increase or maintain sufficient capital, provide for an adequate allowance for loan and lease losses, employ qualified officers and employees, and restrict the payment of dividends. As described in the response to EC 7, the agencies generally have the power to provide interim management (conservatorship) for a bank or to close a bank (receivership) under a variety of circumstances. As described in the response to EC 5, the agencies also have statutory authority to take formal enforcement actions against officers, directors, or employees of a bank or holding company supervised by the federal banking agencies. Enforcement action examples: Federal Reserve Agreement with Columbus Junction State Bank, Columbus Junction, Iowa: dated May 22, 2014, requires capital maintenance plan and improvements in corporate governance and credit related issues. www.federalreserve.gov/newsevents/press/enforcement/enf20140529a1.pdf OCC Agreement with Hopkins Federal Savings Bank, Baltimore, MD: dated April 17, 2014, requires, among other things, loan portfolio management, annual review of commercial loans, and criticized assets program. www.occ.gov/static/enforcement-actions/ea2014-051.pdf FDIC Consent Order against The Bank of Princeton, Princeton, New Jersey: dated January 30, 2014, requires improvements to board of directors' oversight and BSA program. https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=ab8f251e-bc9a-4561-8c82-3f74780d6596

EC 5	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Legal Framework/ Practices and Procedures	As discussed in the Overview to this Principle, remedial penalties and sanctions may be applied to banks and holding companies and, when appropriate, to management, board members, employees, and other individuals who participate in a bank's or holding company's affairs (Institution-Affiliated Parties or IAPs). IAP also includes, under certain circumstances, independent contractors (e.g., attorneys, accountants, appraisers) to banks. Formal supervisory actions, including penalties and sanctions, may be taken against the bank or holding company and its IAPs. These actions against IAPs include: Cease and Desist Order – A C&D may include provisions that limit the individual's activities at the bank or holding company, require the individual to take affirmative action, or make restitution or reimbursement to the bank or holding company if the individual was unjustly enriched by the violation or practice or demonstrated reckless disregard for the law. Removal and Prohibition Order – An agency may remove any current IAP from the bank or holding company for violations of law and other misconduct and prohibit any current or former IAP from further participation in the banking industry. A removed or prohibited individual may not serve as an officer, director, or employee of any bank or holding company, acquire shares of any bank or holding company, or exercise certain shareholder rights without prior regulatory approval. To support a Removal and Prohibition Order, the agency must determine that the IAP has engaged in a violation of law or regulation or in other specified misconduct; that the IAP's misconduct caused or will probably cause loss to the bank or holding company, prejudice depositors, or resulted in gain to the individual; and that the individual has demonstrated continuing or willful disregard for the safety and soundness of the bank or holding company or the individual's action involved personal dishonesty. Suspension Order – An agency may suspend a current IAP if the agency determines that the party's conduct meets the standard for removal and that a suspension is necessary to protect the bank or holding company or its depositors. A Suspension Order is immediately effective upon being served and remains in effect until the proceeding on the proposed Removal and Prohibition Order is resolved, unless stayed by a court. Civil Money Penalty – An agency may assess CMPs against an IAP under the same circumstances as a CMP against a bank as described in the response to EC 2. Prompt Corrective Action Directive – An agency may require a bank that is deemed to be significantly undercapitalized to dismiss certain senior executive officers and directors. Examples of enforcement actions against an individual: Federal Reserve Order of Prohibition Issued Upon Consent: *In the Matter of Jerry J. Williams, a Former Institution-Affiliated Party of Orion Bancorp, Inc. and Orion Bank, Naples, Florida*, dated June 12, 2012, prohibits the individual from participation in any banking organization supervised by the agencies. www.federalreserve.gov/newsevents/press/enforcement/20120613a.htm Federal Reserve Order of Prohibition and Order of Assessment of Civil Money Penalty Issued Upon Consent: *In the Matter of Brian T. Posey, a Former Institution-Affiliated Party of Security Bank, Tulsa, Oklahoma*, dated November 16, 2011, prohibits the

EC 5	Principle 11: Corrective and sanctioning powers of supervisors
	individual from participation in any banking organization supervised by the agencies and requires the payment of a civil money penalty of $35,000. www.federalreserve.gov/newsevents/press/enforcement/20111116a.htm Federal Reserve Prompt Corrective Action Directive: *In the Matter of Orion Bank, Naples, Florida*, dated November 9, 2009, required immediate dismissal of bank president and chief executive officer pursuant to PCA. http://www.federalreserve.gov/newsevents/press/enforcement/enf20091113a1.pdf FDIC Prohibition Order and Assessment of a Civil Money Penalty. *In the Matter of Paul J. Piikkila, an Institution-Affiliated Party of Horicon Bank, Horicon, Wisconsin*, dated September 18, 2013, prohibits the individual from participation in any bank or holding company supervised by the agencies and requires the payment of a civil money penalty of $10,000 http://www.fdic.gov/news/news/press/2013/pr13094a.html OCC Order of Prohibition, Order for Civil Money Penalty, and Order for Payment of Restitution (all by consent): *In the Matter of James A. Regas, former Chairman of the Board, Western Springs National Bank & Trust, Western Springs, IL*, dated March 13, 2013, prohibits the individual from participation in any bank or holding company supervised by the agencies, requires the payment of a civil money penalty in the amount of $250,000, and requires the payment of restitution in the amount of $681,617 (consistent with plea agreement with law enforcement). www.occ.gov/static/enforcement-actions/ea2013-027.pdf

EC 6	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	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.
Legal Framework/ Practices and Procedures	The U.S. federal banking agencies 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. As described in the responses to EC 2 and 4 of this Principle, 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. The Federal Reserve, as the supervisor of holding companies, has the authority to take a full range of enforcement actions against holding companies and their nonbank affiliates. *See, e.g.*, 12 U.S.C. § 1844(e). 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 managerial and financial support to the bank (known as the Source of Strength doctrine). As discussed in the Overview above, the Dodd-Frank Act codified the Source of Strength doctrine at 12 U.S.C. § 1831*o*-1.

EC 6	Principle 11: Corrective and sanctioning powers of supervisors
	Enforcement action examples: Federal Reserve Cease & Desist Order against Metropolitan Bank Group, Inc., Chicago, Illinois: dated April 12, 2013, limits the parent bank holding company from taking dividends or other payments from the bank, and places restrictions on compensation. www.federalreserve.gov/newsevents/press/enforcement/enf20130418a1.pdf OCC Consent Cease & Desist Order against First National Bank in Howell, Howell, MI: dated October 31, 2013, requires an affiliate transactions policy and permits affiliate transactions only with prior board review and approval. http://www.occ.gov/static/enforcement-actions/ea2013-162.pdf FDIC Modified Consent Order against North Community Bank, Chicago, Illinois: dated May 7, 2013, restricts payments to affiliates, requires review of past affiliate expenses, requires development of new affiliate expense policy, and requires improvement in BSA program. https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=e98dbd26-84a5-4625-b474-7a48be075797

EC 7	Principle 11: Corrective and sanctioning powers of supervisors
Criterion	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).
Legal Framework/ Practices and Procedures	See statute related to bank liquidation and receivership at 12 U.S.C. § 1821 and the PCA statute at 12 U.S.C. § 1831*o*. Please see the responses to EC 2, 3, and 4 of this Principle for a description of supervisory tools available to address problems, deficiencies, or violations at banks and holding companies. When a problem bank does not have the ability or resources to solve its deficiencies, the U.S. federal banking agencies have authority to appoint a conservator or a receiver.[67] The agencies may appoint a conservator or receiver under a variety of circumstances, including when a bank is critically undercapitalized or when it is undercapitalized and has no reasonable prospect of becoming adequately capitalized; is unable to meet depositors' demands for payment; or is operating in an unsafe or unsound condition that would likely cause insolvency or substantially dissipate the bank's assets. It should be noted, the Federal Reserve's ability to appoint a conservator or receiver for a bank is more limited by statute than the OCC's and FDIC's. The FDIC may use its back-up authority to appoint itself conservator or receiver of any insured bank under these same criteria. The conservator takes full control of the bank and assumes the powers of the shareholders and board of directors. Under federal law, a conservator can repudiate contracts and temporarily limit customer withdrawals and payments to creditors, thereby avoiding a liquidity crisis and

[67] A holding company is subject to the same Federal bankruptcy laws that apply to other types of companies.

EC 7	Principle 11: Corrective and sanctioning powers of supervisors
	liability for failure to make payments. If the bank returns to a safe and sound condition, the conservator may return control of the bank to the shareholders or prepare the bank for sale. The agencies may generally close a bank and appoint a receiver on the same grounds described above for conservatorship. (For state-chartered banks, the appropriate state banking agencies have concurrent powers to close banks, but the grounds vary by state). By law, the FDIC is always appointed the receiver for closed insured banks. In addition to authority to appoint a conservator or a receiver of a bank, Title I and Title II of the Dodd-Frank Act provide significant new authorities to the FDIC, Federal Reserve, and other regulators to address the failure of systemically important holding companies and nonbank financial institutions. Title I requires all companies covered under it to prepare resolution plans, or ‘‘living wills,’’ to demonstrate how they 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. See 12 CFR 360.10. Title II of the Dodd-Frank Act establishes a back-up authority for the FDIC to place systemically important holding companies and nonbank financial institutions into an FDIC receivership process if no viable private sector alternative is available to prevent the default of the financial company and if a resolution through the bankruptcy process would have serious adverse effects on U.S. financial stability.

EC 8	Principle 11: Corrective and sanctioning powers of supervisors
Additional Criterion	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Legal Framework/ Practices and Procedures	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. In general, the U.S. federal banking agencies strive to promptly address deficiencies, problems, or violations of law or regulation at the supervised banks and holding companies. As described in the response to EC 1, the deficiencies or problems are most often resolved through the ongoing dialogue that occurs during the examination process. When further supervisory action is necessary, it is most often accomplished through informal supervisory action (which is not mandated by statute). When formal supervisory action is necessary, the agencies take appropriate measures in a timely manner. Aside from PCA, there are generally no specific statutory requirements that establish timetables for taking supervisory action. However, formal enforcement actions generally are implemented within a reasonable time frame to effectuate appropriate corrective action commensurate with the risks of the bank or holding company. Moreover, formal enforcement actions establish timeframes for each of the actionable articles in the enforcement action.

EC 8	Principle 11: Corrective and sanctioning powers of supervisors
	As described in the response to EC 3 of this Principle, PCA requires the agencies to take actions to promptly address capital deficiencies at banks. A bank or holding company must submit a capital restoration plan within 45 days or less of becoming undercapitalized; the agency must review the plan within 60 days of submission and determine if it is acceptable. If the capital restoration plan is not acceptable, the bank will be subject to the restrictions applicable to significantly undercapitalized banks.

EC 9	Principle 11: Corrective and sanctioning powers of supervisors
Additional Criterion	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities (e.g., SEC) of its actions and, where appropriate, coordinates its actions with them.
Legal Framework/ Practices and Procedures	The "Policy Statement on Interagency Notification and Coordination of Enforcement Actions" discusses federal banking agency coordination. *See* Federal Reserve SR letter 97-5 (ENF) and 62 *Fed. Reg*. 7782 (1997). The U.S. federal banking agencies work closely together to address supervisory concerns of common interest. The Federal Reserve, as the "umbrella" supervisor 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 those subsidiaries and take supervisory actions when appropriate. The Federal Reserve coordinates its actions and shares information where appropriate with U.S. federal banking and other agencies and foreign supervisors to effect supervisory action and reduce regulatory redundancies. The following examples illustrate coordination of supervisory actions among the supervisors: In 2012, the Federal Reserve, OCC, FinCEN, and OFAC took separate, coordinated actions, including assessing approximately $1.9 billion in forfeitures and penalties, against HSBC Holdings plc, London, U.K., HSBC North America Holdings, Inc., New York, N.Y., and HSBC Bank USA, N.A, McClean, Virginia, related to Bank Secrecy Act and anti-money laundering requirements and U.S. economic sanctions. www.federalreserve.gov/newsevents/press/enforcement/20121211b.htm In 2010 and 2011, the Federal Reserve, OCC, and SEC took separate, coordinated actions against two holding companies and their wholly owned subsidiary banks related to certain anti-competitive activities (JPMorgan Chase & Co., New York, New York, and JPMorgan Chase Bank, N.A., Columbus, Ohio; and Bank of America Corporation and Bank of America, N.A., both of Charlotte, North Carolina). www.federalreserve.gov/newsevents/press/enforcement/20101207b.htm

Assessment of Principle 11	Compliant
Comments	

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.[68]

(Reference documents: *Home-host information sharing for effective Basel II implementation, June 2006;*[69] *The supervision of cross-border banking, October 1996; Minimum standards for the supervision of international banking groups and their cross-border establishments, July 1992; Principles for the supervision of banks' foreign establishments, May 1983; and Consolidated supervision of banks' international activities, March 1979;* DFA, Title I and II.*)*

EC 1	Principle 12: Consolidated supervision
Criterion	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.
Legal Framework	The Federal Reserve is the consolidated supervisor for U.S. banking holding companies (BHCs)--including financial holding companies (FHCs)—and for savings and loan holding companies (SLHCs). The relevant governing statutes are the Bank Holding Company Act (BHC Act), as amended and enhanced by the Gramm-Leach Bliley Act and the Dodd -Frank Act (among others), and the Home Owners' Loan Act (HOLA), which governs SLHCs. Regulations implementing those statutes include the Federal Reserve's Regulation Y (12 CFR part 225), Regulation LL (12 CFR part 238), and Regulation MM (12 CFR part 239). Consolidated supervision responsibility, particularly from the resolution perspective, is also derived from the DFA Title I and II. The Federal Reserve achieves a comprehensive understanding of the overall structure of banking groups through the ongoing supervision process, which includes regular reporting requirements, on-site inspections, meetings among banking supervisors, and other regulators and regular contact with a banking group's management. 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 relevant primary supervisors,[70] functional regulators, and foreign supervisors for information and analysis about other entities within a holding company structure.

[68] Please refer to footnote 19 under Principle 1.
[69] When assessing compliance with the Core Principles, this reference document is only relevant for banks and countries which have implemented Basel II.
[70] The term "primary supervisor" refers to the primary federal banking supervisor of a bank or savings association subsidiary of a holding company or of a U.S. banking office of an FBO. *See* the self-assessment introduction for a description of supervisory responsibilities of primary supervisors.

EC 1	Principle 12: Consolidated supervision
	Title IV of the DFA repealed the so-called "Fed-lite" provisions of the GLB Act, expanding the Federal Reserve's authority to examine, supervise, impose prudential standards on, take enforcement against, and obtain information from functionally regulated subsidiaries of bank holding companies. 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 Board examination authority over BHC subsidiaries, including functionally regulated subsidiaries, to inform the Board 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 bank holding company system that may pose a threat to the safety or soundness of the BHC or any of its depository institution subsidiaries or the stability of the financial system of the United States; 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 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.
Practices and Procedures	The Federal Reserve develops a comprehensive understanding of the overall structure of banking groups and the effectiveness of their risk management processes through: (1) regular on- and off-site inspections of the consolidated organizations, their nonbank subsidiaries, and their essential control functions such as internal audit and loan review; (2) continuous monitoring of emerging developments by reviewing information provided in required periodic regulatory financial and structure reports and in internal management reports; (3) meetings with banking and other functional supervisors responsible for regulating subsidiaries or foreign activities of the banking organization and review of their examination reports; and (4) ongoing contact with the banking group's management. When supervision activities identify risk to the safety and soundness of the holding company or its affiliates, the Federal Reserve is authorized to initiate legal enforcement actions to facilitate or compel corrective action. For nonbank financial companies designated by the Financial Stability Oversight Counsel (FSOC) for supervision by the Federal Reserve, and insurance and commercial SLHCs, enhanced prudential standards are under development to provide for implementation of the consolidated supervision for these entities. Further information on the supervision of insurance operations is provided in the Federal Reserve's self-assessment of implementation of the IAIS Insurance Core Principles. SR letters 12-17, 11-11 and 08-9 describe the Federal Reserve's approach to consolidated supervision.

EC 2	Principle 12: Consolidated supervision
Criterion	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 resolution and recovery plans, capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
Legal Framework	The Federal Reserve imposes the prudential standards discussed under Principles 4-7, 19-21, and 23-25 (on capital adequacy, risk management, and risk-specific measures), the internal audit and controls measures described under Principle 8, and the accounting

EC 2	Principle 12: Consolidated supervision
	and disclosures standards discussed under Principle 13 on a consolidated, group-wide basis. As those sections disclose, the Federal Reserve's authority to impose corrective measures in these areas is explicitly conferred by statute or expressly addressed by regulation, interagency guidelines, supervisory guidance, and related materials. In addition, the authority is implicit in the U.S. federal banking agencies' responsibility for safeguarding the safety and soundness of banks.
Practices and Procedures	The Federal Reserve requires regular financial and organizational structure reporting by all holding companies. Larger holding companies (over $500 million in assets) report financial data on a consolidated basis, while smaller, shell bank holding companies provide parent only financial statements which, when combined with bank financial reports, provide a 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. The Federal Reserve has established prudential standards to address a broad range of supervisory issues and concerns. These include, but are not limited to, standards to address: (1) Resolution and recovery plans for large holding companies - See the Practices and Procedures section of Principle 8, EC 6 for detail, as well as SR letter 12-17, "Consolidated Supervision Framework for Large Financial Institutions" and SR 14-1, "Heightened Supervisory Expectations for Recovery and Resolution Preparedness for Certain Large Bank 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. Holding companies are expected to serve as sources of financial and managerial strength to their subsidiary insured depository institutions. As such, holding companies should be ready to use available resources to provide capital during periods of financial stress or adversity and maintain financial flexibility and capacity to obtain additional resources as needed. Holding companies must comply with a broad range of prudential standards aimed to ensure their ongoing ability to act as a source of financial and managerial strength to subsidiary depository institutions. As summarized below, additional objectives that go beyond a focus on subsidiary depository institutions have recently been established for the largest holding companies: 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 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 by maintaining operational resilience through effective corporate governance, risk management practices, and recovery planning.

EC 2	Principle 12: Consolidated supervision
	2. Reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness. Each firm is expected to ensure the sustainability of its critical operations and banking 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.

EC 3	Principle 12: Consolidated supervision
Criterion	The supervisor reviews whether management oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate in context of the organization's risk profile and systemic importance. Host supervisors have access to all the material information from their foreign branches and subsidiaries, including host regulatory reports. The host supervisor also assesses whether local policies and processes are adequate and local management has the necessary expertise to manage host country operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements of the host country. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations. They may, but need not, rely on the supervisory work and conclusions of host country supervisors.
Legal Framework	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), 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. 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. As discussed in Principles 3 and 15, the U.S. federal banking agencies 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 federal banking agencies informally evaluate host country supervisors through ongoing communication with host supervisors and evaluation and inspection of the cross-border establishments.
Practices and Procedures	The federal banking agencies 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 (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.

EC 3	Principle 12: Consolidated supervision
	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. 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. As part of the ongoing supervisory process, the foreign operations of U.S. banking groups are expected to submit to host country supervisors the required regulatory reports and make available to host supervisors all information relevant to the local operations. This allows the hosts to assess the adequacy of policies and procedures, the expertise of local management and the supervisory condition of the local operations, including their compliance with local rules and regulations. The U.S. federal banking agencies 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.

EC 4	Principle 12: Consolidated supervision
Criterion	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.
Legal Framework	Statutory provisions expressly authorize examinations of and the submission of reports by regulated banks and their affiliates, including foreign offices and subsidiaries (*see* 12 U.S.C. §§ 161, 324, 326, 334, 338, 481, 602, 1464(d)(1)(B), 1467a(b)(4), and

EC 4	Principle 12: Consolidated supervision
	1844(c). A provision of the International Banking Act provides for communication and cooperation with foreign bank supervisors (*see* 12 U.S.C. §3109).
Practices and Procedures	As noted in EC 3, for holding companies with international operations or risks, the federal banking agencies 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. federal banking agencies' 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 variety of approaches to supervise and have, for example, required special reports and audits of foreign offices. Additionally, the U.S. federal banking agencies 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. In accordance with principles promulgated by the Financial Stability Board, the Federal Reserve participates with other U.S. and international supervisors in crisis management group meetings to enhance preparedness for the cross-border management and resolution of a failed global systemically important financial institution. The U.S. federal banking agencies also participate in supervisory colleges with international supervisors. As discussed in Principle 13, the U.S. federal banking agencies 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.

EC 5	Principle 12: Consolidated supervision
Criterion	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.
Legal Framework	The U.S. federal banking agencies 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.
Practices and Procedures	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.

EC 5	Principle 12: Consolidated supervision
	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. 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.

EC 6	Principle 12: Consolidated supervision
Criterion	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: (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.
Legal Framework	As discussed under Principles 1.6, 15, and 16, the U.S. federal banking agencies 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.
Practices and Procedures	The U.S. federal banking agencies 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 can be conducted. In practice, the federal banking agencies 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.

EC 7	Principle 12: Consolidated supervision
Criterion	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.[71]

[71] Please refer to Principle 16, Additional Criterion 2.

EC 7	Principle 12: Consolidated supervision
Legal Framework	As noted in EC 4, statutes authorize the relevant federal banking agencies to examine and require reports from individual banks in the group. The U.S. federal banking agencies 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.
Practices and Procedures	An important element of effective consolidated supervision is the supervision of individual banks within a banking organization. The federal banking agencies 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. Effective consolidated supervision requires strong, cooperative relationships between the federal banking agencies and relevant domestic and foreign primary banking supervisors or functional regulators. These relationships respect the individual statutory authorities and responsibilities of the respective supervisors and regulators and provide for appropriate information flows and coordination so that individual responsibilities can be carried out effectively while limiting the potential for duplication or undue burden. Information sharing among domestic and 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 Dodd-Frank Act and the GLB Act that govern the interaction between the Federal Reserve as consolidated supervisor, and the other primary federal banking supervisors. Under these provisions, in conducting consolidated supervisory responsibilities, the Federal Reserve relies to the fullest extent possible on the assessments and information developed by other supervisors and regulators, including: (i) reports that a holding company or its subsidiary has provided to other federal or state supervisors or to an appropriate self-regulatory organization; (ii) information that is otherwise required to be reported publicly; and (iii) externally audited financial statements. In addition, the Federal Reserve relies to the fullest extent possible on the reports of examination of: (i) a bank made by its appropriate federal or state supervisory authority, (ii) a broker-dealer or investment adviser made by or on behalf of the SEC or Commodity Futures Trading Commission (CFTC), relevant state regulatory authority, or a licensed insurance company made by, or on behalf of, its appropriate state regulatory authority. The U.S. federal banking agencies 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. federal banking agencies also consider transactions or relationships between the bank and its affiliates.

EC 7	Principle 12: Consolidated supervision
	In conjunction with state bank and thrift supervisors, the U.S. federal banking agencies 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 federal banking agencies related to securities and insurance companies in a holding company or a financial conglomerate that includes a bank. U.S. law authorizes the U.S. federal banking agencies to exchange financial records, examination reports, and other information regarding banks and holding companies.

EC 8	Principle 12: Consolidated supervision
Additional Criterion	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.
Legal Framework	Only companies that are regulated BHCs may hold controlling interests in banks, and their managerial resources 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. federal banking agencies 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)).
Practices and Procedures	As noted in EC5, as consolidated supervisor the Federal Reserve has the authority and responsibility to understand and assess the risks that the parent holding company may pose to the holding company itself or its bank subsidiaries. As noted in EC6, the Federal Reserve has the authority to take action against a parent holding company to prevent it from engaging in unsafe or unsound practices or to address violations of law that occur in connection with its own business operations even if those operations are not directly connected to the holding company's subsidiary banks. 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.

Assessment of Principle 12	Largely Compliant

Comments	A lack of full compliance with this principle is based on the absence of a capital rule for corporate and insurance company SLHCs, and rules, guidance, and a formal rating system for SLHCs have not been adopted.

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.

(Reference documents: *FSB Key Attributes for Effective Resolution Regimes, November 2011; Good practice principles on supervisory colleges, October 2010; Home-host information sharing for effective Basel II implementation, June 2006*[72]*; The high-level principles for the cross-border implementation of the New Accord, August 2003; Shell banks and booking offices, January 2003; Report on Cross-Border Banking Supervision, June 1996; Information flows between Banking Supervisory Authorities, April 1990; Principles for the supervision of banks' foreign establishments (Concordat), May 1983.)*

EC 1	**Principle 13: Home-host relationships**
Criterion	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 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.
Legal Framework	The U.S. federal banking agencies have statutory authority to share confidential supervisory information with foreign banking regulators (*see* 12 U.S.C. § 3109). Information may be shared if disclosure is appropriate for bank supervisory or regulatory purposes, and sharing would not prejudice the interests of the United States. Foreign bank regulators must agree to keep the information confidential to the extent possible under applicable law. Under this authority, the U.S. federal banking agencies have established supervisory colleges for U.S. banking groups that have material cross-border operations. The U.S. federal banking agencies 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.
Practices and Procedures	The Federal Reserve and OCC each chairs 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

[72] When assessing compliance with the Core Principles, this reference document is only relevant for banks and countries that have implemented Basel II.

EC 1	Principle 13: Home-host relationships
	which the Federal Reserve and OCC do not have standing information-sharing arrangements participate on the basis of *ad hoc* confidentiality undertakings. 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. As appropriate, supporting documentation is circulated to college members before and after meetings. Documentation on banks' activities relevant to host supervisors is also circulated between meetings.

EC 2	Principle 13: Home-host relationships
Criterion	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 group[73] 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.
Legal Framework	The U.S. federal banking agencies share information bilaterally with home and host supervisors, under both standing arrangements, such as memoranda of understanding (MoUs) and statements of cooperation (SOCs), and in response to requests on a case-by-case basis. As noted in EC 1, the U.S. federal banking agencies also share information in supervisory colleges. The MoUs and SOCs are nonbinding statements of intent to share information, cooperate in connection with onsite examinations, and protect the confidentiality of received information. On a case-by-case basis, the U.S. federal banking agencies share information with foreign supervisors that have a legitimate supervisory need for the information and agree to keep it confidential.
Practices and Procedures	U.S. federal banking agencies 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. federal banking agencies have ongoing contact with supervisors in other countries in which U.S. banks have material operations. Information sharing by the U.S. federal banking agencies 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

[73] 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.

EC 2	Principle 13: Home-host relationships
	specific bank, holding company or supervisory issue. Additionally, U.S. federal banking agencies periodically visit foreign supervisory authorities to discuss supervisory issues. The U.S. federal banking agencies 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. federal banking agencies 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. federal banking agencies 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. federal banking agencies 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 *(Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations, i.e.,* Federal Reserve SR letter 00-14 and OCC's *Federal Branches and Agencies Supervision Handbook*[74]), 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; 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. federal banking agencies communicate with home country supervisors on subsidiaries of foreign banks and banking organizations. The U.S. federal banking agencies will apprise home supervisors of significant concerns and impending supervisory actions, and will provide reports of examination upon request. Information sharing through MoUs, SOCs or similar arrangements has become increasingly common. Today, U.S. federal banking agencies 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).*[75] Typically, an

[74] www.occ.treas.gov/handbook/fba.pdf
[75] www.bis.org/publ/bcbs83.pdf?noframes=1

EC 2	Principle 13: Home-host relationships
	MoU addresses sharing of information, including contact during the authorization process of a cross-border establishment and contact and communication in the ongoing supervision of such entities; supervisory cooperation in carrying out inspections in the host jurisdiction, as well as cooperation in BSA/AML violations, terrorist financing, and unauthorized banking business; information sharing about parallel banking organizations; sharing and safeguarding confidential information and using it for lawful supervisory purposes only; encouraging continuous and informal contacts between the supervisors; and arranging visits and internships where practical. U.S. federal banking agencies are authorized to share relevant supervisory information with foreign banking supervisors even in the absence of a formal arrangement such as an MoU. In practice the U.S. federal banking agencies share significant information with foreign supervisors whether the U.S. federal banking agencies 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. federal banking agencies 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.

EC 3	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	Under the statutory authority that allows sharing confidential supervisory information with foreign bank regulators (*see* EC 1), the U.S. federal banking agencies coordinate supervisory activities with host and home supervisors to improve the effectiveness and efficiency of supervision.
Practices and Procedures	As noted in the response to EC 2, the U.S. federal banking agencies 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 crisis management groups. Additionally, U.S. federal banking agencies periodically visit foreign supervisory authorities to discuss supervisory issues. As host country supervisors, the U.S. federal banking agencies 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. federal banking agencies regularly conduct examinations of the foreign operations of banks and BHCs in coordination with host country supervisors.

EC 4	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	In addition to the MoUs and SoCs described above, the U.S. federal banking agencies 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.
Practices and Procedures	The U.S. federal banking agencies communicate with foreign supervisors through formal processes (*i.e.*, MOUs, SOCs, supervisory colleges) and informal processes (*e.g.*, ad how conference calls, email). Ongoing communication between home and host supervisors and with supervised banking 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. Also, the U.S. supervisors have implemented the Financial Stability Board's protocols for establishing supervisory colleges for major global banks. In doing so, the U.S. supervisors have convened supervisory colleges with host supervisors of significant operations of U.S. banks. The aforementioned practices all facilitate a common understanding of key supervisory issues and promote consistency in supervisory approach and messaging.

EC 5	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	The U.S. federal banking agencies have 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. Section 15 of the International Banking Act (12 U.S.C. § 3109) authorizes the U.S. federal banking agencies to disclose information obtained in the course of exercising their supervisory or examination authority to any foreign bank regulatory or supervisory authority. The disclosure must be appropriate and it cannot prejudice the interests of the United States. The U.S. federal banking agencies also have authority under section 8(v) of the Federal Deposit Insurance Act (12 U.S.C. § 1818(v)(2)(C)) to assist foreign banking supervisors by investigating and collecting information and evidence. Such assistance may be provided only when 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 relating to banking matters or currency transactions administered or enforced by the requesting authority. The U.S. federal banking agencies also have authority to share information with others in appropriate cases. *See*, e.g., 12 U.S.C § 326; 12 U.S.C. § 1817(a)(2)(C); 12 CFR part 4, subpart C; 12 CFR 309.6(b)(3). With specific reference to cross-border cooperation for

EC 5	Principle 13: Home-host relationships
	crisis preparation, Crisis Management Groups (CMGs) have been established for the largest, most systemic, U.S. banking groups and the U.S. federal banking agencies are in the process of completing cooperation agreements that will govern the activities and information sharing in each CMG.
Practices and Procedures	The U.S. federal banking agencies 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. federal banking agencies also participate as home and host authorities in supervisory colleges established for numerous banking institutions at which recovery plans created by those institutions are reviewed. Pursuant to the authorities outlined above, the U.S. federal banking agencies have entered into a number of memoranda of understanding, statements of cooperation, and other arrangements establishing frameworks for cooperation and the exchange of information in connection with their respective supervisory, resolution, and other responsibilities with foreign authorities. U.S. federal banking agencies are authorized to share relevant supervisory information with foreign banking supervisors even in the absence of a formal arrangement such as an MoU, and in practice the U.S. federal banking agencies share significant information with foreign supervisors whether the U.S. federal banking agencies 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 it is provided.

EC 6	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	*See* response to EC 5.
Practices and Procedures	The U.S. federal banking agencies 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. federal banking agencies also participate as home and host authorities in supervisory colleges established for numerous banking institutions at which recovery plans created by those institutions are reviewed.

EC 7	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	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 United States, 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, which directed the Federal Reserve to issue these standards in order to prevent or mitigate risks to U.S. financial stability that could arise from the material financial distress or failure of ongoing activities of certain U.S. and foreign banking organizations. For a foreign banking organization 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 Financial Stability Oversight Council has determined pose a grave threat to the financial stability of the United States. 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. Last, the U.S. intermediate holding company requirement facilitates a level playing field between foreign and U.S. banking organizations operating in the United States, in furtherance of national treatment and competitive equity.
Practices and Procedures	As noted, the IBA establishes a framework under which "national treatment" is afforded to foreign banks doing business in the United States. 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*[76] provide

[76] www.occ.gov/handbook/fba.pdf

EC 7	Principle 13: Home-host relationships
	guidance for assessing whether a consumer compliance or Community Reinvestment Act (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*[77] and the Federal Reserve's CA letter 03-12. 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 savings associations[78]

EC 8	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	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. The U.S. federal banking agencies expect foreign home supervisors to notify the relevant U.S. federal banking agencies in advance of any onsite inspection or examination of U.S. operations of a foreign bank. It is the practice of the U.S. federal banking agencies always to notify foreign host supervisors when the U.S. federal banking agencies plan to do an onsite inspection or examination of a cross-border operation of a U.S. banking group in that host supervisor's jurisdiction.
Practices and Procedures	Foreign supervisors may conduct on-site examinations of their banks' cross-border establishments in the United States and would generally have access to all information, including individual customer account information, necessary for assessing safety and soundness and compliance with KYC requirements. Before conducting such examinations, foreign supervisors should contact the relevant U.S. federal banking agencies 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. federal banking agencies. 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. In general, the U.S. federal banking agencies expect to be permitted on-site access to foreign offices and 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. federal banking agencies inform host supervisors in advance of intended visits to foreign offices and subsidiaries. MOUs and SOCs generally contain provisions regarding on-site examinations.

[77] www.occ.treas.gov/handbook/banksup.pdf (pages 17-19)
[78] The statute and regulations governing SLHCs apply to both foreign and domestic SLHCs. *See generally*, 12 U.S.C.§ 1467a; 12 CFR Parts 583-585.

EC 9	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	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.
Practices and Procedures	A foreign shell bank is a foreign bank without a physical presence in any country. Shell banks are not permitted to operate in the United States. In addition, the United States has taken measures to prevent foreign shell banks from directly or indirectly accessing the U.S. financial system. Banks also must take reasonable steps to ensure that any correspondent account established, maintained, administered, or managed in the United States 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 US 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 United States for any foreign shell bank other than a regulated affiliate of a U.S. or foreign bank. *See* 31 CFR 103.177

EC 10	Principle 13: Home-host relationships
Criterion	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.
Legal Framework	As a general matter, the U.S. federal banking agencies 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.
Practices and Procedures	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 agencies involved 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. federal banking agencies 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 01-30; and OCC's PPM 5500-1 (Rev).

Assessment of Principle 13	Compliant

Comments	

Principle 14: Corporate governance

The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organisational structure, control environment, responsibilities of the banks' Boards and senior management,[79] and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.

(Reference documents: *Principles for enhancing corporate governance, October 2010 and Compensation principles and standards assessment methodology, January 2010.)*

EC 1	Principle 14: Corporate governance
Criterion	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.
Legal Framework	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. The Federal Reserve, the OCC, and the FDIC (federal banking agencies) 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 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 *Bank Holding Company Supervision Manual*, *Commercial Bank Examination Manual*, and specific supervisory letters (e.g., SR Letter 12-17, *Consolidated Supervision Framework for Large*

[79] Please refer to footnote 27 under Principle 5.

EC 1	Principle 14: Corporate governance
	Financial Institutions; SR Letter 08-09, *Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations*; and SR Letter 97-25, *Risk-Focused Framework for Supervision of Community Banks*). 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 in the Comptroller's Handbook, including booklets on *Duties and Responsibilities of Directors*, *Management and Board Processes*, *Insider Activities*, and *Management Information Systems*. The OCC's Licensing Manual *Charters* also provides specific requirements for directors and senior management of national banks. The OCC is currently in the process of preparing an updated Comptroller's Handbook, *Corporate and Risk Governance*. In addition, the OCC has published other guidance designed specifically for directors, including *The Director's Book-The Role of a National Bank Director*, *Detecting Red Flags in Board Reports-A Guide for Directors*, and *Internal Controls-A Guide for Directors*. The OCC also offers workshops across the country for community bank directors. 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 foreign banking organizations (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. *See Bank*

EC 1	Principle 14: Corporate governance
	Holding Company Supervision Manual, Section 2124.07.4; *Commercial Bank Examination Manual*, Section 5000.1; SR Letter 04-18, *Bank Holding Company Rating System*; SR Letter 95-51, *Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies*; and the United States Sentencing Commission's *Federal Sentencing Guidelines Manual*. *See* OCC's *Comptroller's Handbook*: Safety and Soundness booklets, Asset Management booklets, and Consumer Compliance booklets. 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. These expectations include ensuring that each bank's board of directors is focused on protecting the safety and soundness of the institution by adopting separate and focused governance and risk management practices; requiring large institutions to have a well-defined personnel management program to ensure appropriate staffing levels, orderly succession, and appropriate compensation tools; defining and maintaining an acceptable risk appetite across the organization in key risk categories; implementing reliable oversight programs, including audit and risk management; and ensuring that the board of directors is willing and able to provide a credible challenge to bank management's decision-making and taking an active role in supervision of management. The OCC began informally communicating these expectations to large banks in 2010, with examiners meeting with banks' management teams on a regular basis to update and assess the bank's progress toward meeting the OCC's Heightened Expectations. 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 proposed Heightened Expectations guidelines would apply to banks supervised by the OCC with average total assets of $50 billion or greater. The OCC has proposed to issue these guidelines as a new Appendix D to 12 CFR part 30. The proposed guidelines provide that each member of the board has a duty to oversee a bank's conformance with safe and sound banking practices. Consistent with this duty, the board should ensure that the bank establishes and implements an effective framework that complies with the proposed guidelines. The board or its risk committee should also approve any changes to the framework. The proposed 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 would be mandated to establish effective talent management processes 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 public comment period on the proposed guidelines closed on March 28, 2014, and the adoption of final guidelines is forthcoming.
Practices and Procedures	The U.S. federal banking agencies conduct on-site examinations of each holding company and bank for which they have primary supervisory authority, and review the quality and soundness of the organization's corporate governance. Supervised financial institutions must provide the federal banking agencies with full and complete access to their books, records, employees, and directors or risk imposition of administrative sanctions. The agencies have developed examination procedures which

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	are designed to inform judgments on the ratings assigned in the bank holding company and bank rating systems. As noted in the Federal Reserve's *Bank Holding Company Supervision Manual*, Section 2124.07, and the OCC *Comptroller's Handbook, Bank Supervision Process* booklet, the business of banking is fundamentally predicated on taking risks, and the components of the supervisory rating system are strongly influenced by risk exposure. Consequently, the procedures for full-scope inspections focus to a large degree on assessing the types and extent of risks to which financial institutions and their subsidiaries are exposed, evaluating the organization's methods of managing and controlling its risk exposures, and ascertaining whether management and directors fully understand and are actively monitoring the organization's exposure to those risks. The U.S. federal banking agencies 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 *Bank Holding Company Supervision Manual*, Section 1050.3.1, and OCC *Comptroller's Handbook, Safety and Soundness* booklets. The Federal Reserve's BHC rating system provides an assessment of certain risk management and financial condition factors that are common to all BHCs, as well as an assessment of the potential impact of the parent BHC and its nondepository subsidiaries (collectively nondepository entities) on the BHC's subsidiary depository institutions. *See Bank Holding Company Supervision Manual*, Section 1000. Under this system, the Federal Reserve endeavors to ensure that all BHCs, including financial holding companies (FHCs), are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on the BHCs that exhibit financial and operational weaknesses or adverse trends. Under the OCC's Risk Assessment System (RAS) examiners document their conclusions regarding the quantity of risk (high, moderate or low), the quality of risk management (strong, satisfactory or weak), the level of supervisory concern (measured as aggregate risk of high, moderate or low), and the direction of risk (decreasing, stable or increasing). Examinations of large and mid-size banks focus on the overall integrity and effectiveness of risk management systems. Annual validation, a vital component of large and mid-size bank examinations, verifies the integrity of these risk management systems. Risk management systems in

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	community banks will vary based on the level and complexity of risk a bank assumes. Examinations of community banks focus on a bank's practices and its ability to properly manage risk. In addition, compliance with some rules is monitored on an ongoing basis through the collection and analysis of financial and structure reports which financial institutions are required to file on a periodic basis. 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 and operation of sound business practices. These internal compliance programs are evaluated by the federal banking agencies during on-site examinations.

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Criterion	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determine 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.
Legal Framework	As noted in EC 1 above, the U.S. federal banking agencies conduct regular on-site examinations of banks and bank holding companies, the frequency of which is based in part on the size and overall risk profile of the institution. With certain exceptions for small banks, the federal banking agencies conducts full scope, on-site examinations at least once during each 12-month period, but an institution may be examined as frequently as deemed necessary. *See* 12 CFR 208.64; Federal Reserve SR Letter 96-14 (SUP), *Risk-focused Safety and Soundness Examinations and Inspections*; SR Letter 07-8, *Expanded Examination Cycle for Certain Financial Institutions*; SR Letter 13-21, *Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less*; and *Commercial Bank Examination Manual*, Section 1000.1; and OCC *Comptroller's Handbook* and *Bank Supervisory Process Booklet*. It is the responsibility of the directors and management of the parent company to establish and supervise the policies of subsidiaries, either directly or through appropriate delegation of authority. *See Bank Holding Company Supervision Manual*, Section 2010.0. The importance of written policies in a delegated, decentralized organization cannot be overemphasized, and the selection of qualified officers to carry out policies is equally important. If written policies have not been developed by the holding company, supervisory staff should recommend that major policies be written and communicated to subsidiaries. Policies should ensure that subsidiaries are not managed for cross purposes and should avoid concentrations of risks on a consolidated basis. Additionally, the bank's board must carefully review holding company policies that affect the bank to ensure that the policies adequately serve the bank. The bank's board is responsible for either approving or recording its lack of approval of holding company directives that affect the bank and then monitor those directives. *See* OCC's *The Director's Book*. 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

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	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.* The federal banking agencies 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. 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, *Bank Holding Company Rating System.*[80] With regards to rating domestically chartered banks (nationally-chartered banks, state-chartered member banks, state-chartered nonmember banks, and savings associations), the federal banking agencies 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).[81] 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. 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. If a bank is determined to be a problem or have exhibited significant deterioration in its condition, examiners are required to conduct meetings with the bank's board of directors. While the board of directors itself may not directly undertake the work to remediate supervisory findings, it is important that the board be made aware of significant supervisory issues and ultimately be accountable for the safety and soundness and assurance of compliance with applicable laws and regulations of the organization. Examiners formally

[80] Indicative RFI/C (D) ratings are assigned to SLHCs per SR 13-08.
[81] *See* Federal Reserve SR Letter 96-38; and OCC *Bank Supervision Process* booklet.

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	communicate Matters Requiring Immediate Attention (MRIAs) and Matters Requiring Attention (MRAs) in writing to the board. The board of directors is required to respond in writing regarding planned corrective action within timeframes that may be specified by the examiners. In cases where the organization fails to take appropriate corrective action or make satisfactory progress to address the MRIA or MRAs, a formal or informal investigation, or enforcement action may be initiated. *See* SR Letter 95-19 (SUP), *Revisions to Guidance on Meetings with Boards of Directors*; SR Letter 96-26, *Provision of Individual Components of Supervisory Rating Systems to Management and Boards of Directors*; SR Letter 13-13, *Supervisory Considerations for the Communication of Supervisory Findings*; *Commercial Bank Examination Manual*, Section 5030.1. *See* OCC *Comptroller's Handbook: Large Bank Supervision, Community Bank Supervision and the Bank Supervision* booklets. The federal banking agencies have a broad range of enforcement powers over financial institutions and institution-affiliated parties. These include formal actions such as cease-and-desist orders, written agreements, prompt corrective action directives, and civil money penalties. *See* 12 U.S.C. § 1818(e). Supervisors may also use informal supervisory tools when circumstances warrant a less severe form of action, including commitments, resolutions of the institution's board of directors, and memoranda of understanding. *See* *Commercial Bank Examination Manual*, Section 5040.1, and the *Comptroller's Handbook and The Director's Book*.
Practices and Procedures	Financial institutions are expected to have policies, internal controls and information systems that are appropriate to the size of the institution and the nature, scope and risk of its activities and that provide for: 1) an organizational structure that establishes clear lines of authority and responsibility for monitoring adherence to established policies; 2) effective risk assessment; 3) timely and accurate financial, operational and regulatory reports; 4) adequate procedures to safeguard and manage assets; and 5) compliance with applicable laws and regulations. The federal banking agencies evaluate the adequacy of the bank's and holding company's internal controls, including its corporate governance policies and practices, during on-site examinations, on- and off-site periodic monitoring and supervisory activities, and through various surveillance activities. In conducting these activities, supervisors review whether the bank and holding company have internal controls in place that are adequate for the nature and scale of their business and the associated risks. When evaluating the adequacy of a bank's and holding company's internal controls and audit procedures, supervisors consider whether 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. The federal banking agencies conduct risk assessments and full scope examination with a focus on the organization's policies and procedures for identifying, managing, and controlling its risk exposures and determining whether the management and directors are actively involved in the oversight of the organization's risk management program. *See* Amended "Interagency Guidance on the Internal Audit Function and its Outsourcing," pp. 2-3; Federal Reserve *Bank Holding Company Supervision Manual*, Section 1000; *Commercial Bank Exam Manual*, Section 1010; SR Letter 95-51; and OCC *Comptroller's Handbook* "*Internal Control*," "*Internal and External Audit*," and "*Bank Supervision Process*" booklets; *Examination Handbook* sections "External Audit" and "Internal Audit" sections; and FDIC *Risk Management Manual of Examination Policies*, section 4.2. The U.S. federal banking agencies 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 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

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	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.[82] *See* discussion of the CAMELS and RFI/D (C) rating systems in Legal Framework for EC 2 above. Examiners generally discuss their supervisory findings in exit meetings with an institution's board of directors and senior management, and then communicate their findings in writing to the institution's board of directors or an executive-level committee of the board. If a bank is determined to be a problem or have exhibited significant deterioration, examiners are required to conduct meetings with the bank's board of directors. While the board itself may not directly undertake the work to remediate supervisory findings, it is important that the board be made aware of significant supervisory issues, require management to implement corrective actions, and are ultimately be accountable for the safety and soundness and assurance of compliance with applicable laws and regulations of the organization. Section 404 (b) of SOX, 15 U.S.C. § 7262(b), requires auditors of public companies to annually render an opinion on the effectiveness of the entity's internal controls over financial reporting. Under section 36 of the FDI Act, 12 U.S.C. § 1831m(b) & (c), management of nonpublic banks with $1 billion or more in total assets must annually assess the effectiveness of internal control over financial reporting as of year-end and have the bank's and holding company's independent auditor render an opinion on management's assertion concerning internal control. *See* 12 CFR 363.2(b), 363.3(b), & Appendix A (FDIC's implementing regulation). Supervisors review these reports as well as the list of weaknesses or deficiencies from auditor's opinions under SOX to determine where control weaknesses exist and whether management is addressing these deficiencies in a timely manner. *See* SR Letter 96-26, *Provision of Individual Components of Supervisory Rating Systems to Management and Boards of Directors*; SR Letter 13-3, *Supervisory Considerations for the Communication of Supervisory Findings*; *Commercial Bank Examination Manual*, Section 5030.1 and OCC *Comptroller's Handbook: Large Bank Supervision, Community Bank supervision and Internal and External Audit* booklets. Once the OCC finalizes the proposed Appendix D to 12 CFR part 30, it is anticipated that OCC examiners will assess whether the banks are meeting the standards set forth therein. If a bank is not meeting the standards, the OCC would have discretion to determine whether to require the bank to submit a plan specifying the steps it will take to comply with the standards. In addition, the OCC may initiate the enforcement process when it determines, through examination or otherwise, that the applicable bank has failed to meet the standards contained in the proposed Appendix D. In such cases, the bank would have 30 days to submit a compliance plan. If the bank fails to submit a compliance plan, or fails to materially comply with an OCC-approved compliance plan, the OCC may pursue

[82] For more information on the FRS's bank holding company rating system, see SR letter 04-18, "Bank Holding Company Rating System," available at: http://www.federalreserve.gov/boarddocs/srletters/2004/sr0418.htm.

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	further, formal enforcement actions which could result in civil money penalties under 12 U.S.C. § 1818. *See* generally Appendices A and B to 12 CFR parts 30 and 170.

EC 3	Principle 14: Corporate governance
Criterion	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.
Legal Framework	As noted in EC 1 above, 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, 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, SOX). 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. 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. The bank holding company'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. *See* 12 U.S.C. § 5365; and 12 CFR 252.132, 252.144, and 252.153. As discussed in EC 2, as part of the regular examination process of banks and bank holding companies, the federal banking agencies assess the adequacy of an institution's corporate governance structures, adherence to various state and federal laws and regulations governing the nomination and appointment of directors, and the institution's adherence to its internal policies and procedures with respect to the composition and effectiveness of the board of directors. For example, the OCC's Licensing Manuals, including *Charters* and *General Policies and Procedures*, list specific requirements for a national bank's organizational documents. In

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	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 required to establish and adhere to a formal, ongoing training program for independent directors. OCC examiners would evaluate each director's knowledge and experience. 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. *See* 12 U.S.C. § 1831m(g); and 12 CFR 363.5. 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. *See* 15 U.S.C. § 78j-1. 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. *See* 15 U.S.C. § 7265. Additionally, as part of their remedial powers, the federal banking agencies may limit the powers of institution-affiliated parties (IAP) (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. Id. § 1818(e)(7). In general, supervisors try to address deficiencies in the composition of the board or management by less formal means and as part of a broader effort to resolve prudential concerns. There is also a 30-day prior-notice requirement for appointing any new directors or senior executive officers of banks and bank holding companies. *See* section 32 of the FDI Act (12 U.S.C. 1831i) and subpart H of Regulation Y (12 CFR 225.71). This notice requirement also applies to any change in the responsibilities of any current senior executive officer that proposes to assume a different position. *See* SR Letter 03-06, Guidance Regarding Restrictions on Institutions in Troubled Condition. 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.
Practices and Procedures	As discussed in EC 1, 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. The federal banking agencies' primary expectations for the board and its committees include:

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	• 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; • 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 strong corporate values and conduct, prudent risk taking and compliance with the law and ethical business practices; • Approving significant strategies and policies; • Demonstrating leadership, expertise, and effectiveness; • Ensuring the organization has an effective and independent internal audit function; • Ensuring the organization has appropriate policies governing the segregation of duties and avoiding conflicts of interest; and • Ensuring that public disclosures are consistent with how the board and senior management assess and manage the risks of the organization, balancing quantitative and qualitative information with clear discussions about risk management processes, and reflect evolving disclosure practices for peer organizations. The federal banking agencies' guidance states the board should be knowledgeable about the general content of the compliance program and exercise appropriate oversight of the program. Accordingly, the board should review and approve key elements of the organization's compliance risk management program and oversight framework, including firm-wide compliance policies, compliance risk-management standards, and roles and responsibilities of committees and functions with compliance oversight responsibilities. The board should oversee management's implementation of the compliance program and the appropriate and timely resolution of compliance issues by senior management. The board should exercise reasonable due diligence to ensure that the compliance program remains effective by at least annually reviewing a report on the effectiveness of the program. The board may delegate these tasks to an appropriate board-level committee.

EC 4	Principle 14: Corporate governance
Criterion	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty".[83]
Legal Framework	As noted in footnote 6 below and 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 United States. For a plaintiff to place an action against the corporation's board of directors in the court of law, the plaintiff would need to

[83] 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."

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	prove that one of the directors breached their fiduciary duty and breached their duty of care or duty of loyalty. Banks in the United States 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".
Practices and Procedures	The federal banking agencies establish expectations of boards of directors and senior management.[84] The level of technical knowledge required of directors may vary 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. For each BHC and bank, the federal banking agencies develop an understanding of the legal, operating, and corporate governance structure of the organization and its primary strategies, business lines, and risk management and internal control functions. *See Bank Holding Company Supervision Manual*, Section 1050.1, and *OCC Comptroller's Handbook, Bank Supervision Process* booklet This understanding will inform the development of a risk assessment and supervisory plan for the BHC or bank. Key elements that are identified and understood by the supervisory staff include: 1) corporate strategy; 2) significant activities; 3) structure; 4) corporate governance, risk management, and internal controls for primary risks; and 5) presence in critical and key financial markets. Also, as noted in EC 1, the federal banking agencies will 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 as well as guidance. In addition, compliance with some rules is monitored on an ongoing basis through the collection and analysis of financial and structure reports that must be filed. Federal banking agencies confirm that banks and holding companies assessment includes an evaluation of the board members qualifications, effectiveness, and their exercise of good judgment in fulfilling their duties. These internal compliance programs and risk management practices are evaluated by these agencies during on-site examinations.

[84] *See* OCC *Comptroller's Handbooks* "Insider Activities," "Duties and Responsibilities of Directors," and "Management and Board Processes."

EC 5	Principle 14: Corporate governance
Criterion	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite[85] and strategy, and related policies; establishes and communicates corporate culture and values (eg through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Legal Framework	*See* EC 1 and EC 2, and OCC *Comptroller's Handbooks*, *Insider Activities*, and *Duties and Responsibilities of Directors* booklets and *The Director's Book*.
Practices and Procedures	As noted in EC 1 and EC 2 above, the federal banking agencies 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. *See also* SR Letter 12-17/CA Letter 12-14, *Consolidated Supervision Framework for Large Financial Institutions*; SR Letter 08-09/CA Letter 08-12, *Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations*; SR Letter 97-25, *Risk-Focused Framework for the Supervision of Community Banks*; and *Bank Holding Company Supervision Manual*. For OCC, *see Comptroller's Handbook, Large Bank Supervision, Community Bank Supervision and Bank Supervision Process* booklets. The OCC's supervision of national banks and federal savings associations (collectively, banks) is directed at identifying significant or emerging problems in individual banks and the banking system and ensuring that such problems are appropriately corrected. 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. The OCC assesses how well a bank manages its risks over time, rather than assessing only the condition at a single point in time. Federal banking agencies review whether the board oversees the direction of 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

[85] "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.

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	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. 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. 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.

EC 6	Principle 14: Corporate governance
Criterion	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.
Legal Framework	*See* EC 1 and EC 5.
Practices and Procedures	The federal banking agencies 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 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. 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. Senior management is expected to provide effective supervision of the day-to-day activities of all officers and employees, including the supervision of the senior officers and

EC 6	Principle 14: Corporate governance
	the heads of business lines. Additionally, senior management is expected to provide the board with timely, accurate, and comprehensive MIS reports that are adaptive to changing circumstances regarding risks and controls. As discussed in EC 3, the federal banking agencies 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.* 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 and assess whether the bank's board of directors is meeting the expectations described above.

EC 7	Principle 14: Corporate governance
Criterion	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.
Legal Framework	The federal banking agencies 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 and are rectified if there are deficiencies. To be consistent with safety and soundness, 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

EC 7	Principle 14: Corporate governance
	corporate governance processes related to these arrangements. Banking organizations are expected to immediately address any identified deficiencies in these arrangements or processes that are inconsistent with safety and soundness. Further, boards of directors at banking organizations are ultimately responsible for ensuring that their 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 that may pose a threat to the safety and soundness of the organization. The expectations of the Guidance are reemphasized in SR Letter 12-17/CA Letter 12-14, *Consolidated Supervision Framework for Large Financial Institutions*, where boards of directors, with the support of senior management, are expected to ensure that compensation arrangements and other incentives are consistent with the corporate culture and institutional risk appetite. In the proposed Appendix D to 12 CFR part 30, the OCC reiterates the need for the bank to establish and adhere to compensation and performance management programs that meet the requirements of applicable statutes and regulations and are appropriate to ensure that management and staff adhere to an effective risk governance framework; ensure that the risk creators compensation plans and decisions appropriately consider level and severity of issues raised by independent risk management and internal audit; and prohibit incentive-based pay/compensation that encourages inappropriate risks by providing excessive compensation that could lead to material financial losses. Section 39(c) of the FDI Act (Compensation Standards) requires the federal banking agencies 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. *See also* 12 CFR 7.2011; 12 CFR 163.39; 12 CFR part 30, App. A; 12 CFR part 208, App. D. Additionally, except for certain extensions of credit that are made in the ordinary course of the consumer credit business of the issuer, are generally made available by such issuer to the public, and are made by such issuer on market terms or terms no more favorable than those offered to the general public for such extensions of credit, Section 402 of SOX prohibits public companies, including banks and BHCs, from offering, renewing, or extending the terms of personal loans to any executive officer or director of the company. Section 402 of SOX applies to all extensions of credit by banks which are not otherwise subject to the insider lending restrictions of the Federal Reserve Act (12 U.S.C. §§ 375a and 375b; 12 U.S.C. § 1468(b); 12 CFR 31; and 12 CFR 215).
Practices and Procedures	The federal banking agencies communicate supervisory findings related to incentive compensation through relevant reports of bank examination or inspection as well as continuous monitoring activities. The agencies work with banking organizations as necessary through the supervisory process to ensure that they promptly correct any deficiencies that may be inconsistent with the safety and soundness of the organization. If the deficiencies are not addressed, agencies' findings can be incorporated, as appropriate, into the organization's rating component(s) and subcomponent(s) relating to risk-management, internal controls, and corporate governance under the relevant supervisory rating system, as well as the organization's overall supervisory rating. In addition, 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

EC 7	Principle 14: Corporate governance
	the safety and soundness of the organization, particularly when the organization is not taking prompt and effective measures to correct the deficiencies. For example, the appropriate federal supervisor may implement an enforcement action if material deficiencies are found to exist in the organization's incentive compensation arrangements or related risk-management, control, or governance processes, or the organization fails to promptly develop, submit, or adhere to an effective plan designed to ensure that its incentive compensation arrangements do not encourage imprudent risk-taking and are consistent with principles of safety and soundness. As provided under section 8 of the FDI Act (12 U.S.C. 1818), an enforcement action may, among other things, require an organization to take affirmative action, such as developing a corrective action plan that is acceptable to the appropriate federal supervisor to rectify safety-and-soundness deficiencies in its incentive compensation arrangements or related processes. Where warranted, the appropriate federal supervisor may require the organization to take additional affirmative action to correct or remedy deficiencies related to the organization's incentive compensation practices. 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 (*see* discussion in EC 1). 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 (IAP) (12 CFR part 359); *see also* SR Letter 03-6, *Guidance Regarding Restrictions on Institutions in Troubled Condition*. 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.

EC 8	Principle 14: Corporate governance
Criterion	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (eg special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Legal Framework	The federal banking agencies establish expectations of boards of directors and senior management through various interagency statements including those referred to below. The level of technical knowledge required of directors may vary depending on the size, complexity, and business practices of the bank and 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. Directors and senior management oversight of the enterprise-wide compliance program, including approval of risk-management policies and monitoring of internal processes, is essential. *See* "Interagency Statement on Application of Recent Corporate Governance Initiatives to Non-Public Banking Organizations" (May

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	2003)[86], "Amended Interagency Guidance on the Internal Audit Function and its Outsourcing" (April 2003)[87], "Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities" (January 2007)[88], FDIC "Statement of Policy Concerning the Responsibilities of Bank Directors and Officers." (October 2005).[89] *See* also *Comptroller's Handbook, Related Organizations* booklet. In particular, the "Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities" provides risk management principles that should assist financial institutions in identifying, evaluating, and managing the heightened legal and reputational risks that may arise from their involvement in complex structured finance transactions (CSFTs). The board and senior management of a financial institution also should establish a "tone at the top" through both actions and formalized policies that sends a strong message throughout the financial institution about the importance of compliance with the law and overall good business ethics. The board and senior management should strive to create a firm-wide corporate culture that is sensitive to ethical or legal issues as well as the potential risks to the financial institution that may arise from unethical or illegal behavior. This kind of culture coupled with appropriate procedures should reinforce business-line ownership of risk identification, and encourage personnel to move ethical or legal concerns regarding elevated risk CSFTs to appropriate levels of management. In appropriate circumstances, financial institutions may also need to consider implementing mechanisms to protect personnel by permitting the confidential disclosure of concerns (i.e. whistle-blower protections). As in other areas of financial institution management, compensation and incentive plans should be structured, in the context of elevated risk CSFTs, so that they provide personnel with appropriate incentives to have due regard for the legal, ethical and reputational risk interests of the institution. Additionally, a financial institution's policies and procedures should provide for the appropriate levels of management and the board of directors to receive sufficient information and reports concerning the institution's elevated risk CSFTs to perform their oversight functions. "Interagency Guidance on Asset Securitization Activities"[90] discusses the role of the board of directors regarding securitization activities the bank conducts. The board is expected to ensure that there is audit staff competent to perform the review and the findings of audit or internal reviews regarding the data integrity, model algorithms, key underlying assumptions, and the appropriateness of the valuation and modeling process for the securitized assets retained by the institution are reported to the board or board committee. Additionally, sensitivity analysis of the changes in default rates, prepayment or payment rates, and discount rates should be performed and reported to the board, and the board is accountable for ensuring the "model builders" possess the necessary expertise and technical proficiency. Finally, the board and management are accountable for developing and implementing policies that limit the amount of retained interests that may be carried as a percentage of total equity capital.
Practices and Procedures	SR Letter 90-16, *Implementation of Examination Guidelines for the Review of Asset Securitization Activities*, provides extensive examination guidelines for supervisory staff to review asset securitization activities at the bank. This includes evaluating board review and approval of policies and procedures, as well as ensuring periodic and timely reporting of these activities to the board of

[86] *See* Federal Reserve SR letter 03-8; OCC Bulletin 2003-21; and FDIC FIL-17-2003.
[87] *See* Federal Reserve SR letter 03-5; OCC Bulletin 2003-12; and FDIC FIL-21-2003.
[88] *See* Federal Reserve SR letter 07-5; OCC Bulletin 2007-1; and FDIC p. 5369 "Pocket Guide Directors" (1988).
[89] *See* FDIC FIL-119-2005.
[90] *See* Federal Reserve SR Letter 99-37, *Risk Management and Valuation of Retained Interests Arising from Securitization Activities;* OCC Bulletin 1999-46, *Interagency Guidance on Asset Securitization Activities;* and FDIC FIL 109-99, *Guidance on Asset Securitization.*

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	directors. Similarly, *the OCC Comptroller's Handbook, Asset Securitization* booklet provides examination guidance to review asset securitization activities. Additionally, external and internal audits support board of directors and senior management understanding of the bank's and banking group's operational structure and its risks.

EC 9	Principle 14: Corporate governance
Criterion	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.
Legal Framework	As part of their remedial powers, the federal banking agencies 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 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. In addition, to the power to remove IAPs from office under the circumstances described above, federal banking agencies also have broad enforcement powers to bring formal and informal enforcement actions against IAPs. For example, civil money penalties may be assessed for failing to comply with laws and regulations, final or temporary cease-and-desist orders, prompt corrective action directives, or other written agreements. *See* 12 U.S.C. §§ 1817(j), 1844, and 1972. *See also* 12 U.S.C. 1831(i) and implementing regulations at 12 CFR 5.51 and part 163, subpart H (rules for (a) when a national bank and a Federal savings association, respectively, must notify the OCC of a change in its directors and senior executive officers and (b) the OCC's review and response of such notice).
Practices and Procedures	*See* discussion in Legal Framework above.

EC 10	Principle 14: Corporate governance
Additional Criterion	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.

EC 10	Principle 14: Corporate governance
Legal Framework	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.
Practices and Procedures	The federal banking agencies 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	Compliant.
Comments	

Principle 15: Risk management process

The supervisor determines that banks[91] have a comprehensive risk management process, including effective board of directors (board) and senior management oversight, to identify, measure, evaluate, monitor, report and control or mitigate[92] 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 supervisor determines that the risk management process is commensurate with the risk profile and systemic importance of the bank.[93]

(Reference documents: *Principles for enhancing corporate governance*, October 2010; *Enhancements to the Basel II framework*, July 2009; and *Principles for sound stress testing practices and supervision*, May 2009.)

Overview

[91] 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.

[92] 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.

[93] 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.

Principle 15: Risk management process

Taking and managing risks are fundamental to the business of banking. Accordingly, the agencies place significant supervisory emphasis on the adequacy of an institution's management of risk, including its system of internal controls. The agencies expect holding companies and banks to have in place comprehensive risk management policies and processes for identifying, evaluating, monitoring and controlling or mitigating all material risks. For banks, this expectation ultimately derives from the statutory responsibility of the agencies for the safety and soundness of institutions under their jurisdiction. *See, e.g.*, 12 U.S.C. § 1831p-1; 12 U.S.C. § 1818(b). Authority also derives from the agencies' ability to impose minimum capital levels on individual banks and BHCs as necessary and appropriate under the circumstances. *See* 12 U.S.C. §§ 3907, 3909.[94] These requirements are addressed in implementing safety and soundness guidelines, *see* 12 CFR parts 30 (OCC), 208 (Federal Reserve), 364 (FDIC), and Regulatory Capital Rules, *see* 12 CFR parts 3, 5, 6, 165, and 167 (OCC), 12 CFR parts 208, 217, and 225 (Federal Reserve), and 12 CFR parts 303, 308, 324, 327, 333, 337, 347, 360, 362-3645, 290, and 391 (FDIC). The Federal Reserve's authority is also derived from section 165 of the Dodd-Frank Act which requires the Federal Reserve to impose enhanced prudential standards on large BHCs, including, among other things, stress testing requirements; enhanced capital, leverage, liquidity, and risk management requirements; and a requirement to establish a risk committee.[95]

Since rules and regulations cannot reasonably prescribe the specific practices each individual institution should utilize in managing its risk, agencies have issued prudential policy and guidance documents that expand upon the requirements set forth in U.S. laws and regulations, and articulate expectations for sound practices. The agencies rely extensively on these policy and guidance documents in conducting their supervisory activities. Expectations regarding risk management programs (active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls) are detailed in supervisory guidance and examination manuals issued by the agencies and discussed in further detail below. These resources emphasize that individual programs should be appropriate to the size and activities of consolidated organizations and individual institutions and that risk management activities should be sufficiently independent of the business lines. Institutions are expected to conduct regular evaluations of their risk management systems to ensure that the systems are adjusted, as appropriate, in light of new products, changing risk profiles and external market developments.

EC 1	**Principle 15: Risk management process**
Criterion	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:

[94] The HOLA requires that safety and soundness regulations and policies that apply to savings associations must be at least as stringent as those that apply to national banks. *See* 12 U.S.C. § 1463(c). Although 12 U.S.C. § 3907 does not apply to savings associations, the HOLA requires the application of similar capital requirements to savings associations as to banks.

[95] 12 U.S.C. 5365.

EC 1	Principle 15: Risk management process
	(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 recognised; (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 take the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Legal Framework	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, *see, e.g.* 12 CFR Part 208, Appendix D-1, Part II; 12 CFR Part 30, Appendix A, Part II; the interagency guidelines implementing the 1996 Market Risk Amendment to Basel I (12 CFR Part 3, Appendix B, section (4)(b) (national banks), 12 CFR Part 208, Appendix E (state member banks), 12 CFR 225, Appendix E, section 4(b) (BHCs), 12 CFR 325, Appendix C, section 4(b) and 324, Subpart F (state nonmember banks); and the operational risk management provisions in the interagency guidelines on the advanced Basel II approaches, *see, e.g.*, 12 CFR Part 3, Appendix C, section 22 (h) and (j) (national banks and, subject to timing and transition provisions in the rules, Federal savings associations), 12 CFR Part 208, Appendix F, section 22(h) and (j) (state member banks), 12 CFR 225, Appendix G, section 22(h) and (j) (BHCs), 12 CFR 324.122(g) (state nonmember banks**)**; and the agencies' Supervisory Guidance on the Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Accord.[96] Assessments of the quality of risk management are included as part of the evaluation of the overall organization. The agencies have also established guidelines to help banking organizations establish incentive compensation policies that do not encourage imprudent risk-taking and are consistent safety and soundness of the organization. Guidance on Sound Incentive Compensation Policies, 75 FR 36395. The federal banking agencies and other federal agencies have also proposed rules to implement provisions of U.S. law that prohibit incentive-based payment arrangements, or any feature of any such arrangement, at a financial institutions, including holding companies and banks, that the agencies determine encourages inappropriate risks by a financial institution by providing excessive compensation or that could lead to material financial loss. Financial institutions also must disclose to its appropriate Federal regulator the structure of its incentive based compensation arrangements sufficient to determine whether the structure provides ''excessive compensation, fees, or benefits'' or ''could lead to material financial loss'' to the institution. *See* 76 CFR 21170; 12 U.S.C. 5641.

[96] 73 Fed. Reg. 44620 (July 31, 2008).

EC 1	Principle 15: Risk management process
	In 2010, the U.S. Congress passed the Dodd-Frank Act (DFA), which contained a range of additional requirements relating to risk management, capital, liquidity, stress testing, and other areas. These requirements are predominantly targeted at larger institutions and include the Enhanced Prudential Standards and early remediation requirements in sections 165-166 of DFA. Most of these requirements apply to banking institutions with at least $50 billion in total assets,[97] but some risk management and stress testing requirements also apply to institutions between $10 billion and $50 billion (such as annual company-run stress tests and formation of a risk committee).[98] 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. *See* 12 CFR Part 252, the Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations; 79 Fed. Reg. 17240. Similarly, the Volker Rule and derivatives push-out rule impose additional risk management responsibilities on management and the board. To further the goal of the Dodd-Frank Act, the OCC developed a set of "Heightened Expectations" to enhance the supervision and strengthen the risk management practices of large national banks. These expectations include ensuring that each bank's board of directors is focused on protecting the safety and soundness of the institution by adopting separate and focused risk management practices; defining and maintaining an acceptable risk appetite across the organization in key risk categories; implementing reliable oversight programs, including audit and an independent risk management function. The OCC began informally communicating these expectations to large banks in 2010, with examiners meeting with banks' management teams on a regular basis to update and assess the bank's progress toward meeting the OCC's Heightened Expectations. The OCC has also applied aspects of the Heightened Expectations to midsize banks.

[97] See 12 U.S.C. 5365(b)(1)(A)(iii) (require establishment of enhanced risk-management requirements for BHCs with total consolidated assets of $50 billion or more).

[98] See 12 U.S.C. 5365(h) (publicly traded BHCs with total consolidated assets of $10 billion or more are required to establish risk committees; the committee is responsible for the oversight of the enterprise-wide risk management practices of the company, must have a certain number of independent directors as members as the Federal Reserve determines is appropriate, and must include at least one risk-management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms). The enhanced risk-management and risk committee requirements were part of a set of enhanced prudential standards regulations implemented by the Federal Reserve. The Federal Reserve may determine to apply the enhanced prudential standards to any SLHC, if appropriate to ensure the safety and soundness of such company, on a case-by-case basis. See 79 Fed. Reg. 17240.

EC 1	Principle 15: Risk management process
	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 proposed heightened standards guidelines would generally apply to insured national banks, insured Federal savings associations and insured Federal branches of foreign banks supervised by the OCC with average total assets of $50 billion or greater. The OCC has proposed to issue these guidelines as a new Appendix D to 12 CFR 30. The public comment period on the proposed guidelines closed on March 28, 2014, and the adoption of final guidelines is forthcoming. The Federal Reserve has established, through its Capital Plan Rule and its annual CCAR, additional requirements for BHCs with at least $50 billion in assets to ensure they properly assess their risks (including those arising during adverse conditions) and maintain sufficient capital to support those risks. *See* 12 CFR 225.8 and 12 CFR part 252, subparts B, E, and F. 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. The adequacy of processes and level of capital are assessed by the Federal Reserve on an annual basis in the CCAR exercise, discussed in more detail in the response to BCP 16. It should be noted that the capital plan rule is designed to work in conjunction with the stress test rules adopted by the Federal Reserve to implement the stress testing requirements of Dodd-Frank Act[99] which establish a framework for the Federal Reserve to conduct supervisory stress tests of large BHCs and require them to conduct annual and mid-cycle company-run stress tests.[100] A banking organization'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 may be considered unsafe and unsound conduct. If an agency determines that a bank fails to meet any standard established by the agency or by interagency guidelines, the agency may require the institution to submit an acceptable plan to achieve compliance. *See* 12 U.S.C. § 1831p-1(e). The agency also has the flexibility to pursue other courses of action, including enforcement actions or less formal actions, given the specific circumstances and severity of an institution's noncompliance with one or more standards. In the event that an institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan, the agency will pursue an enforceable order to require the institution to correct the deficiency. The agency may, and in some cases must, take other supervisory and/or enforcement actions, until the deficiency has been corrected.
Practices and Procedures	U.S. federal banking agencies 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:

[99] *See* 12 USC 5365(i) and 12 CFR Part 252.

[100] In addition, the stress test rules require state member banks and SLHCs with total consolidated assets of more than $10 billion and BHCs with total consolidated assets of more than $10 billion but less than $50 billion to conduct annual company-run stress tests. See 12 CFR Part 252, Subpart H; 77 FR 62396 (October 12, 2012).

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	active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, 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 utilize 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 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 DFA further solidified this position by creating specific risk management requirements for larger firms. 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. This new approach reflects the lessons from the 2008-9 financial crises. After the financial crisis, the OCC developed a set of 'Heightened Expectations' to enhance its supervision and strengthen the governance and risk management practices of large national banks. In 2010, the OCC began communicating and applying the Heightened Expectations. Proposed standards in the form of guidelines developed from these expectations were issued for comment in January 2014. The proposed standards describe the requirements for a risk governance framework, and set out the roles and responsibilities that are fundamental to the design and implementation of the framework. The proposed guidelines provide that a bank with $50 billion or more in average total consolidated assets ("covered bank") should have a comprehensive written statement that articulates its risk appetite and serves as a basis for the 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 proposed guidelines provide that each member of the board has a duty to oversee a covered bank's compliance with safe and sound banking practices. Consistent with this duty, the board should ensure that the covered bank establishes and implements an effective framework that complies with the guidelines. The board or its risk committee should approve any changes to the framework.

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	The risk management systems for larger firms 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. Large complex banks and holding companies should have risk management systems or units that are sufficiently independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest. 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. 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. *See* BCP 16 for more information. 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 ongoing, risk-focused supervision based upon agency guidance. *See* SR 12-17 and OCC*: Large Bank Supervision booklet of Comptroller's Handbook* and various topical handbooks on specific risk areas and controls, including *Risk Management of Financial Derivatives; Retail Lending, Liquidity Risk, Internal Controls, Leveraged Lending, Rating Credit Risk, and Related Organizations.* Specific risks such as BSA/AML are addressed under their specific Principle. The agencies' supervisory programs emphasize the need to maintain a current assessment of the organization's risk profile and control frameworks which reflects external market developments and other environmental factors which have the potential for swift and dramatic changes in the risk profiles of large complex banks and holding companies. In addition, the agencies maintain a variety of specialty teams for the risks and business lines of the firms, who look at risks, controls, and strategies horizontally across the large bank portfolios. The agencies use similar risk-based supervision 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 forth in SR Letter 95-51, *Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies*, the *Bank*

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	Holding Company Supervision Manual (BHCSM), the *Commercial Bank Examination Manual* (CBEM), the *Trading and Capital-Markets Activities Manual* (Trading Manual), and various other guidance documents. The Federal Reserve assesses the condition, performance, and activities of SLHCs on a consolidated basis in a manner that is consistent with the agency's established risk-based approach regarding BHC supervision, while taking into account, to the greatest extent possible, any unique characteristics of SLHCs and the requirements of the HOLA. *See* Federal Reserve SR Letter 11-11, "*Supervision of Savings and Loan Holding Companies*." The risk management processes of FBOs are assessed in accordance with guidance set forth in SR Letter 00-14, *Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations* (Federal Reserve) and the OCC's *Federal Branches and Agencies Supervision* Handbook. This program emphasizes coordination and cooperation among home and host country regulators, an assessment of the strength of support provided by the FBO, and a risk-focused approach to examinations. Larger FBOs are subject to higher risk management requirements under DFA 165, including for capital, liquidity, risk committees, and chief risk offers (*see* below). For information on this, please see the discussion of this in BCP 12. Similar to the FRB, the OCC uses a risk assessment system (RAS) to consistently 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. *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. federal banking agencies 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. In assessing the adequacy of risk management processes, agencies ensure that banks and holding companies have appropriate risk management strategies that have been approved by the relevant board. Examiners also verify that the board approves appropriate policies and processes for risk-taking and appropriate limits, and hold senior management accountable for taking the steps necessary to monitor and control all material risks consistent with the approved strategies. The agencies' rulemakings in response to DFA require heightened practices in several of these areas. The agencies assess, and ratings reflect, the board's fulfillment of its responsibilities primarily in accordance with the guidance outlined above. Under the agencies' policies and guidelines, boards have responsibility for the level of risk taken by their organizations. Accordingly, they should approve the overall business strategies and significant policies of their organizations, including those related to managing and taking risk. Directors are also expected to provide clear guidance regarding the level of exposures acceptable to their organization and they have the responsibility to oversee that senior management implements the procedures and controls necessary to comply with adopted policies. Publicly traded BHCs with total consolidated assets between $10 and $50 billion, and BHCs with total consolidated assets of $50 billion or more, 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. Similar requirements exist for larger FBOs. *See* 12 CFR part 252, subparts M and O. The BHC's global risk-management framework is

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	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. *See* 12 U.S.C. § 5365; and 12 CFR 252.132, 252.144. Compliance with these standards is conducted as part of the supervisory examination and ongoing monitoring processes. Some examples of Federal Reserve and interagency guidance relating to risk management include: *Interagency Statement on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*[101]; *Interagency Guidance on Nontraditional Mortgage Products*[102]; *Interagency Guidance on Credit Risk Management for Home Equity Lending*[103]; *Interagency Policy Statement on Interest Rate Risk*; *Interagency Advisory on Interest Rate Risk*[104] (SR 10-1); *Interagency Policy Statement on Funding and Liquidity Risk Management*[105] (SR 10-6); *Interagency Appraisal and Evaluation Guidelines*[106] (SR 10-16); *Supervisory Guidance on Implementation Issues Related to the Advanced Measurement Approaches for Operational Risk*[107] (SR 11-8); *Interagency Counterparty Credit Risk Management Guidance*[108] (SR 11-10); *Supervisory Guidance on Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets*[109] (SR 12-7); *Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing*[110] (SR 13-1); *Interagency Guidance on Leveraged Lending*[111] (SR 13-3); *Guidance on Managing Outsourcing Risk* (SR 13-19); OCC Bulletin 2013-29 *Third Party Relationships: Risk Management Guidance*; and *Supervisory Guidance on Dodd-Frank Act Company-Run Stress Testing for Banking Organizations with Total Consolidated Assets of More Than $10 Billion but Less Than $50 Billion* (SR 14-3).

[101] 71 FR 74580.

[102] 71 FR 58609.

[103] OCC Bulletin 2005-22.

[104] OCC Bulletin 2010-1
[105] OCC Bulletin 2010-13
[106] OCC Bulletin 2010-42
[107] OCC Bulletin 2011-21
[108] OCC Bulletin 2011-30
[109] OCC Bulletin 2012-14
[110] OCC Bulletin 2003-12
[111] OCC Bulletin 2013-9

EC 2	Principle 15: Risk management process
Criterion	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: (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.
Legal Framework	*See* response to EC1.
Practices and Procedures	Much of EC1 also applies to this Criterion as a comprehensive risk management process is a precursor to the requirement of EC1 and therefore addressed in some detail in that response. For example, the 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 ongoing 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. For example, supervisors assess a variety management's ability to capture a variety of stress exposures and sensitivities within capital market operations. The OCC applies a similar set of practices for large national banks. An assessment of systemic importance, material legal entities, and critical operations is a key feature of the recovery and resolution requirements of the firms. The firms' plans must detail each of these areas for our review and assessment, as is discussed further in the recovery and resolution section of this response. The federal banking agencies expect banks and holding companies to have both an effective risk management and internal controls system in place with a documented understanding of both. Risk management encompasses the process of identifying key risks, assessing these risks and measuring the bank's exposure, monitoring the risks, risk acceptance and/or risk mitigation, risk reporting. Internal controls ensure that each key risk identified has a policy, process or other measure as well as a control to ensure that such policy, process or other measure is being applied and works as intended.

EC 3	Principle 15: Risk management process
Criterion	The supervisor determines that risk management strategies, policies, processes and limits are: (a) properly documented;

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	(b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorisation by, the appropriate level of management and the bank's Board where necessary.
Legal Framework	*See* response to EC1.
Practices and Procedures	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. As noted above, larger organizations are subject to enhanced standards for risk management, including in this area, under DFA 165. As noted above, the OCC's proposed heightened standards guidelines require covered banks to 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 changes in the bank's risk profile caused by internal or external factors or the evolution of industry risk management practices. Also, the proposed guidelines require the framework to include processes whereby initial communication and ongoing reinforcement of the bank's risk appetite statement occurs throughout the bank in a manner that ensures all employees align their risk-taking decisions with applicable aspects of the risk appetite statement. Also as noted above, the agencies assess, and ratings reflect, documentation supporting the risk management process, the review, updating, and communication of such documentation, and the monitoring of compliance with policies, procedures, and limits primarily in accordance with the guidance noted above. Agencies' policies state that boards should approve significant policies, communicate policies throughout the institution, and modify them when necessary to respond to significant changes in the bank's or holding company's activities or business conditions.[112] They also emphasize the importance of an independent review of the internal control structure, and that large organizations require more frequent monitoring and testing by independent control areas and

[112] *See, e.g.*, Federal Reserve SR Letter 95-51 and CA Letter 06-8; Interagency Policy Statement on the Allowance for Loan and Lease Losses; OCC Bulletin 2006-47; OCC Banking Circular 277, "Risk Management of Financial Derivatives," OCC's *The Director's Book – The Role of the National Bank Director*; FDIC's Risk Management Manual of Examination Policies (Section 4.1 – Management).

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	internal, as well as external auditors, to ensure the integrity of the information used by senior officials in overseeing compliance with policies and limits. Agencies' policies and examiner guidance provides that exceptions to policies/limits are authorized by the appropriate level of management or the board of directors. *See*, examples of guidance noted in response to EC1. *e.g.*, 12 CFR 34.62 and Appendix A to 12 CFR part 34;

EC 4	Principle 15: Risk management process
Criterion	The supervisors determine that the bank's board and senior management obtain sufficient information to 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.
Legal Framework	*See* response to EC1.
Practices and Procedures	Federal banking agency examiners 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 light of the institution's risk profile and business plan and that they are implemented effectively. Senior management is expected to regularly review 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; the OCC's *Community Bank Supervision Handbook*, *Large Bank Supervision Handbook*, *The Director's Book – The Role of a National Bank Director*, and *Detecting Red Flags in Board Reports – A Guide for Directors*, and the FDIC's *Risk Management Manual of Examination Policies* (Section 4.1 – Management). As previously noted, federal banking agency guidance states that directors are responsible for understanding the nature of the risks significant to their organizations, and for ensuring that management is taking the steps necessary to identify, measure, monitor, and control these risks. Directors are also responsible for understanding how these risks relates to adequate capital levels. Boards of directors are expected to periodically review and approve the target level and composition of capital, along with the process for setting and monitoring such targets. Banks and holding companies are expected to maintain capital commensurate with the nature and extent of risks taken and the ability of management to identify, measure, monitor, and control these risks. The types and quantity of risk inherent in a bank's or holding company's activities will determine the extent to which it may be necessary to

EC 4	Principle 15: Risk management process
	maintain capital levels above required regulatory minimums to properly reflect the potentially adverse consequences that these risks may have on the organization's capital. Large organizations should also have an established risk committee responsible for advising the board on the overall current and future risk tolerance/appetite and strategy. Risk coverage should include credit, market, operational, compliance and reputational. There should exist effective ongoing communication from the bank's risk management function and CRO. Regarding enhanced standards for larger institutions, please see also the discussion of the risk committee requirements (EC 1) and chief risk officer requirements (EC 10).

EC 5	Principle 15: Risk management process
Criterion	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.
Legal Framework	*See* response to EC1. In, addition, banking organizations are subject to various requirements that ensure that a company's internal processes for assessing capital adequacy reflect a full understanding of risks and ensure that the amount of capital held corresponds to those risks, including as they are manifested through various stress scenarios. This includes stress testing based on internal models that are appropriate for a company's risk profile and business model. *See* Supervision and Regulation Letter 09-4; 77 Fed. Reg. 62378; 12 CFR 252, Subparts E and F; 77 Fed. Reg. 62396; and 77 Fed. Reg. 61238. *See* OCC Bulletin 2012-16, *Guidance for Evaluating Capital Planning and Adequacy*. Similarly, various rules and interagency guidelines require banking organizations to establish and maintain robust liquidity risk management practices and process for determining the 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 semiannually 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. *See* 12 CFR part 252 and *Interagency Policy Statement on Funding and Liquidity Risk Management*, available at: http://www.federalreserve.gov/boarddocs/srletters/2010/sr1006.pdf. The agencies have also proposed rules to implement a quantitative liquidity requirement that is consistent with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision and designed to promote the short-term resilience of the liquidity risk profile of internationally active banking organizations, thereby improving the banking sector's ability to absorb shocks arising from financial and economic stress, as well as improvements in the measurement and management of liquidity risk. See 78 Fed. Reg. 71818 (November 29, 2013).

EC 5	Principle 15: Risk management process
Practices and Procedures	Federal banking agencies expect banks and BHCs to develop 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. Regulatory capital requirements have limitations in their ability to reflect an organization's full risk profile. For further information on regulatory capital standards, refer to BCP 16. Accordingly, all organizations are expected to understand their underlying risks and hold capital commensurate with those risks – at levels above regulatory minimums – to ensure capital adequacy. The agencies require some organizations to use more sophisticated internal risk measures and capital adequacy assessment processes because of their size, complexity, and the corresponding limitations of regulatory capital requirements to adequately capture their risk profile. Ratings reflect the results of this assessment.[113] Evaluations of the strategic plans and capital adequacy assessments of consolidated organizations and individual institutions are generally conducted as separate targeted examinations. As noted above, the federal agencies' DFA capital stress tests and the Federal Reserve's annual CCAR exercise are significant enhancements to the supervisory approach for ensuring that the largest firms have sufficient capital to support their risks and remain viable entities during times of stress. *See* BCP 16 for more information. In addition, the Federal Reserve undertakes the Comprehensive Liquidity Analysis and Review (CLAR) program annually to assess liquidity sufficiency in normal and under stressful scenarios, and aspects of liquidity risk management for individual firms and across the portfolio of the systemically important financial institutions. Like CCAR, this program includes a Federal Reserve run stress test utilizing data submitted by the regulated firm. *See* BCP 24 for more information.

EC 6	Principle 15: Risk management process
Criterion	Where banks use models to measure components of risk, the supervisor determines that: (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. The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.
Legal Framework	Under the interagency guidelines implementing the advanced Basel II approaches, banks and BHCs are required to validate their advanced systems on an ongoing basis in accordance with specified requirements. *See, e.g.*, 12 CFR Part 3, Appendix C, section 22(j) (national banks and, subject to timing and transition provisions in the rules, Federal savings associations); 12 CFR Part 208, Appendix F, section 22(j) (state member banks); 12 CFR Part 225, Appendix G, section 22(j) (BHCs), 12 CFR 325, Appendix

[113] *See* Federal Reserve SR Letter 99-18 and AD Letter 08-11, which provide examiner guidance for conducting reviews of compliance with these standards; OCC's *Large Bank Supervision* and *Community Bank Supervision* booklets of the Comptroller's Handbook.

EC 6	Principle 15: Risk management process
	D, section 22(j) (state nonmember banks). In addition, they must periodically stress test the advanced approaches, also in accordance with stated specifications. *See id.* Internal models adopted by organizations adhering to the 1996 Market Risk Amendment also must be stress tested. *See* 12 CFR Part 3, Appendix B, section 4(b) (OCC); 12 CFR Parts 208 and 225, Appendix E, section 4(b) (Federal Reserve); and 12 CFR part 325, Appendix C, section 4(b) (FDIC). Under the Basel III capital framework final rules, the provisions in the agencies' capital rules will be redesignated to include the market risk requirements. *See* 78 Fed. Reg. 62018 (Oct. 11, 2013). The agencies rules on DFA stress testing also include requirements for institutions to validate their stress testing models and otherwise ensure that they are functioning as intended. *See* 12 CFR 252 (Federal Reserve); 12 CFR 46 (OCC). Consistent with the current advanced approaches rule, the Regulatory Capital Rules require a banking organization to validate its advanced systems on an ongoing basis, including models used to determine regulatory capital requirements. The validation process must be independent of the advanced systems' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. This validation must include an evaluation of conceptual soundness; an ongoing monitoring process that includes verification of processes and benchmarking; and an outcomes analysis process that includes back testing. *See* 12 CFR parts 3, 5, 6, 165, and 167 (OCC); 12 CFR parts 208, 217, and 225 (Federal Reserve); and 12 CFR parts 303, 308, 324, 327, 333, 337, 347, 360, 362-3645, 290, and 391 (FDIC). *See* also, 79 Fed. Reg. 62018; 78 FR 55340.
Practices and Procedures	In utilizing models and systems to measure risk, banks and BHCs are expected to ensure that risk management models and systems are independently validated and tested with an appropriate frequency. The federal banking agencies offer specialized training courses on various aspects of risk modeling and have staff with specialized econometrics and modeling expertise that can assist examiners in evaluating sophisticated models. In 2011, the Federal Reserve and OCC issued joint supervisory guidance on model risk management (MRM), including validation. That guidance provided standards and expectations for all supervised firms to ensure that their models function as intended and are used appropriately. Supervisors at the Federal Reserve and OCC have been following institutions' implementation of the guidance and assisting them in meeting the MRM standards and expectations. *See* Federal Reserve SR Letter 11-7, "*Guidance on Model Risk Management*;" and OCC Bulletin 2011-12, "*Supervisory Guidance on Model Risk Management*." More generally, the federal banking agencies' supervisory guidance directs that key assumptions, data sources, and procedures utilized in measuring and monitoring risk be appropriate and adequately documented and tested for reliability on an ongoing basis. Models should be independently validated and tested by risk management staff or by internal or outside auditors. The frequency and extent to which organizations should re-evaluate their models and assumptions depends, in part, on the specific risk exposures created by their trading activities, the pace and nature of market changes, and the pace of innovation with respect to measuring and managing risks. Guidance which more specifically addresses model requirements for various types of models is found in the related sections of the agencies' manuals.

EC 6	Principle 15: Risk management process
	The agencies have emphasized that risk analysis should include both quantitative and qualitative elements. Excessive focus on measuring or modelling risk(s) at the expense of other risk management activities may result both in overreliance on risk estimates that do not reflect real exposures and in insufficient action to address and mitigate risk. Organizations implementing the advanced Basel II approaches are required to validate their advanced systems on an ongoing basis in accordance with specified requirements. For those larger organizations subject to the 1996 Market Risk Amendment, qualitative requirements include that these organizations must have an internal model that is fully integrated into its daily management, must conduct independent reviews of its risk management and measurement systems at least annually, and must have policies and procedures for conducting appropriate stress tests and back tests, and for responding to the results of those tests. *See* 12 CFR part 3, Appendix B, section 4(b) (OCC); 12 CFR parts 208 and 225, Appendix E, section 4(b) (Federal Reserve); 12 CFR part 325, Appendix D, section 4(b) (FDIC). Agencies generally conduct separate targeted examinations of an institution's risk management process relating to risk measurement models and systems, as well as of specific risk measurement models.

EC 7	Principle 15: Risk management process
Criterion	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 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.
Legal Framework	The agencies' safety and soundness guidelines require banks and BHCs to have information systems that are appropriate for 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. *See e.g.*, 12 CFR part 30, Appendix A, Part II(A) (OCC); 12 CFR part 208, Appendix D-1, part II(A) (Federal Reserve); 12 CFR part 364, Appendix A, section II.A.(FDIC).
Practices and Procedures	Agencies' examiners review management information systems to ensure its adequacy in measuring, assessing, and reporting on the size, composition, and quality of exposures. Examiners also ensure that these reports appropriately reflect the bank's or holding company's risk profile and capital needs, and that they are provided to the board or senior management on a timely basis. Examiners generally conduct reviews of management information systems in conjunction with the targeted examinations of specific business activities and, at larger organizations, through ongoing supervision. The federal banking agencies assess, and their supervisory ratings reflect, the adequacy of risk management information systems at both the holding company and bank level.[114] 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

[114] Formal ratings are assigned to BHCs per SR 04-18 and indicative ratings are assigned to SLHCs per SR 13-08.

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	sufficiently detailed reports for line managers engaged in the day-to-day management of the organization's activities.[115] 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. Furthermore, guidance and the agencies' supervisory ratings emphasize the need for banks and BHCs s to identify and measure all material risks.

EC 8	Principle 15: Risk management process
Criterion	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Board and senior management understand the risks inherent in new products,[116] 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 ongoing 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.
Legal Framework	*See* response to EC 1.
Practices and Procedures	Agency examiners verify that banks and BHCs 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.[117] Furthermore, agencies consider as a sound practice, having a new product approval policy that requires review and approval by all operational areas affected by such transactions, and is evidenced by an audit trail of approvals before a new product is introduced.[118]

[115] *See, e.g.*, Federal Reserve's SR 99-18 and CA 06-8; OCC's Risk Assessment System factors for determining quality of risk management in its *Community Bank Supervision* and *Large Bank Supervision* booklets, and FDIC's Risk Management Manual of Examination Policies (Section 4.1 – Management).

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

[117] *See* Federal Reserve's SR Letter 95-51, OCC Bulletin 2004-20, *Risk Management of New, Expanded, or Modified Bank Products and Services*, and FDIC's Risk Management Manual of Examination Policies (Sections 4.1 and 4.2- Management and Internal Routine and Controls);

[118] *See* Federal Reserve's TCMM (Section 2000.10, *Overview of Risk Management in Trading Activities*), Bulletin 2004-20; *see also* OCC Banking Circular 277, Risk Management of Financial Derivatives .

EC 8	Principle 15: Risk management process
	The agencies expect the risk management process to reflect the size and the complexity of the product or service offered. Although the board may delegate performance of managerial duties to others, it has the responsibility for overseeing that the bank or holding company is run in a safe and sound manner. In fulfilling its responsibilities, the board or its designee must ensure that a new, expanded, or modified bank product or service is consistent with the strategic goals.[119] Although the comprehensiveness and specificity of supervisory guidance relating to the approval of new products and major risk management initiatives varies among the agencies, examiners generally employ similar procedures in conducting supervisory assessments. The federal banking agencies assess a bank's new activity/product approval process at both the bank and holding company levels. As noted, agency guidance states that before embarking on new activities or introducing products new to the organization, management should identify and review all risks associated with the activity or product and ensure that the infrastructure and internal controls necessary to manage the related risks are in place.[120] When a new product or activity requires explicit agency approval, such conditions are often imposed as part of the approval process and are enforceable conditions under 12 U.S.C. § 1818.[121] The agencies expect that management identifies the risks associated with new activities or products before they are launched and ensures that the appropriate infrastructure and internal controls are established. Furthermore, the agencies consider as a sound practice, having a new product approval policy that requires review and approval by all operational areas affected by such transactions, and is evidenced by an audit trail of approvals before a new product is introduced.

EC 9	Principle 15: Risk management process
Criterion	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.
Legal Framework	The interagency guidelines implementing the 1996 Market Risk Amendment require an independent risk control unit that reports directly to senior management and is independent from business trading units. *See, e.g.*, 12 CFR part 3, Appendix B, section 4(b)(1)(national banks and, subject to timing and transition provisions in the rules, Federal savings associations); 12 CFR part 208, Appendix E, section 4(b)(1) (state member banks); 12 CFR Part 225, Appendix F, section 4(b)(1) (BHCs), 12 CFR part 324, Subpart F and 325, Appendix C (state nonmember banks). Institutions adhering to the advanced approaches to Basel II rules must have control, oversight, and validation mechanisms that maintain the integrity, reliability, and accuracy of those systems. The bank's

[119] *See, e.g.*, Federal Reserve's 95-51, 04-18, and CA 06-8; OCC Bulletin 2004-20, "Risk Management of New, Expanded, or Modified Bank Products and Services"

[120] *Id*.

[121] *See, e.g.*, OCC Interpretive Letter 1101 (July 7, 2008); OCC Interpretive Letter 1065 (July 24, 2006); OCC Interpretive Letter 1039 (September 15, 2005).

EC 9	Principle 15: Risk management process
	validation process must be independent of the advanced systems' development, implementation, and operation, or the validation must be subjected to an independent review of its adequacy and effectiveness. The bank's senior management must ensure that all components of the bank's advanced systems function effectively and the bank's board of directors (or a designated committee) must at least annually review the effectiveness of, and approve, the bank's advanced systems. *See e.g.*, 12 CFR part 3, Appendix C, Section 22(h) (national banks and, subject to timing and transition provisions in the rules, Federal savings associations); 12 CFR part 208, Appendix F, section 22(h) (state member banks); 12 CFR Part 225, Appendix G, section 22(h) (BHCs), and 12 CFR 324.122(i) (state nonmember banks). *See also* 12 CFR part 252, the Enhanced Prudential Standards set forth requirements for Risk Management and the Risk Committee, providing for independence at the director level, requiring certain firms to have a Chief Risk Officer (CRO), and describing requirements for each. The OCC's proposed heightened standards guidelines address the independent risk management function, chief risk executive(s) and the importance of independence at the board or risk committee level for those banks that would be subject to the guidelines.
Practices and Procedures	The federal banking agencies require BHCs 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. Federal banking agencies expect large banks and BHCs to have risk management systems or units that are sufficiently independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest. While organizations are generally given flexibility in how they accomplish this objective, most large, complex banks and BHCs have established dedicated units to manage risk at the group level. *See* EC 10 immediately below for information on the chief risk officer requirements related to risk management duties. Federal banking agencies 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. As noted above, organizations subject to the 1996 Market Risk Amendment and to the advanced approaches under Basel II have more rigorous requirements for independent risk control units. Regulators 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. The risk management function should have sufficient stature within an organization such that issues raised are properly addressed and receive the necessary attention of the board, senior management and business lines. The sophistication of an organization's risk management, compliance and internal control infrastructures needs to keep pace with any changes to its risk profile as well as to the external landscape. New products, business lines and entry into new markets must be seamless and properly risk managed from inception.

EC 9	Principle 15: Risk management process
	Pertaining to larger organizations, please see discussion above regarding risk committee requirements (EC 1) and immediately below for chief risk offer requirements.

EC 10	Principle 15: Risk management process
Criterion	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 reasons for such removal with its supervisor.
Legal Framework	The Federal Reserve's Enhanced Prudential Standards regulations, which implements section 165 of DFA, includes requirements that each BHC with at least $50 billion in assets establish the position of chief risk officer and set forth requirements for Risk Management and the Risk Committee, including independence at the director level. As noted above, there are also requirements for larger FBOs to meet heightened risk management requirements under DFA section 165. *See* 12 U.S.C. 5365(b)(1)(A) and (h); 12 CFR 252; and 79 Fed. Reg. 17240. OCC's proposed Heightened Expectations guidelines address, with respect to those banks subject to them, the role of the chief risk executive, the independent risk management function, and reporting to the board or bank risk committee.
Practices and Procedures	The Federal Reserve's requirements for establishment of a CRO position at all BHCs with at least $50 billion in assets stem from the idea that the complexity and size of the operations of a BHC of this size warrant BHCs having a designated executive in charge of implementing and maintaining the risk management framework and practices approved by the risk committee. Further, the CRO should have risk-management expertise commensurate with the BHC's capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors. Although a company generally should have flexibility to determine the particular qualifications it desires in a CRO, because of the risks posed by BHCs with total assets of $50 billion or more, a CRO should satisfy certain minimum standards. Accordingly, and similar to the risk-committee requirements, the qualification requirements focus on an individual's experience in identifying, assessing, and managing exposures of large, complex financial firms. The BHC should be able to demonstrate that its CRO's experience is relevant to the particular risks facing the company and commensurate with the BHC's structure, risk profile, complexity, activities, and size. The CRO has responsibility for overseeing: establishment of risk limits and monitoring compliance with such limits; implementation and ongoing compliance with appropriate policies and procedures relating to risk management governance, practices, and risk controls; developing and implementing appropriate processes and systems for identifying and reporting risks, including emerging risks; managing risk exposures and risk controls; monitoring and testing risk controls; reporting risk management issues and emerging risks; and ensuring that risk management issues are effectively resolved in a timely manner. The CRO may execute his or her responsibilities by working with, or through, others in the organization.

EC 10	Principle 15: Risk management process
	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.

EC 11	Principle 15: Risk management process
Criterion	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Legal Framework	The agencies expect BHCs and banks to have in place comprehensive risk management policies and processes for identifying, evaluating, monitoring and controlling or mitigating all material risks, including, but not limited to, credit, market, liquidity, interest rate, and operational risk. The agencies have issued supervisory guidance related to each of these risk types pursuant to various statutory and regulatory provisions, including those governing safety and soundness (*see* 12 U.S.C. § 1831p-1; 12 CFR part 30, Appendix A (OCC); and 12 CFR part 208, Appendix D-1 (Federal Reserve); 12 CFR part 364, Appendix A (FDIC) and capital adequacy (*see, e.g.,* 12 USC §§ 3907(a), 3909; 12 CFR part 3, Appendices A, B, and C (national banks and, subject to timing and transition provisions in the rules, Federal savings associations); 12 CFR part 208, Appendices A, E, and F; 12 CFR part 225, Appendices A, E, and G (BHCs)). 12 CFR part 570, Appendix A.
Practices and Procedures	U.S. federal banking agencies 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. Guidance listed above under EC 1 addressing specific aspects of risk management is discussed in further detail in the BCP responses covering the relevant risk principles.

EC 12	Principle 15: Risk management process
Criterion	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialise 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.

EC 12	Principle 15: Risk management process
Legal Framework	The Federal Reserve has taken a number of important steps to improve its supervisory program for large financial institutions. These steps include the development of 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. *See* SR Letter 12-17. In addition, the Federal Reserve has issued guidelines regarding its heightened supervisory expectations for recovery and resolution preparedness for the largest BHCs that builds upon the framework set out in SR Letter 12-17, 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: • 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. The Federal Reserve, in conjunction with the FDIC, have also issued regulations requiring certain BHCs (including FBOs that are or are treated as BHCs) 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. *See* 12 CFR parts 243 and 381. 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. *See* 12 CFR 360.10. 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. *See* e.g., 12 CFR 243.5 and 381.5.
Practices and Procedures	See response to BCP 8, Overview section and EC 6. In DFA resolution planning process regulators monitor bank's preparedness to risks arising from the failure of bank subsidiary, inter-connectedness and cross-border risk management. While the Dodd–Frank Wall Street Reform and Consumer Protection Act (DFA) makes the Federal Reserve and FDIC responsible for receiving and reviewing banking organization resolution plans, the OCC has taken an active role in assisting these agencies in reviewing submitted plans. In addition, the OCC has begun to develop supervisory procedures for reviewing resolution plans in order to develop a more comprehensive understanding of a banking organization's structure, activities, interconnections and dependencies. This enhanced view will allow examining staff to identify areas of current and/or emerging risk, and better target the risk-focused supervision activities. In addition, the OCC participates in DFA stress testing to assess a banking organization's

EC 12	Principle 15: Risk management process
	resiliency. In addition, OCC Bulletin 2012-16, *Guidance for Evaluating Capital Planning and Adequacy* emphasizes the importance of forward-looking assessments of capital adequacy and business resiliency in both normal and stressed environments. The guidance notes that effective contingency planning includes identification of credible mechanisms and strategies for capital preservation and enhancement during an economic downturn or other times of stress.

EC 13	Principle 15: Risk management process
Criterion	The supervisor requires banks to have forward-looking stress testing programmes, 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 programme 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 programme: (a) promotes risk identification and control, on a bank-wide basis; (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing programme or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process.
Legal Framework	As noted above, larger institutions are subject to requirements for annual company-run and supervisory capital stress tests, as well as liquidity stress tests. *See* 12 CFR parts 252 (Federal Reserve), 46 (OCC), 325 (FDIC). For more information on capital stress tests, *see* BCP 16. For more information on liquidity stress tests, *see* BCP 24.
Practices and Procedures	In May 2012, 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.

EC 14	Principle 15: Risk management process
Criterion	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.
Legal Framework	*See* response to EC 1.
Practices and Procedures	Supervisors assess the incorporation of risks into pricing, performance measurement, and the new product process in a variety of ways. The approaches can be classified in two ways. One approach 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. We take this approach in efforts such as CLAR, CCAR and incentive compensation across the portfolio, and also for new product approval and performance scorecards at individual firms. The second approach is a bottom- up method. Reviews of business lines 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. The Interagency Guidance on Sound Compensation Practices, issued in June 2010, 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. Per the guidance, institutions are expected to map risks to individual employees or groups of employees based on specific activities undertaken. This process is crucial to identifying both the range and severity of risks. The initial mapping is validated through further line of business and control function reviews (with attention to both the specific activity and any potential incentives created) and then is usually tested against a series of "filters" or additional review screens in order to ensure completeness. In the design and implementation of compensation frameworks, firms use both risk adjusted financial metrics (including the use of stressed metrics), and risk-related non-financial metrics (such as risk management performance, control components in performance scorecards, risk scorecards or regular risk reviews that feed in to performance evaluations) to help ensure incentive compensation appropriately takes into account risks created by underlying activities and/or behaviors. The incorporation of liquidity risk, for example, is achieved by including in internal profit measures used in incentive compensation awards a charge for liquidity risk that takes into account stressed conditions. This reduces incentives to take imprudent liquidity risk. Finally, supervisors 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. Ways that risk managers assist in achieving balanced compensation arrangements may include: (i) Reviewing the types of risks associated with the activities of covered employees; (ii) Approving the risk measures used in risk adjustments and performance measures, as well as measures of risk outcomes used in deferred pay-out arrangements; and (iii) Analyzing risk-taking and risk outcomes relative to incentive compensation payments. Involvement of risk-management

EC 14	Principle 15: Risk management process
	personnel in the design and monitoring of these arrangements helps ensure that the organization's risk-management functions can properly understand and address the full range of risks facing the organization. Section 956 of the Dodd-Frank Act requires the appropriate federal regulators, including the federal banking agencies, 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 section 956. *See* 76 Federal Register 21170 (April 14, 2011). In prohibiting incentive compensation arrangements that could encourage inappropriate risks, the proposal would require compensation practices at regulated financial institutions to be consistent with three key principles--that incentive compensation arrangements should appropriately balance risk and financial rewards, be compatible with effective controls and risk management, and be supported by strong corporate governance.

EC 15	Principle 15: Risk management process
Additional Criterion	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.
Legal Framework	The authority to impose risk management standards stems primarily from the agencies' statutory authority for ensuring the safety and soundness of banks. *See* 12 U.S.C. § 1831p-1. While existing safety and soundness guidelines and minimum capital requirements do not specifically capture all risks to which banks and holding companies may be exposed, the agencies have broad authority under those guidelines to impose risk management requirements related to risk types not otherwise addressed. These are addressed by supervisory guidance and related materials. In addition, the agencies' capital adequacy guidelines provide authority to require higher minimum capital ratios of an individual bank in view of its circumstances. *See* 12 CFR 3.10 (OCC); 12 CFR Parts 208 and 225, appendix A, § IV, 12 CFR Part 208, appendix F, section 1(c), 12 CFR Part 225, appendix G, section 1(c) (Federal Reserve); 12 CFR 324.1 (state nonmember banks). Institutions subject to the advanced approaches of Basel II-based capital adequacy guidelines are required to have a rigorous internal capital adequacy assessment process that captures all material risks, including those not directly addressed in minimum regulatory capital requirements (which may include liquidity, reputational and strategic risks, among others). Supervisory guidance related to the supervisory review process of capital adequacy (also known as Pillar 2) was published in the *Federal Register* on July 31, 2008.[122] Under the Regulatory Capital Rules, institutions are required to have a rigorous internal capital adequacy assessment process that captures all material risks, including those not directly addressed in minimum regulatory capital requirements (which may include liquidity, reputational and strategic risks, among others). *See* overview to this Principle. The expectations for including the full set of risks affecting capital adequacy are even higher for those institutions subject to CCAR, as outlined in more detail in BCP 16.

[122] *See supra*, n. 726.

EC 15	Principle 15: Risk management process
Practices and Procedures	Although the agencies 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 *all* material risks, including those not directly addressed in the subsequent Principles, such as reputational and strategic risk.[123] 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. An example of interagency guidance issued to address a specific activity which poses heightened reputational risk is SR Letter 07-5, *Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities*. This interagency guidance addresses the risk principles that assist organizations in identifying, evaluating, and managing the heightened legal and reputational risks that may arise from their involvement in complex structured finance transactions. 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.[124]

Assessment of Principle 14	Largely Compliant
Comments	In the five years since the last FSAP when BCP 15 was rated Materially Non-compliant, the U.S. banking agencies have made significant progress in enhancing risk management requirements and expectations for supervised institutions, fortifying supervisory practices to evaluate institutions' risk management practices, and bringing about substantial improvements in institutions' risk management practices. The assessment is not deemed "Compliant" in full because some of the more recent risk management requirements and expectations are not yet fully implemented and ingrained.

[123] The Federal Reserve defines and specifically include reputational risk as a risk type for which the principles of sound management (SR Letter 95-51); *see also*, SR Letter 99-18, *Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles*. The OCC's Risk Assessment System specifically includes both reputation and strategic risks (*see* OCC Handbook *Bank Supervision Process*).

[124] *See supra*, n. 726.

Principle 16: Capital adequacy[125]

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.

(Reference documents: *Revisions to the Basel II market risk framework*, February 2011; *Minimum requirements to ensure loss absorbency at the point of non-viability*, January 2011; *Capitalisation of bank exposures to central counterparties*, July 2012; *Sound practices for back testing counterparty credit risk models*, December 2010; *Guidance for national authorities operating the countercyclical capital buffer*, December 2010; *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010; *Guidelines for computing capital for incremental risk in the trading book*, July 2009; *Enhancements to the Basel II framework*, July 2009; *Range of practices and issues in economic capital frameworks*, March 2009; *International convergence of capital measurement and capital standards: a revised framework, comprehensive version*, June 2006; and *International convergence of capital measurement and capital standards*, July 1988.)

Overview

Laws and Regulations

Federal statutes (1) authorize the federal banking agencies (the Board of Governors of the Federal Reserve System (the Board or the Federal Reserve), the Office of the Comptroller of the Currency (the OCC) and the Federal Deposit Insurance Corporation (the FDIC), (collectively, the federal banking agencies) to establish minimum capital requirements for banks, and (2) require the federal banking agencies to impose two types of capital adequacy standards on banks. *See* 12 USC § 1831o(c), 12 USC § 3907, 12 U.S.C. § 5371. The federal banking agencies also have the authority to establish minimum capital requirements for certain affiliates of banks, including the Board's authority to establish capital requirements for bank holding companies (BHCs). *See* 12 USC § 3907, 3909(b) and savings and loan holding companies (SLHCs). *See* 12 U.S.C. § 1467a(g)(1). Under those authorities, the federal banking agencies have adopted capital adequacy rules for banking organizations, which include national banks, state member and state nonmember banks, Federal savings associations, state savings associations, top-tier bank holding companies (BHCs) not subject to the Board's Small Bank Holding Company Policy Statement, described further below, and certain top-tier SLHCs.[126] These capital requirements include both risk-based capital and leverage capital requirements. *See* 12 CFR part 3 (OCC); 12 CFR part 217 (Federal Reserve); 12 CFR part 324 (FDIC). The federal banking agencies recently revised their capital adequacy rules, and aspects of the prior capital adequacy guidelines remain in effect as the new capital rules transition to full effectiveness. The prior capital adequacy guidelines were located at 12 CFR part 3, Appendices A, B, and C (national banks); 12 CFR part 167 (federal savings banks); 12 CFR part 208, Appendices A, B, and E (state member banks); 12 CFR part 225, Appendices A, D, and E (bank holding companies); 12 CFR part 325, Appendices A, B, C, and D (state nonmember banks); 12 CFR part 390, subpart Z (state savings associations). In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or DFA), Public Law 111-203, 124 Stat. 1376, 1435-38 (2010) is part of the statutory framework governing capital adequacy of banking organizations. The Dodd-Frank Act requires

[125] 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.

[126] *See* 12 C.F.R. 217.2 (definition of Covered Savings and Loan Holding Company). The Board adopted consolidated capital requirements for certain top-tier SLHCs as part of the new capital rule described further below.

the Board to establish enhanced prudential standards for certain BHCs, and requires the federal banking agencies to establish generally applicable risk-based and leverage capital rules and alternate standards of credit-worthiness in place of credit ratings. *See* DFA Section 165 (enhanced prudential standards, as discussed in EC 4 below), 12 U.S.C. § 5365; DFA Section 171, ("generally applicable capital rules," as discussed in EC 7 below), 12 U.S.C. § 5371; DFA Section 939A (removal of external credit ratings), 15 U.S.C. § 78o-7 note.

Risk-based Capital

The risk-based capital rules that are in place for most banking organizations through 2014 (the general risk-based capital rules) are based on the Basel I agreement. Those rules can be found at 12 CFR 3.6, 12 CFR part 3, Appendices A, B, and C (national banks); 12 CFR part 167 (Federal savings associations); 12 CFR part 208, Appendices A, B, E, and F (state member banks); 12 CFR part 225, Appendices A, B, D, E, and G (bank holding companies); 12 CFR part 325, Appendices A, B, and C (state nonmember banks); 12 CFR part 390, subpart Z (state savings associations). In July 2013, the Board and the OCC issued a final rule implementing regulatory capital reforms reflecting agreements reached by the Basel Committee on Banking Supervision (BCBS) in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" and certain changes required by the Dodd-Frank Act (new capital rule) (78 FR 62017 (October 11, 2013)). The FDIC adopted an interim final rule that was substantively identical to the new capital rule in July 2013 and later issued a final rule in April 2014 that is also substantially identical (79 FR 20754 (April 14, 2014)). The new capital rule supersedes the general risk-based capital rules and restructures the banking agencies' regulatory capital rules into a harmonized, codified regulatory capital framework. The federal banking agencies implemented the new capital rule in a consistent fashion across the banking system in order to improve the quality and increase the level of regulatory capital, leading to a more stable and resilient system for banking organizations of all sizes and risk profiles. The federal banking agencies believe that this improved resilience will enhance banking organizations' ability to continue functioning as financial intermediaries, including during periods of financial stress, and reduce risk to the deposit insurance fund and to the financial system.

The new capital rule, among other changes, introduced a new minimum common equity tier 1 capital ratio of 4.5 percent, raised the minimum tier 1 ratio from 4 percent to 6 percent, required all banking organizations to meet a 4 percent minimum leverage ratio (generally applicable leverage ratio), implemented stricter eligibility criteria for regulatory capital instruments consistent with Basel III, and introduced a standardized methodology for calculating risk-weighted assets (the standardized approach). The rule also maintained an 8 percent minimum total capital ratio and incorporated a capital conservation buffer of 2.5 percent, composed of common equity tier 1 capital, that banking organizations must hold to avoid limitations on capital distributions and discretionary bonus payments to executive officers. Under the rule, banking organizations with total consolidated assets of $250 billion or more or total consolidated on-balance sheet foreign exposures of at least $10 billion and institutions that elect to use the advanced approaches risk-based capital rule (the advanced approaches) (advanced approaches banking organizations) must also meet a minimum supplementary leverage ratio of 3 percent based on the international leverage standard agreed to by the BCBS. For purposes of this discussion, an advanced approaches banking organization is deemed to be an internationally-active banking organization and thus questions regarding internationally-active banking organizations will be answered by reference to requirements for advanced approaches banking organizations.

The new capital rule incorporates standardized and advanced approaches methodologies for calculating risk-weighted assets, as well as a methodology for calculating market risk-weighted assets for banking organizations with significant trading activity (generally any banking organization with trading activity equal to either 10 percent or more of its total consolidated assets, or $1 billion or more).

Principle 16: Capital adequacy[125]

All banking organizations must calculate risk-based capital ratios using the standardized approach and, if applicable, the market risk rule (i.e., the generally applicable risk-based capital rules). In addition, advanced approaches banking organizations must calculate risk-based capital ratios using the advanced approaches and, if applicable, the market risk rule. The banking agencies initially adopted the advanced approaches, which are consistent with the advanced approaches of the Basel Capital Accords, in 2007.

Leverage Requirements

The generally applicable leverage ratio supplements the risk-based capital requirement. The new capital rule establishes a minimum ratio of a banking organization's tier 1 capital to average total balance sheet assets of 4 percent. The new capital rule also establishes a minimum supplementary leverage ratio of 3 percent of tier 1 capital to total leverage exposure for advanced approaches banking organizations. Total leverage exposure includes all on-balance sheet assets and many off-balance sheet exposures. This non-risk-based measure of capital adequacy helps to ensure capital adequacy at large, complex organizations that often have substantial off-balance sheet exposures. The minimum supplementary leverage ratio requirement becomes effective on January 1, 2018. However, banking organizations subject to the supplementary leverage ratio are required to begin reporting their supplementary leverage ratio on January 1, 2015.

On April 8, 2014, the banking agencies issued a notice of proposed rulemaking that would modify the denominator calculation for the supplementary leverage ratio in a manner consistent with recent changes published by the BCBS. The revisions in the notice of proposed rulemaking would apply to all internationally active banking organizations, including those subject to the enhanced supplementary leverage ratio, discussed directly below. *See* 79 FR 24596 (May 1, 2014).

On April 8, 2014, the U.S. banking agencies also adopted an enhanced supplementary leverage ratio final rule to strengthen the leverage ratio standards for the largest, most interconnected U.S. banking organizations (79 FR 24528 (May 1, 2014)). The final rule applies to U.S. top-tier BHCs with more than $700 billion in consolidated total assets or more than $10 trillion in assets under custody and their insured depository institution (IDI) subsidiaries. These BHCs must maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3 percent, for a total of more than 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments to executive officers. IDI subsidiaries of these BHCs must maintain at least a 6 percent supplementary leverage ratio to be considered "well capitalized" under the agencies' prompt corrective action framework (PCA). The final rule has an effective date of January 1, 2018.

Effective dates and transitions

The new capital rule requires compliance by different types of organizations at different times, and incorporates transition provisions consistent with the Basel Accord. Generally, banking organizations that are not subject to the advanced approaches must begin complying with the new capital rule on January 1, 2015, whereas advanced approaches banking organizations must begin complying with the rule on January 1, 2014.

Principle 16: Capital adequacy[125]

Thus, in this response, when describing applicable risk-based capital rules, those should be understood to include the general risk-based capital rules until January 1, 2015, as applicable, and, after that date, the new capital rule. These responses, however, for the most part will describe elements of the new capital rule, because they are the going-forward regulatory capital requirements.

Supervisory Action

The banking agencies have clear statutory authority to take a number of remedial measures in the event a bank falls out of compliance with applicable capital adequacy requirements. Under the PCA statute, 12 USC § 1831o, the primary Federal supervisor for a bank may take a range of mandatory and discretionary actions if that institution's capital falls below the required minimum level for any relevant capital measure. The severity of the supervisory action depends on the severity of the capital shortfall. Well-capitalized banks are not subject to any specific regulatory restrictions. However, a bank may not make any capital distributions or pay management fees if either action would leave the bank undercapitalized. If a bank does not meet the definition of "well capitalized" it can be classified into one of four capital categories: adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. *See* 12 CFR 6.4, 12 CFR 165.4 (OCC); 12 CFR 208.43 (Federal Reserve); 12 CFR 324.403, 12 CFR 325.103, 12 CFR 390.453 (FDIC).

While not subject to PCA requirements, a BHC is required to serve as a source of managerial and financial strength to its subsidiary banks, and it must therefore appropriately assess the risks to which it is exposed, evaluate its processes for managing and mitigating those risks, and maintain its capital adequacy relative to its risks. Supervisors' findings relating to these processes are incorporated into the assessment of the "Capital" subcomponent for the BHC's "Financial Condition" rating and may result in enforcement actions if appropriate. *See* SR 09-4.

Capital Plan Rule

Under the capital plan rule issued in November 2011 and as subsequently amended (*see* 12 CFR 225.8) and through its Comprehensive Capital Analysis and Review (CCAR), the Federal Reserve annually evaluates the capital plans of BHC's with over $50 billion in total assets. The review includes the BHCs' capital adequacy, internal capital adequacy assessment processes, and plans to make capital distributions, such as dividend payments or stock repurchases (76 FR 74631 (December 1, 2011)). The Federal Reserve permits capital distributions only for companies that are able to demonstrate sufficient financial strength to maintain capital above regulatory minimums and operate as successful financial intermediaries under stressed macroeconomic and financial market scenarios, even after making their planned capital distributions (*see* EC 6).

Stress-test Rule

In October 2012, the Federal Reserve published a final rule to implement section 165(i)(1) of the Dodd-Frank Act, which requires annual supervisory stress testing for large BHCs using scenarios provided by the Board, and the federal banking agencies individually published final rules implementing section 165(i)(2) of the Dodd-Frank Act, which require financial companies with more than $10 billion in assets to conduct annual company-run stress tests (annual company-run stress tests) using scenarios provided by the federal banking agencies. 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

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banking agency annually determines are appropriate, including, but not limited to, baseline, adverse, and severely adverse scenarios. *See*, e.g., 12 CFR part 46 (OCC); 12 CFR part 252, subparts B, E and F (Federal Reserve); 12 CFR part 325, subpart C (FDIC).

EC 1	Principle 16: Capital adequacy
Criterion	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.
Legal Framework	Federal statutes (1) authorize the federal banking agencies to establish minimum capital requirements for banks, and (2) require the federal banking agencies to impose two types of capital adequacy requirements on banks. *See* 12 U.S.C. § 1831o(c), 12 U.S.C. § 3907, 12 U.S.C. § 5371. The federal banking agencies also have the authority to establish minimum capital requirements for certain affiliates of banks, including the Board's authority to establish capital requirements for BHCs and SLHCs. *See* 12 U.S.C. § 3907, 3909(b); 12 U.S.C. § 1467a(g)(1). Under those authorities, the federal banking agencies previously adopted capital adequacy rules for banks and BHCs, which include both risk-based capital and leverage capital requirements. *See* 12 CFR 3.6, 12 CFR part 3, Appendices A, B, and C (national banks); 12 CFR 325.3, 12 CFR Part 325, Appendices A, B, C, and D (state nonmember banks); 12 CFR part 208, Appendices A, B, E, and F (state member banks); 12 CFR part 225, Appendices A, B, D, E, and G (bank holding companies); 12 CFR part 167 (savings associations); 12 CFR part 390, subpart Z (state savings associations) ("former capital standards"). In 2013, the federal banking agencies adopted the new capital rule to implement Basel III revisions related to minimum capital requirements, the definition of capital, and additional capital "buffer" standards, as well as to incorporate aspects of the Basel II standardized approach and applicable Basel III changes to the advanced approaches. *See* 12 CFR part 3 (national banks and federal savings associations), 12 CFR part 217 (state member banks, bank holding companies, and savings and loan holding companies), and 12 CFR part 324 (state nonmember banks and state savings associations). In both the general risk-based capital rule and the new capital rule, the leverage capital requirement supplements the risk-based capital requirement and establishes a minimum ratio of a banking organization's tier 1 capital to total balance-sheet assets. Advanced approaches banking organizations are also required to meet a minimum "supplementary leverage ratio," consistent with the Basel III leverage ratio.[127] The former capital standards and the new capital rule define the components of tier 1 and tier 2 capital and focus on the permanence of capital and the availability of capital to absorb losses on a going concern basis . *See e.g.*, 12 CFR part 3, subpart C (OCC); 12

[127] The advanced approaches are located in subpart E of the new capital rule. 12 CFR part 3, subpart E; 12 CFR part 217, subpart E; 12 CFR part 324, subpart E. In addition, there are additional requirements for entities subject to the advanced approaches in other parts of the new capital rule, such as the minimum supplementary leverage ratio. *See* 12 CFR 3.10(a)(5); 12 CFR 217.10(a)(5) ; 12 CFR 324.10(a)(5).

EC 1	Principle 16: Capital adequacy
	CFR part 217 subpart C (FRB); 12 CFR part 324, subpart C (FDIC). The new capital rule has three forms of capital: common equity tier 1 capital, additional tier 1 capital, and tier 2 capital. The new capital rule sets forth a list of criteria that an instrument must meet to be included in each category of regulatory capital, which are consistent with Basel III and were designed to ensure that capital instruments do not possess features that would cause a banking organization's condition to further weaken during periods of economic and market stress. *See* 12 CFR part 3, subpart C (OCC); 12 CFR part 217, subpart C (Federal Reserve), 12 CFR part 324, subpart C (FDIC). Common equity tier 1 capital is designed to be the most subordinated and most able to absorb unexpected losses, with additional tier 1 capital and tier 2 capital also structured to absorb losses but subject to less stringent requirements.
Practices and Procedures	Under the new capital rule, banking organizations are subject to common equity tier 1, tier 1, and total risk-based capital ratio requirements on a consolidated basis. The minimum capital requirements for individual banking organizations are 4.5 percent common equity tier 1 risk-based capital, 6 percent tier 1 risk-based capital, 8 percent total risk-based capital, 4 percent tier 1 leverage capital, and 3 percent supplementary leverage capital, if applicable. *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. As mentioned above, the new capital rule incorporates a capital conservation buffer, in addition to the minimum risk-based capital requirements, composed of common equity tier 1 capital. Banking organizations must hold a capital conservation buffer of 2.5 percent of risk-weighted assets to avoid limitations on capital distributions and discretionary bonus payments to executive officers. The calibration of the buffer is supported by an evaluation of the loss experience of U.S. banking organizations as part of an analysis conducted by the BCBS, as well as by evaluation of historical levels of capital at U.S. banking organizations. The banking agencies review the quality and regulatory capital eligibility of more complex instruments as necessary on a case-by-case basis. In addition to meeting the criteria described in subpart C of the new capital rule, a banking organization must request approval from its primary Federal supervisor before including a capital element in regulatory capital, unless: (i) such capital element is currently included in regulatory capital under the supervisors' general risk-based capital and leverage rules and the underlying instrument complies with the applicable eligibility criteria for regulatory capital instruments; or (ii) the capital element is equivalent, in terms of capital quality and ability to absorb losses, to an element described in a previous decision made publicly available by the banking organization's primary federal supervisor. The banking agencies 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 the flexibility necessary 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). With regard to the observation in the 2010 FSAP review that the capital rules allow intangibles to count for a high portion of Tier 1 capital, the adoption by U.S. banking agencies of Basel III means that the agencies have also adopted a more narrow definition of how intangibles can count as capital.

EC 1	Principle 16: Capital adequacy
	All banks are required to report data quarterly on the calculation of their regulatory capital ratios on schedule RC-R of the Consolidated Reports of Condition and Income (Call Report, Forms FFIEC 031 and FFIEC 041). BHCs are required to report data quarterly on the calculation of their regulatory capital ratios on schedule HC-R of the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). An advanced approaches banking organization in parallel run must calculate its ratios in accordance with the advanced approaches in subpart E of the new capital rule for purposes of confidential reporting to its primary federal supervisor on the Federal Financial Institutions Examination Council's (FFIEC) 101 report. For banking organizations that have been approved to calculate risk-based capital using the advanced approaches, some schedules of the FFIEC 101 report are made public. The PCA requirements provide the federal banking agencies with a framework to take necessary measures should a bank become less-than-well capitalized. As noted above, the risk-based and leverage requirements to be "well capitalized" are above the banking agencies' regulatory minimums and those established by the Basel Capital Accords. A bank's total risk-based capital, tier 1 risk-based capital, common equity tier 1 risk-based capital, and leverage ratios, including the supplementary leverage ratio, if applicable, must be at or above the regulatory minimum requirements to be considered adequately capitalized. Should any ratio fall below the minimum requirement, the bank would no longer 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).

EC 2	Principle 16: Capital adequacy
Criterion	At least for internationally active banks,[128] the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Legal Framework	The new capital rule is consistent with the Basel capital framework for internationally active banks and provides for definitions of capital, methods of calculation, and required ratios no lower than those imposed under the applicable Basel Capital Accord.[129]

[128] 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 consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalised on a stand-alone basis.

[129] The federal banking agencies have proposed to revise the new capital rule to reflect recent changes to the Basel leveral capital framework. *See* 79 FR 24596 (May 1, 2014).

EC 2	Principle 16: Capital adequacy
	As indicated above, all banks and most holding companies,[130] regardless of size, are subject to risk-based capital rules that are based on Basel standards. Banking organizations that meet the advanced approaches criteria identified above are subject to the advanced approaches under the new capital rule, which are consistent with the advanced approaches framework of the Basel II Capital Accord and the Basel III changes thereto. Advanced approaches banking organizations are also subject to a definition of capital and supplementary leverage ratio that are consistent with the Basel capital framework leverage ratio. The federal banking agencies have implemented bifurcated risk-based capital frameworks for banks and BHCs (and SLHCs, under the new capital rule). All U.S. banks and BHCs[131] are currently subject to the general risk-based capital framework that is consistent with the Basel I Capital Accord and, starting on January 1, 2015, will become subject to the corresponding rules under the new capital rule (standardized approach). SLHCs were not subject to the former capital standards, but most SLHCs are or will be subject to the new capital rule.[132] Banking organizations, including advanced approaches banking organizations, with significant trading activity are also subject to the market risk rule. The market risk requirements in the new capital rule are consistent with the Basel capital framework, including the 2011 revisions.[133] *See* 12 CFR 3.201(b); 12 CFR 217.201(b); 12 CFR 324.201(b).
Practices and Procedures	Advanced approaches banking organizations are required to enhance the measurement and management of risks, including credit risk and operational risk, through the use of advanced approaches for calculating risk-based capital requirements. These banking organizations are also required to have rigorous processes for assessing their overall capital adequacy in relation to their total risk profile and to publicly disclose information about their risk profile and capital adequacy. Under this framework, risk-based capital requirements will vary on the basis of a banking organization's actual risk profile and experience. As a general matter, banking organizations with a higher risk profile will have higher regulatory capital requirements than those with a lower risk profile. The advanced approaches include a number of prudential safeguards, including a requirement that banking organizations satisfactorily complete a parallel run period before operating under the advanced approaches. Prior to and during the parallel run period, the agencies conduct extensive reviews in consultation with subject matter experts. Approval to use the advanced approaches to calculate risk-based capital requirements is granted by a banking organization's primary Federal supervisor once it has been determined that: 1- the banking organization has developed and adopted a written implementation plan, 2 - the banking organization

[130] Bank holding companies with $500 million or less in total consolidated assets are exempt from the new regulatory capital rules and are instead subject to the standards in the Federal Reserve's Small Bank Holding Company Policy (12 CFR part 225, Appendix C). Savings and loan holding companies with substantial insurance or commercial activities are currently excluded from the new regulatory capital rules. *See* 12 CFR part 217, subpart A.
[131] As discussed in AC 4, the risk-based capital requirement differs for BHCs with consolidated assets of $500 million or less.
[132] Certain SLHCs with substantial commercial or insurance operations are currently excluded from the new capital rule. Consistent with legal requirements, the Federal Reserve anticipates applying capital requirements to these excluded SLHCs in the future. *See* 12 U.S.C. § 5371.
[133] The market risk portion of the former capital standards are also consistent with the Basel capital framework, including the 2011 revisions. The market risk portion of the former capital standards continues to apply to covered entities that are not subject to advanced approaches until January 1, 2015. The OTS did not join the other federal banking agencies in adopting the market risk rule in 1996 as it was not applicable to the trading activities levels of savings associations at that time. 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.

EC 2	Principle 16: Capital adequacy
	has established and maintains a comprehensive and sound planning and governance process to oversee the implementation efforts described in the plan, 3 - the banking organization has demonstrated to its primary federal supervisor that it meets the qualification requirements under the advanced approaches, and 4 - the banking organization has completed a satisfactory parallel run of no less than four quarters.

EC 3	Principle 16: Capital adequacy
Criterion	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 (eg securitisation transactions[134]) entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Legal Framework	The former capital standards require banks and BHCs 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 to savings and loan holding companies. The federal banking agencies have broad statutory authority to establish such minimum capital levels for a bank or holding company as the primary Federal supervisor, at its discretion, deems necessary or appropriate in light of the particular circumstances. 12 U.S.C. §§ 3907(a)(2), 3909. Under the former capital standards, the federal banking agencies have authority to impose specific capital charges on one or more exposures if the applicable capital charge under the rules is not appropriate for the exposures. *See* 12 CFR 3.4, 12 CFR 3.10, 12 CFR 167.3, and 12 CFR 167.11 (OCC); 12 CFR parts 208 and 225, Appendix A, § IV, 12 CFR part 208, Appendix F, section 1(c), 12 CFR Part 225, Appendix G, section 1(c) (Federal Reserve), and 12 CFR part 325 (FDIC). This authority continues under the new capital rule. *See e.g.*, 12 CFR 3.1(d) and 12 CFR part 3, subpart H (OCC); 12 CFR 217.1(d) (Federal Reserve); 12 CFR 324.1(d) (FDIC). 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*). The federal banking agencies 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. *See e.g.*, 12 CFR 3.42(e), 12 CFR 217.3(e), and 12 CFR 324.42(e) (implicit support for securitization exposures); 12 CFR 3.42(i)-(j), 12 CFR 217.42(i)-(j), and 12 CFR 324.42(i)-(j) (credit protection for securitization exposures); 12 CFR 3.131 12 CFR 217.131, and

[134] 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.

EC 3	Principle 16: Capital adequacy
	12 CFR 324.131 (consideration of eligible guarantees and offsetting collateral); 12 CFR 3.132,12 CFR 217.132, and 12 CFR 324.132 (consideration of collateral for OTC derivatives contracts). The standardized and advanced approaches in the new capital rule requires consideration of on-balance sheet as well as off-balance sheet items for risk-weighting purposes. Under the standardized approach, a banking organization would calculate the exposure amount of an off-balance sheet item by multiplying the off-balance sheet component, which is usually the contractual amount, by the applicable credit conversion factor. This treatment applies to all off-balance sheet items, such as commitments, contingent items, guarantees, certain repo-style transactions, financial standby letters of credit, and forward agreements. *See e.g.*, 12 CFR part 3, subpart D (OCC); 12 CFR part 217, subpart D (Federal Reserve); 12 CFR 324, subpart D (FDIC). Advanced approaches banking organizations are subject to the supplementary leverage ratio because these banking organizations tend to have more significant amounts of off-balance sheet exposures that are not captured by the generally applicable leverage ratio. In addition, section 165(k) of the Dodd-Frank Act (12 U.S.C. 5365(k)) provides that for a BHC with $50 billion or more in total consolidated assets, the computation of capital, for purposes of meeting capital requirements, shall take into account any off-balance sheet activities of the company.
Practices and Procedures	A banking organization is generally expected to have internal processes for assessing capital adequacy that reflect a full understanding of its risks and ensure that it holds capital corresponding to those risks and maintains overall capital adequacy. The nature of such capital adequacy assessments should be commensurate with banking organizations' size, complexity, and risk profile. Consistent with longstanding practice, supervisory assessment of capital adequacy will take account of whether a banking organization plans appropriately to maintain an adequate level of capital given its activities and risk profile, including, for example, the level and severity of problem assets and its exposure to operational and interest rate risk and significant asset concentrations. For this reason, a supervisory assessment of capital adequacy may differ significantly from conclusions that might be drawn solely from the level of a banking organization's regulatory capital ratios. As part of evaluating the appropriateness of a banking organization's capital level given its overall risk profile, the supervisory assessment takes into account the quality and trends in a banking organization's capital composition, including the share of common and non-common-equity capital elements. The federal banking agencies may require banking organizations to increase overall capital to be able to support the risks to which they are exposed. Supervisors also evaluate the comprehensiveness and effectiveness of a banking organization's capital planning in light of its activities and capital levels. An effective capital planning process involves an assessment of the risks to which a banking organization is exposed and its processes for managing and mitigating those risks, an evaluation of its capital adequacy relative to its risks, and consideration of the potential impact on its earnings and capital base from current and prospective economic conditions. While the elements of supervisory review of capital adequacy are similar across banking organizations, evaluation of the level of sophistication of an individual banking organization's capital adequacy process is commensurate with the banking organization's size, sophistication, and risk profile. Under the federal banking agencies' Uniform Financial Institutions Rating System, known as CAMELS (for rating definitions, see appendix A of OCC's *Bank Supervision Handbook*: www.occ.gov/handbook/banksup.pdf), the federal banking agencies assess a 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

EC 3	Principle 16: Capital adequacy
	factors into the PCA requirements for banks that are not adequately capitalized (*see* Overview of this Principle). In assessing capital adequacy, the federal banking agencies 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. *See*, *e.g.* OCC's *Bank Supervision*, *Community Bank Supervision* and *Large Bank Supervision* booklets of the Comptroller's Handbook series, www.occ.gov/handbook/banksup.pdf; www.occ.gov/handbook/cbsh2003intro.pdf; www.occ.gov/handbook/cbsh2003appendixes.pdf; http://www.occ.gov/handbook/lbs.pdf; Federal Reserve's *Commercial Bank Examination Manual*, http://www.federalreserve.gov/boarddocs/supmanual/cbem/cbem.pdf; FDIC's Risk Management Manual of Examination Policies (section 2.1 – Capital), http://www.fdic.gov/regulations/safety/manual/. The RFI/C(D) rating system measures the overall performance and condition of BHCs. The "F" component of the RFI/C(D) represents the financial condition of the BHC, which is supported by four subcomponents, one of which is an assessment of the adequacy of the BHC's capital which takes into account the same factors described above for banks. *See* section 4070 of the *Bank Holding Company Supervision Manual*, http://www.federalreserve.gov/boarddocs/supmanual/bhc/bhc.pdf, for a full description of the "F" component under the RFI/C(D) ratings methodology. The RFI/C(D) rating system is also used on an indicative basis for SLHCs. *See* http://www.federalreserve.gov/bankinforeg/srletters/sr1308.pdf.

EC 4	Principle 16: Capital adequacy
Criterion	The prescribed capital requirements reflect the risk profile and systemic importance of banks[135] 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.
Legal Framework/ Practices and Procedures	Consistent with the Basel Capital Accords, 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. For a comprehensive list of assets and their risk-weight classes, as well as procedures for calculating the risks associated with off-balance-sheet items, see 12 CFR Part 3, Appendices A, B, and C (national banks); 12 CFR part 167 (savings associations); 12 CFR part 208, Appendix A (state member banks); 12 CFR part 325, Appendix A (state nonmember banks); 12 CFR part 390, subpart Z (state

[135] 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.

EC 4	Principle 16: Capital adequacy
	savings associations); and 12 CFR part 225, Appendix A (BHCs); 12 CFR part 3, subparts D and E (OCC – revised capital rules); 12 CFR part 217, subparts D and E (Federal Reserve); 12 CFR part 324, subpart D and E (FDIC). The former capital standards and new capital rule, like the Basel Capital Accords they are based on, 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 federal banking agencies 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. A federal banking agency can impose higher capital levels if, in the supervisor's judgment, existing levels are not commensurate with the risks faced. *See* discussion in EC 3. In addition to the risk-based capital requirements, the federal banking agencies also review a bank's or holding company's tier 1 leverage ratio (tier 1 capital divided by average total consolidated assets) when assessing its capital adequacy. Under the new capital rule, advanced approaches banking organizations are also subject to a "supplementary leverage ratio," which is designed to implement the Basel III leverage ratio. The largest U.S. BHCs, those with $700 billion in total consolidated assets or more that $10 trillion in assets under custody, are subject to a leverage buffer greater than 2 percentage points (above the minimum 3 percent supplementary leverage ratio) for a total of more than 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments to executive officers. In addition, the insured depository institution subsidiaries of BHCs subject to the supplementary leverage buffer must maintain a supplementary leverage ratio of at least 6 percent to be considered "well-capitalized" under each agency's prompt corrective action ("PCA") framework. The principal objective of these enhanced leverage standards (which are used as a supplement to the risk-based capital measure) is to place a constraint on the maximum degree to which a bank or holding company can leverage its equity capital base. Federal banking supervisors generally expect and require banks and BHCs to operate at capital levels well above the required minimums (12 CFR part 3, Appendix A (OCC); 12 CFR parts 208 and 225, Appendix A (Federal Reserve); 12 CFR part 325, Appendix A (FDIC); 12 CFR part 3 (OCC); 12 CFR part 217 (Federal Reserve); 12 CFR part 324 (FDIC)). The United States has established PCA requirements for insured depository institutions (*see* 12 U.S.C. § 1831o) which 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, as a result of the GLB Act, BHCs 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. *See* 12 U.S.C. § 1843(j)-(k); 12 CFR part 225, subpart I. PCA requirements are discussed in more detail below in EC 6. By law, the federal banking agencies are required to apply minimum risk-based and leverage capital requirements to insured depository institutions and holding companies that are not less than generally applicable requirements and not quantitatively lower than the generally applicable requirements for insured depository institutions in effect in July 2010. 12 U.S.C. § 5371(b). Thus, an advanced approaches banking organization's capital requirements cannot be lower than its capital requirements under the generally applicable capital rules.

EC 4	Principle 16: Capital adequacy
	Congress directed the Federal Reserve, in section 165 of the Dodd-Frank Act, 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 Board to increase the stringency of the standards in line with the systemic footprint of the company. For foreign-based bank holding companies specifically, the statute directs the Board 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.. In February 2014, the Federal Reserve approved a final rule pursuant to section 165 that establishes enhanced prudential standards for BHCs with more than $50 billion in total consolidated assets. *See* 79 FR 17239 (March 27, 2014). The rule was 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, the stress-testing rule, and the enhanced supplementary leverage ratio rule described in the overview are the Board's capital-related enhanced prudential standards. The rule requires a foreign-based BHC with a significant U.S. presence to establish an intermediate holding company over its U.S. subsidiaries, which will will generally be subject to the same capital requirements as a U.S.-based BHC and facilitate consistent supervision and regulation of the U.S. operations of the foreign bank. *See* also EC 6.

EC 5	Principle 16: Capital adequacy
Criterion	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: (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 considers it prudent to do so; and (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.
Legal Framework/ Practices and Procedures	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. Under the new capital rule, subject banks and holding companies also must apply the standardized approach, and must meet the minimum capital requirements using the more restrictive of advanced and standardized approaches. The federal banking agencies oversee the internal models created by subject banks and holding companies. *See* 12 CFR part 3, appendix C (national banks) and 12 CFR part 167, appendix C (Federal savings associations) (OCC); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D, and 12 CFR part 390, subpart Z, appendix A (FDIC) (former capital standards).

EC 5	Principle 16: Capital adequacy
	See also 12 CFR part 3, subpart E (OCC); 12 CFR part 217, subpart E (Federal Reserve); 12 CFR part 324, subpart E (FDIC) (new capital rule). If the supervisory agency believes that the bank's or holding company's internal models are flawed, the supervisory agency can require that company to change its models. Use of the advanced approaches framework is subject to rigorous qualifying criteria described in the capital rules that must be met on an initial and ongoing basis. Before moving to the advanced approaches for risk-based capital purposes, a banking organization must complete a parallel run that is at least four consecutive calendar quarters, and during which the banking organization's primary Federal supervisor deems the banking organization's 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 the transitions, described in the Overview of this Principle) for all applicable regulatory and supervisory purposes, but the banking organization also must calculate its capital ratios using the advanced approaches and report pertinent information to its primary Federal supervisor. A banking organization's primary Federal supervisor will notify the bank of the date when it may begin to use the advanced approaches for risk-based capital purposes. Before providing this notification, the primary Federal supervisor must determine that the banking organization fully complies with all of the rule's qualification requirements and that the banking organization has an adequate process to ensure ongoing compliance. If the Federal supervisor determines that a banking organization that has been approved to use the advanced approaches subsequently fails to comply with the qualification requirements, the federal banking agency will notify the banking organization in writing of the failure to comply. The banking organization must establish and submit a plan satisfactory to the federal banking agency to return to compliance with the qualification requirements. *See* 12 CFR part 3, appendix C, section 23(b); 12 CFR part 167, appendix C, section 23(b) (OCC); 12 CFR part 208, appendix F, section 23(b), 12 CFR part 225, appendix G, section 23(b), 12 CFR part 325, appendix D, section 23(b), and 12 CFR part 390, subpart Z, appendix A, section 23(b) (FDIC). A bank or holding company is required to notify its primary Federal 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. *See* 12 CFR part 3, appendix C, section 23(a); 12 CFR part 167, appendix C, section 23(a) (OCC); 12 CFR part 208, appendix F, section 23(a), 12 CFR part 225, appendix G, section 23(a), 12 CFR part 325, appendix D, section 23(a), and 12 CFR part 390, subpart Z, appendix A, section 23(a) (FDIC). These principles will also apply to SLHCs. *See* 12 CFR § 3.123(a) (OCC); 12 CFR § 217.123(a) (Federal Reserve); 12 CFR § 324.123(a) (FDIC) (new capital rule). If the primary Federal 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. *See* 12 CFR part 3, appendix C, section 23(b)(3); 12 CFR part 167, appendix C, section 23(b)(3) (OCC); 12 CFR part 208, appendix F, section 23(b)(3), 12 CFR part 225, appendix G, section 23(b)(3), 12 CFR part 325, appendix D, section 23(b)(3), and 12 CFR part 390, subpart Z, appendix A, section 23(b)(3) (FDIC).

EC 5	Principle 16: Capital adequacy
	In addition, a banking organization applying the market risk rule (discussed in the Overview of this Principle and in EC 2) must have its internal model and risk-management procedures evaluated by its primary Federal supervisor to ensure compliance with the market risk rule's qualifying standards. *See* 12 CFR 3.203 (OCC); 12 CFR 217.203 (Federal Reserve); 12 CFR 324.203 (FDIC). For example, a banking organization must obtain prior approval from its primary Federal supervisor before using an internal model to calculate market risk-weighted assets under the market risk rule and 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. *See* 12 CFR 3.203(c) (OCC); 12 CFR 217.203(c) (Federal Reserve); 12 CFR 324.203(c) (FDIC). The general risk-based capital rules under the former capital standards generally do not allow use of banking organization 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. *See* 12 CFR part 3, Appendix A, section 4(g)(1) (OCC); 12 CFR part 208, Appendix A, § III.B.3 and 12 CFR part 225, Appendix A, § III.B.3 (Federal Reserve); 12 CFR 325, Appendix A, section II.B. Similarly, the standardized approach under the new capital rule generally does not allow use of banking organization internal estimates, though there are limited exceptions. *See e.g.*, 12 CFR part 3, subpart D, 12 CFR part 217, subpart D and 12 CFR part 324, subpart D. There are requirements for using such estimates, generally including supervisory approval prior to use.

EC 6	Principle 16: Capital adequacy
Criterion	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).[136] The supervisor has the power to require banks: (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.
Legal Framework	All banking organizations must hold capital commensurate with a forward-looking view of their risk profile, see EC3 practices and procedures. The Federal Reserve has established capital planning and stress testing requirements for large bank holding companies. *See* 12 CFR part 252; 12 U.S.C. 5365(i). The Federal Reserve's stress test rules for BHCs with assets greater than $50 billion 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 Board, and require that these companies conduct semi-annual company-run stress tests.

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

EC 6	Principle 16: Capital adequacy
	Additionally, in October 2012, the federal banking agencies individually published final rules implementing section 165(i)(2) of the Dodd-Frank Act, 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 federal banking agencies. The federal banking agencies issued final rules and final guidance describing supervisory expectations for stress tests conducted by these companies. *See* 12 CFR 252, subparts F and L (Board), 12 CFR part 46 (OCC), 12 CFR 325, subpart C (FDIC); *Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of more than $10 Billion but less than $50 Billion* (http://www.federalreserve.gov/bankinforeg/srletters/sr1403.pdf). 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 banking agency annually determines are appropriate, including, but not limited to, baseline, adverse, and severely adverse scenarios. *See, e.g.*, 12 CFR part 46 (OCC); 12 CFR part 252 subparts B, E, and F (Federal Reserve); 12 CFR part 325, subpart C (FDIC). In addition, BHCs with $50 billion or more in total consolidated assets are subject to specific, annual capital planning requirements, as discussed in the overview. *See* 12 CFR 225.8. Under this rule, a BHC is required to submit an annual capital plan to the Board 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 BHC will, under expected conditions and stressed scenarios, maintain regulatory capital ratios and a pro forma tier 1 common ratio above 5 percent 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. The federal banking agencies have the power to require corrective action if, in their judgment, a bank's current or prospective capital plan is inadequate and causes it to be in an unsafe or unsound condition. *See e.g.*, 12 CFR part 3, subparts I and J; 12 CFR 6.5 (OCC); 12 CFR 217.1(d) (Federal Reserve); 12 CFR 324.10(d) (FDIC).
Practices and Procedures	The Federal Reserve's annual Comprehensive Capital Analysis and Review (CCAR) is an intensive assessment of the capital adequacy of U.S. domiciled, top-tier BHCs with total consolidated assets of $50 billion or more and of the practices these BHCs use to manage their capital. The Federal Reserve expects each BHC 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 evaluated on a forward-looking, post-stress basis; the BHCs 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 percent 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 U.S. BHCs. The Federal Reserve's qualitative assessment of BHCs' capital plans reflects differing expectations across the various aspects of BHCs' capital planning processes for BHCs of different sizes, scopes of operations, activities, and systemic importance. For example, in all aspects of capital planning, the Federal Reserve has significantly heightened supervisory expectations for the largest and most complex BHCs and expects these BHCs to have the most sophisticated,

EC 6	Principle 16: Capital adequacy
	comprehensive, and robust capital planning practices. The Federal Reserve conducts these qualitative and quantitative assessments of a firm's capital plan and either objects to, or provides a non-objection to, each BHC's capital plan. When the Federal Reserve objects to a BHC's capital plan, the BHC may not make any capital distribution unless the Federal Reserve indicates in writing that it does not object to the distribution. Each year, the Federal Reserve has published (1) instructions outlining how to complete and submit a capital plan and (2) supervisory scenarios that are to be used in the CCAR post-stress capital analysis. *See Comprehensive Capital Analysis and Review 2014: Summary Instructions and Guidance* (http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131101a2.pdf) and *2014 Supervisory Scenarios for Annual Stress Tests* (http://www.federalreserve.gov/bankinforeg/bcreg20131101a1.pdf). In addition, the Federal Reserve described its supervisory expectations for capital planning at CCAR BHCs. *See Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Current Range of Practice* (http://www.federalreserve.gov/bankinforeg/bcreg20130819a1.pdf); *see also* SR Letter 12-17 *Consolidated Supervision Framework for Large Financial Institutions* (http://www.federalreserve.gov/bankinforeg/srletters/sr1217.pdf). The analytical framework and supervisory models used in the post-stress capital analysis are published in *Dodd-Frank Act Stress Test 2014: Supervisory Stress Test Methodology and Results* (http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140320a1.pdf). Finally, each year the Federal Reserve's decision to object or provide a non-objection to each BHCs capital plan, as well as the results of the qualitative and quantitative assessment are released publicly. *See CCAR 2014: Assessment Framework and Results* (http://www.federalreserve.gov/newsevents/press/bcreg/ccar_20140326.pdf). For banking organizations not subject to CCAR, the agencies collect data on covered institutions' 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 company-run stress tests are subject to onsite supervisory examination and inspection. These stress test results provide the agencies with forward-looking information that assist the agency in assessing an institution's risk profile and capital adequacy. The objective of the annual company-run stress tests is to help assess whether banking organizations with assets over $10 billion have sufficient capital to continue operations throughout times of economic and financial stress. 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 United States and key foreign countries. The agencies consult with each other annually to determine scenarios that are appropriate for use for each annual stress test.

EC 7	Principle 16: Capital adequacy
Additional Criterion	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.
Legal Framework	Banks, BHCs with over $500 million in total consolidated assets, and most SLHCs are or will be subject to the new capital rule that is broadly consistent with the Basel standards, including the definition of capital, the risk coverage, the method of calculation, the scope of application, and the capital required. Under the new capital rule, banking organizations that are not advanced approaches banking organizations follow the standardized framework and the market risk rule if relevant, both of which are broadly consistent with applicable Basel standards. *See* 12 CFR part 3, Appendix A, § 2 (national banks and Federal savings banks); 12 CFR part 208, Appendix A, § II (state member banks); 12 CFR part 225, Appendix A, § II (bank holding companies); 12 CFR part 325, Appendix A, § I (state nonmember banks); 12 CFR 3.20 (national banks and Federal savings banks); 12 CFR 217.20 (state member banks and covered holding companies); 12 CFR 324.20 (state nonmember banks and state savings associations). The definition of capital applies to banking organizations whether or not the organization is subject to the advanced approaches. The differences between the definition of capital as applied to advanced approaches banking organizations and all other banking organizations subject to the new capital rule are described in the practices and procedures section below. The calculation of risk weights under the standardized approach is found in subpart D and under the advanced approaches is found in subpart E. The market risk rule applies to banking organizations that have significant trading activities as described in the Overview of this Principle. *See* 12 CFR part 3, subparts C, D, and E, 12 CFR 3.201(b) (national banks and Federal savings associations); 12 CFR part 217, subparts C, D, and E, 12 CFR 217.201(b) (state member banks and bank holding companies); 12 CFR part 324, subparts C, D, and E, 12 CFR 324.201(b) (state nonmember banks and state savings associations). In addition, section 171 of the Dodd-Frank Act requires the federal banking agencies to establish on a consolidated basis minimum risk-based and leverage capital requirements for BHCs, SLHCs, 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. Accordingly, under the new capital rule, an advanced approaches banking organization that has successfully completed a parallel run process 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 advanced approaches banking organizations and thereby provides that institutions that are using internal-ratings-based models, and those which are not, are subject to generally applicable capital requirements.
Practices and Procedures	Bank and BHC capital ratios are calculated on a consolidated basis and applied in a manner consistent with Basel standards. SLHCs subject to the new capital rule will be treated the same as BHCs when the new capital rule becomes effective.

EC 7	Principle 16: Capital adequacy
	With respect to the definition of capital, an advanced approaches banking organization is required to, and other institutions may make a one-time election to, include the majority of AOCI components in common equity tier 1 capital. This distinction reflects the federal banking agencies' recognition that although inclusion of the majority of AOCI components in common equity tier 1 capital reflects better loss-absorption capacity at a specific point in time, the tools used by larger, more complex banking organizations for managing interest rate risk are not necessarily readily available for all banking organizations. In addition, once an advanced approaches banking organization has received notification from its primary Federal supervisor under section 121(d) that it may exit parallel run, it must deduct from common equity tier 1 capital elements the amount of expected credit loss that exceeds the banking organization's eligible credit reserves.

EC 8	Principle 16: Capital adequacy
Additional Criterion	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.[137]
Legal Framework	Minimum capital requirements apply at both the bank and holding company levels, as described above. Other prudential supervisors of holding company subsidiaries may set minimum capital requirements for those subsidiaries. If a federal banking agency believes a bank or holding company is operating in an unsafe or unsound manner, including after taking into account affiliate capital adequacy, the supervisor can require it to hold more capital. *See e.g.*, 12 U.S.C. 1831o(f)(2); 12 USC 3907(a)(2); 12 CFR 3.1(d) and 12 CFR part 3, subpart H (OCC); 12 CFR 217.1(d) (Federal Reserve); 12 CFR 324.1(d) and 12 CFR part 324, subpart H (FDIC). By statute, BHCs and SLHCs are required to serve as sources of financial strength for any subsidiaries that are depository institutions. 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).
Practices and Procedures	The capital adequacy of BHCs (and SLHCs subject to the new capital rule as of January 1, 2015) is assessed on a top-tier, fully consolidated basis. Capital ratios also are assessed on a consolidated basis at the subsidiary bank level. The federal banking agencies 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. *See* also EC 3. BHCs 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. See the Federal Reserve's Small Bank Holding Company Policy Statement, 12 CFR part 225, Appendix C. 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.

[137] Please refer to Principle 12, Essential Criterion 7.

Assessment of Principle 16	Compliant
Comments	

Principle 17: Credit risk[138]

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 conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk[139] (including counterparty credit risk) 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.

(Reference documents: *Sound practices for back testing counterparty credit risk models*, December 2010; FSB *Report on Principles for Reducing Reliance on CRA Ratings*, October 2010; *Enhancements to the Basel II framework*, July 2009; *Sound credit risk assessment and valuation for loans*, June 2006; and *Principles for the management of credit risk*, September 2000.)

Overview

Banks and holding companies are subject to credit-risk management requirements pursuant to U.S. federal banking regulations. References: Federal Reserve: 12 CFR part 208, appendix D-1, part II(C), (D) (addressing loan documentation and credit underwriting); 12 CFR part 225, appendix G (capital adequacy guidelines); 12 CFR part 208, subpart E (addressing real estate lending standards and setting requirements for lending policies); OCC: 12 CFR part 30, appendix A, part II (C), (D) (addressing loan documentation and credit underwriting); 12 CFR part 3, appendix C (addressing capital adequacy guidelines); 12 CFR part 34, subpart D (addressing real estate lending standards and requirements for lending policies). These references are further developed in extensive supervisory guidance and related materials. See U. S. federal banking agencies' manuals,[140] as well as "Supervisory Guidance on Internal Ratings-Based Systems for Credit Risk, Advanced Measurement

[138] Principle 17 covers the evaluation of assets; Principle 18 covers the management of problem assets.

[139] Credit risk may result from on- and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions, and trading activities.

[140] For the Federal Reserve, see *Commercial Bank Examination* and *Bank Holding Company Inspection Manuals.* For the OCC, see *Comptroller's Handbooks*, including those on the following topics: *Loan Portfolio Management; Rating Credit Risk; Commercial Real Estate Lending (also addresses construction lending); Leveraged Lending; Retail Lending Examination Procedures; Concentrations of Credit; Oil and Gas Production Lending; Other Real Estate Owned; Asset-Based Lending; Accounts Receivable and Inventory Financing; Residential Real Estate Lending; Credit Card Lending; Agricultural*

Principle 17: Credit risk[138]

Approaches for Operational Risk, and the Supervisory Review Process (Pillar 2) Related to Basel II Implementation." (73 *Fed. Reg*. 44620 (July 31, 2008)). 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. federal banking agencies 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).

As noted in Principle 15, the U. S. federal banking agencies adhere to the UFIRS and evaluate every bank against UFIRS guidelines during on-site examinations.[141] 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 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.

EC 1	Principle 17: Credit risk
Criterion	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.
Legal Framework	See Overview above. U.S. law also addresses credit risk among large financial institutions (BHCs and nonbank financial companies) by requiring credit exposure reporting and the establishment of single counterparty credit limits for these institutions in order to limit the risks that any individual institution could pose to another.[142] Proposals have been made to implement these requirements.[143] It is expected that a

Lending; Mortgage Banking; Asset Securitization; *Installment Loans; Floor Plan Loans; Student Lending*. For the FDIC, see the *Risk Management Manual of Examination Policies*, as well as the *Credit Card Activities and Credit Card Securitization Manuals*.

[141] Bank holding companies are evaluated using the RFI rating system. Branches and agencies of foreign banks are evaluated using the ROCA guidelines. See Principle 15 for further details.

[142] 12 U.S.C. 5365(d) and (e)(2).

[143] See Federal Reserve proposal at 77 Fed. Reg. 594 (Jan. 5 2014)(single-counterparty credit limits); Federal Reserve and FDIC proposal at 76 Fed. Reg. 22648 (Apr. 22, 2011)(credit exposure reports).

EC 1	Principle 17: Credit risk
	final rule on single-counterparty credit limits would reflect a current quantitative impact study (QIS) on the effects of the counterparty credit limits and would be coordinated with the Basel Committee's work on a similar large exposure regime that would apply to all global banks. Further, pursuant to the Dodd-Frank Act, banks are required to take into account credit exposure arising from derivatives, repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions in calculating prudential limits.[144] Federal branches and agencies of FBOs are also subject to the same lending limits as national banks (*see* 12 U.S.C. 3102(b), 12 CFR 28.13) with certain exceptions for capital equivalency (*see* 12 U.S.C. 3102(b)(1), 12 CFR 28.14)). State licensed branches and agencies are subject to the same limits as federal branches and agencies and, thus, are subject to the limits of national banks (*see* 12 U.S.C. 3102(b) and 3105(h)(2)). The three federal banking agencies, along with three other federal agencies, have proposed credit risk retention rules that would (a) require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an asset backed security, transfers, sells, or conveys to a third party, and (b) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain. These rules will incent securitizers to monitor and ensure the quality of the assets underlying a securitization transaction and, thus, will help align the interests of the securitizer with the interests of investors and ensure that assets pose low credit risk. *See* 15 U.S.C. 780-11; 78 Fed. Reg. 57928 (Sept. 20, 2013) As noted in Principle 15, large BHCs are required to establish enterprise-wide risk committees and adhere to enhanced risk management standards[145] in order to ensure that a company's risk management framework is commensurate with the company's structure, risk profile, complexity, activities, and size. The framework must include policies and procedures that establish risk-management governance, risk-management practices, and risk control infrastructure for the company's global operations, as well as processes and systems for implementing and monitoring compliance with such policies and procedures. The processes and systems must (a) identify and report risks and risk-management deficiencies, including emerging risks, to ensure effective and timely implementation of corrective actions that address risk management deficiencies for the company's global operations; (b) specify managerial and employee responsibility for risk management in order to ensure the independence of the risk management functions; and (c) integrate management and associated controls with management goals and the company's compensation structure for the company's global operations. *See* 12 CFR part 252.

[144] 12 U.S.C. 84(b); 12 CFR part 32. *See also* 12 U.S.C. 1828 (an insured state-chartered bank may engage in derivative transactions only if "the law with respect to lending limits of the state in which the insured state bank is chartered takes into consideration credit exposure to derivative transactions.").
[145] 12 U.S.C. 5365(b)(1)(A) (requiring the Federal Reserve Board to establish enhanced risk-management requirements for bank holding companies with total consolidated assets of $50 billion or more); 12 U.S.C. 5365(h) (stating that the Federal Reserve shall require a publicly traded bank holding company with total consolidated assets of $10 billion or more to establish a risk committee that: is responsible for the oversight of the enterprise-wide risk management practices of the company; has the number of independent directors that the Federal Reserve Board determines is appropriate; and includes at least one risk-management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms).

EC 1	Principle 17: Credit risk
	In addition, 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. *See*, e.g., 12 CFR part 208, Appendix D-1, Part II; 12 CFR part 30, Appendix A, part II; interagency guidelines implementing the 1996 Market Risk Amendment to Basel I (12 CFR Part 3, Appendix B, section (4)(b) (national banks); 12 CFR part 208, Appendix E (state member banks); 12 CFR part 225, Appendix E, section 4(b) (BHCs); 12 CFR part 325, Appendix C, section 4(b); and 12 CFR part 324, subpart F (state nonmember));[146] the operational risk management provisions in the interagency guidelines on the advanced Basel II approaches (12 CFR part 3, Appendix E, section 22 (h) and (j) (national banks); 12 CFR part 208, Appendix F, section 22(h) and (j) (state member banks); 12 CFR part 225, Appendix G, section 22(h) and (j) (BHCs); and12 CFR part 324, Subpart E (state nonmember banks); and the agencies' Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Accord.[147] The federal banking agencies issued guidance on Counterparty Credit Risk (CCR) management for banking organizations with large derivatives portfolios in establishing and maintaining (CCR) management practices. For banks and bank holding companies with large derivative portfolios used to manage CCR their board or a committee should clearly articulate the banking organization's risk tolerance for CCR. In addition senior management should establish and implement a comprehensive risk measurement and management framework consistent with this risk tolerance that provides for the ongoing monitoring, reporting, and control of CCR exposures. To effectively measure and manage CCR a banking organization should employ a range of risk-measurement metrics and approaches in order to promote a comprehensive understanding of CCR and how it changes in varying environments. *See* Interagency Supervisory Guidance on Counterparty Credit Risk Management. The agencies have also issued final guidance to help banking organizations establish incentive compensation policies that encourage prudent risk-taking and are consistent with safety and soundness of the organization. *See* Guidance on Sound Incentive Compensation Policies (75 Fed. Reg. 36395 (June 25, 2010). In addition, as required by the Dodd-Frank Act, the federal financial regulators have proposed rules to require financial institutions (including holding companies and banks) to report the structure of all incentive-based compensation arrangements so federal regulators can determine whether the arrangement provides excessive compensation or could lead to material financial loss. 12 U.S.C. 5641; 76 Fed. Reg. 21170 (Apr. 14, 2011).
Practices and Procedures	U. S. federal banking agencies adhere to the UFIRS and evaluate every bank against UFIRS guidelines during on-site examinations.[148] 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 quantitative measurements of the levels

[146] Effective January 1, 2015, a national bank or federal savings association subject to the market risk rule will apply the market risk rule set forth at 12 CFR Part 3, subpart F, for the purposes of both the generally applicable and the advanced approaches risk-based capital requirements.
[147] 73 Fed. Reg. 44620 (July 31, 2008).
[148] Bank holding companies are evaluated using the RFI rating system. Branches and agencies of foreign banks are evaluated against the ROCA guidelines.

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	of delinquent, troubled, and classified assets and qualitative evaluations of the adequacy of 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.

EC 2	Principle 17: Credit risk
Criterion	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,[149] 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.
Legal Framework	The authorities cited in response to EC 1, above, provide for active board involvement in the approval, periodic review, and continual oversight of senior management's implementation of a bank's and holding company's overall business strategies and significant policies — including those related to originating and managing credit risk. A board also must ensure that senior management is fully capable of managing the lending and other credit-extension activities that the bank or holding company conducts. The board is responsible for understanding the level and nature of credit risk to the bank and holding company, setting the firm's risk appetite, and ensuring that management implements appropriate risk-management practices to identify, measure, monitor, and control these risks.
Practices and Procedures	U.S. federal banking 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. U.S. federal banking supervisors review compliance with supervisory guidance on credit-risk management, 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.

[149] "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.

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Criterion	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: (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 system; (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 ongoing basis; (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; (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 (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.
Legal Framework	Pursuant to the authorities cited at the outset of this Principle, the U.S. federal banking agencies generally expect that a bank's or holding company's policies and processes for managing credit risk will establish an appropriate and properly controlled credit-risk environment. U.S. federal banking agencies' expectations in this regard are enumerated in supervisory guidance and generally include the features listed in this EC.
Practices and Procedures	The U.S. federal banking agencies have issued supervisory guidance on sound risk-management practices for credit-risk and loan portfolio management. The agencies have published examination manuals that they supplement with specific topical guidance. *See* generally Federal Reserve SR letters; FDIC Financial Institution letters (FIL) and Statements of Policy (SOP); and OCC Bulletins, Supervisory Memoranda, Comptroller's Handbooks, Alerts, Consumer Advisories, and Policy and Procedures Manual. During the course of examinations, U.S. federal banking 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: o 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.

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	o 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.
	o 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.
	o Credit administration practices include initial and ongoing 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.
	o 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 (a) information relating to the borrower's financial condition, collateral, and its valuation and (b) other pertinent documents, such as guarantor information, loan agreements, proof of security interest in collateral, and adherence to loan covenants.
	o 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.
	o Stress testing processes are effective in identifying the impact of (a) portfolio-level stress events on asset quality, earnings, and capital; (b) business-level stress on credit concentrations; and (c) downside scenarios on individual credit exposures.
	o 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:
	  o Has management information systems that are structured to monitor current and potential exposures against established limits and strategic goals and objectives; and
	  o 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 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.
	o 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 both policies and procedures, as well as board and senior management oversight. *See Guidance on Model Risk Management*, Federal Reserve SR Letter 11-7, April 4, 2011; *Supervisory Guidance on Model Risk Management*, OCC Bulletin 2011-12 (April 4, 2011).

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	o The bank or holding company has policies and procedures governing problem loan management including delinquency and charge-off practices. Supervisors determine whether (a) policies, procedures, and processes are in place for the timely identification of problem loans and (b) 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. o 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. o 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. o Policies and procedures for the Allowance for Loan and Lease Losses comply with both accounting and supervisory guidance. o 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 (a) confirm compliance with these limits, (b) require review and approval of limits, and (c) 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. o The bank or holding company has adequate risk-management practices for approving, monitoring, and controlling third-party (*i.e.*, 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 (a) include monitoring the quality of loans by origination source and (b) enable management to identify problems, such as early payment defaults and incomplete packages, and take appropriate action, as needed. o The bank or holding company has comprehensive, formal strategies for managing risks in secondary market activities. Supervisors determine whether contingency planning includes how the bank or holding company will respond to reduced demand in the secondary market. References: "Interagency Questions and Answers on Capital Treatment of Recourse, Direct Credit Substitutes, and Residual Interests in Asset Securitizations" (May 23, 2002) (See OCC Bulletin 2002-22;[150] Federal Reserve SR letter 02-16; and FDIC FIL-54-2002).

[150] Effective January 1, 2015, the OCC will address recourse in 12 CFR Part 3, subpart D.

EC 3	Principle 17: Credit risk
	As noted above, the agencies' expectations for each of these components will vary based on the size and complexity of the institution. 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. The agencies regularly review and update their supervisory guidance and examination processes to address emerging practices and risks. Quite often, interagency working groups are assembled to revise existing guidance in order to address a current supervisory concern.

EC 4	Principle 17: Credit risk
Criterion	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.
Legal Framework	As discussed under Principles 19 and 20, banks and holding companies also are subject to limits on exposures to single borrowers or groups of borrowers. In addition, interagency guidelines on safety and soundness require banks and holding companies, in connection with credit-underwriting activity, to take adequate account of concentrations of credit risk. References: 12 CFR Part 208, Appendix D-1, part II(D)(5); 12 CFR Part 30, Appendix A, Part II(D)(5); 12 CFR. Part 364, Appendix A, Part II(D)(5). Supervisory guidance elaborates further on expectations regarding the monitoring of credit concentrations. Together, these sources require banks and holding companies to have policies and processes in place to monitor the total indebtedness of entities to which they extend credit. *See* also response to EC1 above.
Practices and Procedures	U.S. federal banking supervisors review credit policies to determine whether (a) they address the permissible amounts and types of credit that a bank or holding company may provide and (b) they require that the bank or holding company is in compliance with regulatory limits and supervisory guidance for monitoring concentrations of risk. Supervisors review policies, procedures, and controls to determine that the bank or holding company has established effective systems for measuring and monitoring credit exposures and ensuring (a) compliance with internal and regulatory limits and (b) that any new and existing asset concentrations are reported to the board or other appropriate committee.

EC 5	Principle 17: Credit risk
Criterion	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Legal Framework	The statutes on transactions with related parties, discussed under Principle (20), require credit decisions to be made free of conflicts of interest and on an arm's length basis. In certain situations, credit decisions are required to be made by the board without participation of the interested party. Terms must be in accordance with those offered to members of the general public. Compliance is reviewed as part of the normal supervisory process. Reference: 12 CFR Part 215 (Regulation O) addresses insider transactions. See Principle (20) for more information on the statutes.

EC 5	Principle 17: Credit risk
Practices and Procedures	U.S. federal banking agencies require banks and holding companies to develop policies that (1) define and address real and potential conflicts of interest and (2) acknowledge that credit decisions are to be given an independent and complete credit evaluation and, in certain situations, require board approval. The agencies 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. U.S. federal banking agencies 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. U.S. federal banking 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 identified and properly controlled. 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, principal shareholders, or related interests of such persons. Such loans are reviewed to determine whether they (a) were made on substantially the same terms as those prevailing at the time for comparable arm's length transactions, (b) involve greater-than-normal risk of repayment or default, or (c) 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. 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.

EC 6	Principle 17: Credit risk
Criterion	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.
Legal Framework	Consistent with interagency safety and soundness standards and guidelines, the credit policies of banks and holding companies must appropriately address the credit risk exposures of the institution, including through the involvement of the institution's board and senior management in the managing the nature, size and scope of the credit exposures. *See* EC 3 and 12 CFR 208, Appendix D-1.

EC 6	Principle 17: Credit risk
	Section 23A and 23B of the Federal Reserve Act were designed to protect commercial banks from the risks arising from transactions between the bank and its affiliates and limits the ability of a bank to transfer to its affiliates the subsidy arising from the bank's access to the federal safety net. The statute and regulations primarily advance this goal by imposing quantitative and qualitative restrictions on affiliate transactions. The quantitative restrictions include limiting the aggregate amount of certain transactions between a member bank and any single affiliate to no more than 10 percent of the bank's capital stock and surplus, and the aggregate amount of such transactions with all affiliates to no more than 20 percent of the bank's capital stock and surplus.[151] Qualitative restrictions include certain collateral requirements for covered transactions between affiliates and an IDI, restrictions on the transfer of "low-quality assets" from affiliates to an IDI, and a requirement that any covered transaction shall be on terms and conditions consistent with safe and sound banking practices. *See* 12 U.S.C. § 371c and 371c-1. See also 12 CFR Part. 223. As discussed in EC 1 above, U.S. law also addresses credit risk among large financial institutions (BHCs and nonbank financial companies) by requiring credit exposure reporting and the establishment of single counterparty credit limits for the institutions in order to limit the risks that any individual institution may pose to another.[152] Proposals have been made to implement these requirements.[153] It is expected that a final rule on single-counterparty credit limits would reflect a current quantitative impact study (QIS) on the effects of the counterparty credit limits and would be coordinated with the work begun by the Basel Committee on similar large exposure regimes that would apply to all global banks. Further, banks are required to take into account credit exposure arising from derivatives and securities financing transactions in calculating prudential limits.[154] Federal law requires each federal banking agency to establish safety and soundness standards for all insured depository institutions, including standards relating to loan documentation and credit underwriting. *See* 12 U.S.C. 1831p-1. On an interagency basis, the agencies published guidelines that set out the safety and soundness standards. The standards require institutions to establish and maintain loan documentation practices that enable the institution to make informed lending decisions and to assess risk, as necessary, on an ongoing basis. Institutions must also identify the purpose of a loan and the source of repayment, assess the ability of the borrower to repay the indebtedness in a timely manner; ensure that any claim against a borrower is legally enforceable; demonstrate appropriate administration and monitoring of a loan; and appropriately consider the size and complexity of a loan. Institutions must also maintain prudent credit underwriting practices that are commensurate with the types of loans the institution may originate; consider the terms and conditions under which loans will be made; consider the nature of the markets in which loans will be made;

[151] Sections 23A and 23B and its implementing regulations apply by their terms to "member banks"—i.e., any national bank, State bank, trust company, or other institution that is a member of the Federal Reserve System. In addition, the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) applies sections 23A and 23B to insured State non-member banks in the same manner and to the same extent as member banks. The Home Owners' Loan Act (12 U.S.C. 1468(a)) also applies sections 23A and 23B to insured savings associations in the same manner and to the same extent as if they were member banks (and imposes two additional restrictions). Section 312(b)(2)(A) of the Dodd-Frank Act makes key enhancements to 23A. 12 U.S.C. 5412.

[152] 12 U.S.C. 5365(d) and (e)(2).

[153] See 77 Fed. Reg. 594 (single-counterparty credit limits); 76 Fed. Reg. 22648 (credit exposure reports).

[154] 12 U.S.C. 84(b); 12 CFR part 32.

EC 6	Principle 17: Credit risk
	provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed; establish a system of independent, ongoing credit review and appropriate communication to management and to the board of directors; take adequate account of concentrations of credit risk; and ensure loans are appropriate to the size of the institution and the nature and scope of its activities. *See Interagency Guidelines Establishing Standards for Safety and Soundness* (12 CFR part 30, Appendix A; 12 CFR. part 208, Appendix D-1; 12 CFR part 364, Appendix A).
Practices and Procedures	U.S. federal banking 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. 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*[155] directs banks and holding companies with commercial real estate concentrations to (a) evaluate the correlation between related real estate sectors, (b) establish internal lending guidelines and concentration limits, and (c) 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 forth exposure thresholds which is 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. Also *see* OCC Comptroller Handbook: Concentration of Credit and OCC Bulletin OCC-011-48. U.S. federal banking 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.[156] State-chartered banks have limits imposed by each state regulator, but such limits are generally consistent with those established by the OCC. Similarly, the agencies' real estate lending regulations include supervisory loan-to-value limits for certain categories of real estate loans and capital limitations on the aggregate amount of loans that exceed those limits.[157] 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. The U.S. federal banking agencies 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. For example, the "Interagency Statement on

[155] See Federal Reserve SR letter 07-01; OCC Bulletin 2006-46 (Dec. 6, 2006); and FDIC FIL-104-2006.
[156] 12 CFR parts 215 (Regulation O), 223 (Regulation W), and 32.
[157] See 12 CFR 34, subpart D, Appendix A; 12 CFR 160.101(d).

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	Sound Practices Concerning Elevated of Risk Complex Structured Finance Activities"[158] specifies that transactions and exposures identified as posing an elevated level of risk are subject to heightened review. It provides that the policies and procedures should be designed to identify, manage, and control the risks in those transactions and that the risk dimensions of these transactions be fully understood, monitored, and controlled by management. *See* also *Interagency Credit Risk Management Guidance for Home Equity Lending*,[159] *Interagency Guidance on Nontraditional Mortgage Product Risks*,[160] *Interagency Guidance on Leveraged Lending*,[161] and *Interagency Appraisal and Evaluation Guidelines*.[162]

EC 7	Principle 17: Credit risk
Criterion	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.
Legal Framework	Under the U.S. federal banking agencies' 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. References: 12 U.S.C. §§ 161, 325-26, 481, 483, 602, 625, 1464(d), 1464(v), 1467(h), 1467a(b), 1817(a), 1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 1867, 3102(b), and 3105(c). The agencies 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.[163] 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. *See* also: section 5 of the Bank Holding Company Act of 1956 (authorizing the Federal Reserve to examine each BHC and nonbank subsidiary thereof); section 7 of the International Banking Act of 1978 (authorizing the Federal Reserve to examine each branch or agency of a foreign bank); section 4 (b) of the International Banking Act (directing the OCC to coordinate with the Federal Reserve to examine Federal branches and agencies); Section 25(a) of the Federal Reserve Act and 12 CFR § 211.7 (Regulation K) (authorizing the Federal Reserve to examine Edge and agreement corporations); and 12 CFR part 238 (Regulation LL) (pursuant to

[158] See Federal Reserve SR letter 07-5; OCC Bulletin 2007-1; FDIC FIL-3-2007.
[159] See Federal Reserve SR letter 05-11; OCC Bulletins 2005-22 and 2006-43; FDIC FIL-58-2008.
[160] See Federal Reserve SR letter 06-15; OCC Bulletin 2006-41; FDIC FIL 89-2006.
[161] See Federal Reserve SR letter 13-3; OCC Bulletin 2013-9; and FDIC FIL 13-2013.
[162] See Federal Reserve SR letter 10-16; OCC Bulletin 2010-42; and FDIC FIL 82-2010.
[163] See 12 U.S.C. 1867(c); Federal Reserve SR Letter 13-19; see also OCC-2013-29, Risk Management Guidance (Oct. 30, 2013);.

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	the Dodd-Frank Wall Street Reform and Consumer Protection Act, giving the Federal Reserve the authority to examine and supervise savings and loan holding companies and their non-depository subsidiaries).
Practices and Procedures	The U.S. federal banking agencies may issue regulations or guidance to further supplement or clarify the authorities cited above regarding access to books, records and personnel of the bank and holding company. References: Federal Reserve (SR letter 97-17, which summarizes the Federal Reserve's examination authority); OCC PPM 5310-10 (providing guidance to supervisors in securing access to a bank's books and records); and section 10 of the FDI Act. During the course of examinations, financial institution management is to provide supervisors with full access to all records and employees of the bank and holding company. This includes access to 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 may be subject to supervisory sanctions and prosecution.

EC 8	Principle 17: Credit risk
Criterion	The supervisor requires banks to include their credit risk exposures in their stress testing programs for risk management purposes.
Legal Framework	*See* the authorities cited response to EC 1 above. *See* also annual stress testing rules at 12 CFR parts 46.8 (OCC), 252.151 et seq. (Federal Reserve), and 325.206 (FDIC). *See* also *Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations With Total Consolidated Assets of More Than $10 Billion but Less than $50 Billion (*79 Fed. Reg. 14153 (Mar. 13, 2014*)*.
Practices and Procedures	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: • 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. Reference: *Guidance on Stress Testing for Banking Organizations with Total Consolidated Assets of more than $10 Billion* (Federal Reserve SR Letter 12-7; FDIC Financial Institution Letter FIL-47-2011; OCC Bulletin 2012-14) *Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of More than $10 Billion but Less than $50 Billion* (Federal Reserve SR Letter 14-3; OCC Bulletin 2014-5; FDIC Press Release PR-19-2014, March 5, 2014).

Assessment of Principle 17	Compliant
Comments	

Principle 18: Problem assets, provisions and reserves[164]

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.[165]

(Reference documents: *Sound credit risk assessment and valuation for loans*, June 2006 and *Principles for the management of credit risk*, September 2000.)

EC 1	**Principle 18: Problem assets, provisions and reserves**
Criterion	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.
Legal Framework	The safety-and-soundness provision of the FDI Act, 12 U.S.C. § 1831p-1(b) requires the U.S. federal banking agencies 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 concentrations; and (f) provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk. *See* 12 CFR 30, appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208, appendix D-1, § II(G);12 CFR 364, appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G). U.S. federal law provides that the accounting principles applicable to reports or statements required to be filed with federal

[164] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.
[165] 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).

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	banking agencies generally must be uniform and consistent with U.S. generally accepted accounting principles (U.S. GAAP). See 12 U.S.C. § 1831n(a)(2)(A); *see* also id. § 1463(b). In certain situations, the U.S. federal banking agencies can prescribe alternate accounting principles, provided the alternate principles are "no less stringent" than U.S. GAAP. *See* 12 U.S.C. § 1831n(a)(2)(B). U.S. GAAP includes guidance on accounting for impairment in a loan portfolio and other credit exposures. See Accounting Standards Codification (ASC) Topic 450-20, *Contingencies – Loss Contingencies*; and ASC Subtopic 310, *Receivables*. The U.S. federal banking agencies have issued and, as warranted, periodically updated interagency policy statements on the Allowance for Loan and Lease Losses (ALLL), addressing the supervisory expectations about supervised banks' application of and documentation supporting a bank's ALLL. These policy statements elaborate on the asset quality obligations, noted above, set forth in the interagency safety-and-soundness guidelines. The ALLL represents one of the most significant estimates in financial statements and regulatory reports. The "Interagency Policy Statement on the Allowance for Loan and Lease Losses[166]" (December 13, 2006 discusses important aspects of loan loss allowance practices and is designed to assist banks in establishing a sound process for determining and documenting an appropriate ALLL in accordance with supervisory expectations and U.S. GAAP. These expectations include, among other matters (a) the responsibilities of boards of directors, management, and supervisors of banks regarding the ALLL; (b) factors to be considered in the estimation of the ALLL; and (c) and 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. 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. This Interagency Statement on the ALLL requires banks to identify incurred losses that are to be estimated in accordance with 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. *See* "Interagency Guidance on Certain Loans Held for Sale" (March 26, 2001). ASC Topic 450-20 and ASC 310 provide guidance on how to estimate the inherent (incurred) losses on individual loans and groups of loans for financial reporting purposes, but this guidance does not affect the U.S. federal banking agencies' processes or decisions related to asset classifications and write-offs, which are addressed in separate interagency guidance. *See* Classification Definitions in Attachment 1 to the "Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions" (October 29, 2013); and "Revised Uniform Retail Credit Classification and Account Management Policy" (June 12,

[166]The "Interagency Policy Statement on the Allowance for Loan and Lease Losses" will be referred to as the Interagency Statement on the ALLL throughout this principle. For the Federal Reserve, it is part of SR letter 06-17; for the OCC, it is in Bulletin 2006-47; for the FDIC, it is FIL-105-2006.

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	2000). Supervisors monitor adherence with this guidance and with the other supervisory issuances discussed above, during on-site examinations. On December 20, 2012, the FASB issued an exposure draft of the proposed accounting standards update on the Accounting for Credit Losses on Certain Financial Instruments. This proposal is still being finalized. When adopted, the FASB proposal would affect all entities that possess financial assets, including OCC regulated institutions, as it would require a change in current allowance methods. Under the existing model, credit loss recognition is delayed until a credit loss has been incurred. The FASB's proposed Current Expected Credit Loss (CECL) model would require an institution to estimate all expected shortfalls in contractually required cash flows by considering past events, current conditions, and reasonable and supportable forecasts. The model aims to provide earlier recognition of credit losses in the financial statements by removing the "incurred" threshold for recognizing credit losses.
Practices and Procedures	U.S. federal banking agencies require each bank to establish and maintain a system that is commensurate with the size and the nature and scope of its operations to identify problem assets and prevent deterioration in those assets. U.S. federal banking supervisors confirm that the bank: • Conducts periodic credit reviews to identify problem assets; • Estimates the incurred losses in those assets and establishes reserves that are sufficient to absorb these losses; • Compares problem asset aggregates to capital; • Takes appropriate corrective action to resolve problem assets; • Considers the size and potential risks of material asset concentrations; and • Provides periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk. *See* 12 CFR 30 appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208 appendix D-1; and 12 CFR 364 appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G). The Interagency Statement on the ALLL requires banks to adopt and adhere to written policies and procedures that are appropriate to its size and the nature, scope, and risk of its lending activities. At a minimum, supervisors confirm that these policies and procedures ensure that the bank has an effective loan review system and controls (including an effective loan classification or credit-grading system) that identify, monitor, and address asset quality problems in an accurate and timely manner. To be effective, the bank's loan review system and controls must be responsive to changes in internal and external factors affecting the level of credit risk in the portfolio. Regardless of the structure of the loan review system, supervisors evaluate that an effective loan review system should have, at a minimum, the following objectives: • To confirm that management promptly identifies loans with potential or demonstrated credit weaknesses. In situations where management does not accurately and timely identify such loans, loan review has the responsibility and authority to make such determinations. • As necessary, to appropriately grade or adversely classify loans, especially those with well-defined credit weaknesses that jeopardize repayment, so that timely action can be taken and credit losses can be minimized.

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	• To determine or require that management identifies relevant trends that affect the collectability of the portfolio and isolates segments of the portfolio that are potential problem areas. • To assess the adequacy of, and adherence to, internal credit policies and loan administration procedures and to monitor compliance with relevant laws and regulations. • To evaluate the activities of lending personnel including their compliance with lending policies and, as needed, the quality of their loan approval, monitoring, and risk assessment. • To provide senior management and the board of directors with an objective and timely assessment of the overall quality of the loan portfolio. • To provide management with accurate and timely credit-quality information for financial and regulatory reporting purposes, including the determination of an accurate internal problem loan identification process that is necessary to establish and maintain an appropriate ALLL. As a bank's or holding company's risk profile changes whether due to new products, increased volumes or changes in concentrations, the quality of its portfolio, or the overall economic environment, supervisors confirm that the institution updates its risk-management practices and measures. In general, in measuring these risks and potential losses, U.S. federal banking agencies 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 agencies expect banks and holding companies to consider the impact of contingent exposures arising from loan commitments, securitization programs, counterparty credit, and other transactions.

EC 2	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	The framework for assessing the classification process is established in the federal banking agencies' safety and soundness regulations. *See* 12 CFR 30 appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208 appendix D-1; 12 CFR 364 appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G). *See* also Attachment 1 and page 13 et seq. to the Interagency Statement on the ALLL.
Practices and Procedures	U.S. federal banking supervisors confirm the adequacy of a bank's loan classification, loss provisioning process, and overall capital adequacy during each supervisory cycle. The U.S. federal banking supervisors do not use external experts to support the supervisor's opinion. 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 practices. Supervisors review the policies, procedures, and internal controls for classification of, and provisioning for, credit risk as well as compliance with laws and

EC 2	Principle 18: Problem assets, provisions and reserves
	regulations. To support this assessment, supervisors generally conduct transaction testing to assess the effectiveness of these 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 of directors and senior management an accurate and timely picture of the bank's or holding company's credit risks. The agencies' respective examination manuals contain detailed procedures that supervisors follow in conducting their reviews.[167] For example, supervisors evaluate and test each bank's credit-risk-rating policy and procedures. In addition, as outlined in the Interagency Statement on the ALLL, supervisors review and adjust the classification or grading of the bank's loan portfolio; assess the credit quality of a its loan portfolio; and check the appropriateness of its ALLL methodology, documentation and reported amount. *See* Interagency Statement on the ALLL p. 13 and beyond. The "Policy Statement on Prudent Commercial Real Estate Loan Workouts"[168] instructs supervisors to evaluate commercial real estate credits for possible supervisory classification and requires supervisors to evaluate the methodology and process that management has followed to estimate the ALLL to ensure that all of the relevant factors affecting the collectability of the portfolio have been appropriately considered. The "Interagency Uniform Retail Credit Classification and Account Management Policy" (June 12, 2000) also provides guidance to supervisors on classifying retail portfolios, or segments thereof, where underwriting standards are weak and present unreasonable credit risk and on criticizing account management practices that are deficient. It also instructs supervisors to ensure that the bank's ALLL provides adequate coverage for probable losses inherent in the portfolio. The guidance on the ALLL contained in these interagency policies is consistent with U.S. GAAP. Additionally, through the agencies' Shared National Credit Program, teams of supervisors from the agencies 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.

EC 3	Principle 18: Problem assets, provisions and reserves
Criterion	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures.[169]

[167] *See* the OCC's *Community Bank Supervision, Large Bank Supervision, Loan Portfolio Management, Rating Credit Risk and Retail Lending* booklets of Comptroller's Handbook series; the Federal Reserve's *Commercial Bank Examination Manual, Section 2040.3, Loan Portfolio Management Examination Procedures*; and the FDIC's *Risk Management Manual of Examination Policies, Section 3.2, Loans*.

[168] *See* Federal Reserve SR letter 09-7; OCC, the *Commercial Real Estate and Construction Lending* booklet of the Comptroller's Handbook series; and FDIC FIL-61-2009.

[169] 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.

EC 3	Principle 18: Problem assets, provisions and reserves
Legal Framework	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 a federal banking agency. Implementing supervisory guidance makes clear that systems for classification and provisioning should take into account off-balance-sheet exposures.
Practices and Procedures	Agency guidelines state that the risk ratings used by banks and holding companies should be applied to off-balance-sheet exposures such as letters of credit and unfunded commitments that the bank or holding company is obligated to fund. *See*, *e.g.*, OCC's *Loan Portfolio Management Handbook* or Federal Reserve's *Commercial Bank Examination Manual*. The Interagency 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. U.S. federal banking supervisors assess the structure of off-balance-sheet instruments to understand the explicit and implicit credit risk to the bank. Such activities include securitizations, underwritings of exposures requiring distribution in capital markets, structured securities, and derivatives. U.S. federal banking agencies expect banks and holding companies to estimate credit exposures in accordance with U.S. GAAP. U.S. GAAP requires any allowance for credit losses on off-balance-sheet exposures to be reported on the balance sheet as an "Other Liability," and not as part of the ALLL. *See* Interagency Statement on the ALLL, p. 3.

EC 4	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	Under the interagency safety-and-soundness guidelines, a bank should establish and maintain a system that, among other things, identifies and resolves problem assets. *See* 12 CFR 30, appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208, appendix D-1, § II(G); 12 CFR 364, appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G). Under related 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.
Practices and Procedures	In accordance with long standing supervisory guidance as clarified in the Interagency Statement on the ALLL, U.S. federal banking supervisors confirm that banks and holding companies evaluate the ALLL reported on the balance sheet as of the end of each quarter, or more frequently if warranted, and credit or debit provision expense to bring the ALLL to an appropriate level as of each evaluation date. The determination of the ALLL and the necessary provision expense 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 including current market and economic conditions. The ALLL estimates reflect rigorous quantitative analyses supplemented by considerable amounts of management judgment. U.S. federal banking supervisors review bank policies, processes, and practices to ensure that they promptly and timely charge off loans, or portions of loans, where available information confirms the exposure to be uncollectible. Using the Interagency "Classification of Credit" definitions and the uniform retail credit classification guidance, supervisors can direct banks and holding

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	companies to take charge-offs or change loan classifications. Also, if the supervisor concludes that the reported ALLL level is not appropriate or determines that the ALLL evaluation process is based on the results of an unreliable loan review system or is otherwise deficient, supervisors are empowered to require a bank or holding company to correct these deficiencies as dictated in the Interagency Policy Statement on the ALLL.

EC 5	Principle 18: Problem assets, provisions and reserves
Criterion	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).
Legal Framework	Under supervisory guidance implementing the interagency safety-and-soundness guidelines on identifying and resolving problem assets, banks and holding companies are expected to have appropriate policies and processes and organizational resources for the early identification of deteriorating assets, ongoing oversight of problem assets, and collecting on past-due obligations. *See* 12 CFR 30, appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208, appendix D-1, § II(G); 12 CFR 362, appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G).
Practices and Procedures	To facilitate early identification of deteriorating assets, U.S. federal banking agencies require banks and holding companies to have effective loan administration and loan review systems that make use of a risk-rating system that rates or grades loans and other assets. The agencies 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. Based on a combination of on-site examinations and off-site monitoring, U.S. federal banking supervisors assess the quality and timeliness of the bank's or holding company's rating system, classification process, and credit workout processes to determine if they are appropriate. This assessment would include proper accounting treatment and regulatory credit risk grade or classification of all types of loans undergoing renewal, extension, workout, or other modification, which may or may not constitute a Troubled Debt Restructures (TDRs)[170] for accounting purposes. 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. In the review and classification or grading of assets, supervisors consider all significant factors that affect the collectability of the obligation, including the value of any collateral. *See* Interagency Statement on the ALLL, pp. 6 – 8 and Attachment 1 and Federal Reserve's Commercial Bank Examination Manual, Section 2060.1. For retail transactions, supervisors evaluate a bank's account management and collection and foreclosure processes to determine whether institutional intervention is appropriately mitigating or reducing potential losses.

[170] TDRs are considered impaired loans under GAAP.

EC 5	Principle 18: Problem assets, provisions and reserves
	Supervisors have issued specific supervisory classification for retail credits. *See* "Uniform Retail Credit Classification and Account Management Policy"; 65 Fed. Reg. 36903 (June 12, 2000); Federal Reserve SR letter 00-8; OCC Bulletin 2000-20; FDIC FIL-40-2000 (June 29, 2000). In the U.S., the agencies have generally found that, for most retail products, the quality of retail credit is best indicated by the repayment performance of individual borrowers. As a result, under these guidelines, banks and holding companies are expected to classify loans and recognize losses when payments are contractually a minimum number of days in arrears. OCC Bulletin 2014-4 clarified the agency's expectations for the treatment of secured Consumer Debt Discharged in Chapter 7 Bankruptcy. Also, banks and holding companies are required to establish explicit standards that control the use of extensions, deferrals, renewals, and rewrites. The policy does not preclude supervisors from classifying individual loans or entire portfolios regardless of delinquency status or criticizing account management practices that are deficient or improperly managed. Supervisors may deviate from the minimum classification guidelines outlined in the policy if underwriting standards, risk management, or account management standards are weak and present unreasonable credit risk. *See* Federal Reserve's CBEM, section 2060.1; OCC's *Retail Lending Examination Procedures* Handbook; and FDIC FIL-40-2000. For loans not covered by the policy on retail credit, above, the U.S. federal banking agencies consider credit risk factors beyond just arrearage. Credits are required to be classified when well defined weaknesses that jeopardize liquidation of the credit exist. In classifying such credits, the agencies use the following asset designations – "Special Mention," "Substandard," "Doubtful," and "Loss." The Federal Reserve's criteria are in *Commercial Bank Examination Manual*, section 2060.1; OCC's is in the *Rating Credit Risk* Handbook; and the FDIC's FIL-40-2000 as well as section 3.2 of the Risk Management Manual of Examination Policies.

EC 6	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	Under the U.S. federal banking agencies' 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, as well as employees involved in a matter under review and bank service companies and independent servicers subject to the Bank Service Company Act. *See* 12 U.S.C. §§ 161, 325-26, 481, 483, 484, 602, 625, 1464(d) and (v), 1467a(b), 1820(b), 1844(c), and 3105(c). Supervisory guidance specifies the information that is expected to be maintained by banks and holding companies with respect to credit risk management, including details on credit and investment portfolios. Supervisors have full access to this information, and to all employees involved in assuming, managing, controlling and reporting on credit risk, during examinations. Further, banks and holding companies are required to submit quarterly regulatory financial reports of their financial condition to supervisors (referred

EC 6	Principle 18: Problem assets, provisions and reserves
	to as Call Reports). This information includes details on categories of credits and assets, delinquencies, and provisioning. Supervisors have full and complete access to this information during on-site examinations and may request additional details, as appropriate. As clarified in the Interagency Statement on the ALLL, the U.S. federal banking agencies require that the allowance estimates be based on a comprehensive and well-documented analysis of the loan portfolio, and states that each institution's management is responsible for documenting its analysis according to the standards set forth in the July 2001 Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions (the "2001 Policy Statement").
Practices and Procedures	During the course of examinations, U. S. supervisors are provided with full access to all records and employees of the bank or holding company. 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. The U.S. federal banking agencies utilize the quarterly regulatory financial reports, as well as regular internal bank reports prepared for the bank's management, to monitor and assess the condition of banks and holding companies and to identify trends in loan and asset performance. This information also assists supervisors in identifying potential areas for further supervisory review. Supervisors use the reports at the level of granularity necessary to make evaluations of the bank's or holding company's internal processes and management competence. As clarified in the Interagency Statement on the ALLL, the U.S. federal banking agencies require that the allowance estimates be based on a comprehensive and well-documented analysis of the loan portfolio, and each institution's management is responsible for documenting its analysis according to the standards set forth in the 2001 Policy Statement. The Interagency Statement on the ALLL also requires banks to submit a report to the board of directors that summarizes the results of the loan review process, the loan loss allowance calculation process, and an evaluation of the appropriateness of the current ALLL level at least quarterly. The policy indicates that the board of directors should be informed more frequently than quarterly when material adverse trends are noted. As the size and complexity of a bank increases, supervisors use more granular reports to make their assessments and to find potential areas of weakness. In addition to reporting current credit quality findings, the board of directors should receive reports on comparative trends that identify significant changes or trends in the overall quality of the portfolio. Findings should also address the adequacy of, and adherence to, internal policies and procedures, as well as compliance with laws and regulations, in order to facilitate timely correction of any noted deficiencies. Reports submitted to a bank's or holding company's board of directors are also provided to supervisors. The regulatory reports submitted by banks and holding companies, generally on a quarterly basis, include a reconciliation of the ALLL and information on charge-offs, provisions, and past-due and nonaccrual loans. *See* Interagency Statement on the ALLL, Attachment 1; Call Reports, Y-9 reports.

EC 7	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	If provisions are deemed to be inadequate, the federal banking agencies will require corrective measures. In any case, the U.S. federal banking agencies have the authority to require additional provisions if an institution's ALLL is not adequate or to impose other remedial measures. *See generally* 12 U.S.C. § 1818(b). Also, banks and holding companies must file with the federal banking agencies quarterly financial reports (12 U.S.C. §§ 161(a) and (c), 324, 1817, and 1464(v)), and civil money or other penalties may be assessed for significant failures, such as an inaccurate ALLL. U.S. federal banking supervisors assess the credit quality of a bank's loan portfolio, the appropriateness of its ALLL methodology and documentation, and the appropriateness of the reported ALLL in the bank's regulatory reports. Identified deficiencies in the loan review program, including the level of problem assets, should be noted in examination reports. Banks and holding companies are expected to correct any noted deficiencies, including, if appropriate, by increasing their levels of provisions and the ALLL and/or overall financial strength. Additional supervisory action may be taken based on the magnitude of the observed shortcomings. *See* Interagency Statement on the ALLL (December 13, 2006).
Practices and Procedures	As indicated in the Interagency Statement on the ALLL, if a U.S. federal banking supervisor determines the reported ALLL level is not appropriate or determines that the ALLL evaluation process is based on the results of an unreliable loan review system or is otherwise deficient, supervisors will require the bank or holding company to take corrective action to address these deficiencies. Supervisors will note serious concerns regarding the ALLL in their reports of examination. The U.S. federal banking agencies may also take enforcement action against the bank or holding company, based on the magnitude of the observed shortcomings in the ALLL process, including the materiality of any error in the reported amount of the ALLL. When a bank's or holding company's ALLL is inadequate, supervisors will require it to adjust its ALLL by an amount sufficient to bring the ALLL reported on its regulatory reports to an appropriate level as of the evaluation date. This adjustment should be reflected in the current period provision or through the restatement of prior period provisions, as appropriate for the circumstance. *See* Interagency Statement on the ALLL, p. 15. The federal banking agencies can require the addition of capital or an adjustment of capital to reflect the insufficient levels of provisions and ALLL. *See* 12 CFR 3, Subpart H – Establishment of Individual Minimum Capital Ratios for an Individual Bank or Individual Federal Savings Association. Evaluations of capital adequacy fully incorporate assessments of asset quality, ALLL appropriateness and earnings strength. Material shortfalls in the ALLL or regulatory capital are immediately met with supervisory action. As indicated in the Interagency Statement on the ALLL, the U.S. federal banking agencies require banks to have an effective loan review system and controls (including an effective loan classification or credit-grading system) that identifies, monitors, and manages asset quality problems in a prudent manner. Through periodic on-site and off-site supervisory activities, the agencies assess

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	whether classification and provisioning processes are adequate. If the U.S. federal banking supervisor concludes that the reported ALLL level is not appropriate or determines that the ALLL evaluation process is based on the results of an unreliable loan review system or is otherwise deficient, supervisors will require the bank or holding company to adjust the ALLL and address the process deficiencies. Supervisors do not rely on management's current estimate of credit losses when supervisors find a bank's or holding company's internal credit administration practices ineffective. When an examination identifies material credit administration weaknesses or a significant volume of problem loans and the ALLL amount appears deficient in such cases, supervisors require the bank's or holding company's management to expeditiously address the appropriateness of its ALLL estimate and to make provisions as necessary to address deficiencies identified through the supervisors' review. Supervisory recommendations on an appropriate level for the ALLL are included in the federal banking agency's report of examination, and supervisors may require a formal written response from the bank or holding company on the action to be taken. Supervisors monitor the bank's or holding company's corrective actions to ensure that deficiencies have been addressed (Interagency Statement on the ALLL, pp. 6 and 15).

EC 8	Principle 18: Problem assets, provisions and reserves
Criterion	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 realisable value, taking into account prevailing market conditions.
Legal Framework	The interagency safety-and-soundness guidelines require banks to establish and maintain systems for identifying problem assets and preventing deterioration of those assets which include guidelines for loan documentation. *See* 12 CFR 30, appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208, appendix D-1, § II(G); 12 CFR 364, appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G). As part of this system, the bank is expected to establish a credit administration function and conduct periodic asset quality reviews to identify problem assets. The U.S. federal banking agencies 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. *See* 12 CFR 34, subpart D; 12 CFR 160.100 and 160.101; 12 CFR 208, subpart E; 12 CFR 225, subpart G; 12 CFR 365, subpart A; and 12 CFR 390.264 and 390.265.
Practices and Procedures	As clarified in the Interagency Statement on the ALLL and the 2001 Policy Statement, supervisors ensure that valuation approaches and techniques are consistent with U.S. GAAP. 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, pursuant to ASC 310-10. When a loan is identified as being impaired, a bank shall measure impairment based on the

EC 8	Principle 18: Problem assets, provisions and reserves
	present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor 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. generally accepted accounting principles, i.e., "the price that would be received to sell an asset . . . in an orderly transaction between market participants at the measurement date." An "orderly transaction" is defined as "a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets . . . 'it is not a forced transaction (for example, a forced liquidation or distress sale)." If repayment of the individually impaired loan is dependent on the sale of the collateral, the fair value of the collateral must be adjusted to consider estimated costs to sell. For real estate secured credits, supervisors assess compliance with appraisal regulations and accompanying guidance to determine the market value of real estate securing the credit. As part of the appraisal regulations, the U.S. federal banking agencies incorporate the appraisal standards as set forth in the U.S. Uniform Standards of Professional Appraisal Practice. For loans evaluated for impairment on a pool basis, estimates of credit losses should 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. For example, loans that are fully secured by deposits maintained at the bank would be evaluated for collectability with a thorough analysis of the borrowers' ability to repay that includes the value of the deposit. *See* Interagency Statement on the ALLL, pp. 6 and 15 and the 2001 Policy Statement, Federal Reserve SR letter 01-17, pp. 13 and 16; OCC Bulletin 2001-37 (July 20, 2001); and FDIC FIL-63-2001 (July 25, 2001). Also *see* "Interagency Appraisal and Evaluation Guidelines" FDIC FIL-82-2010, Federal Reserve SR Letter 10-16, and OCC Bulletin 2010-42.

EC 9	Principle 18: Problem assets, provisions and reserves
Criterion	Laws, regulations or the supervisor establish criteria for assets to be: (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).
Legal Framework	The safety and soundness regulations (12 CFR 30, Appendix A; and 12 CFR 208, Appendix D), requires institutions to establish and maintain a system to identify problem assets. Pursuant to the safety-and-soundness provision of the FDI Act, 12 U.S.C. § 1831p-1(b), the U.S. federal banking agencies have established criteria for identifying an asset as "impaired" and measuring the impairment on these assets using criteria consistent with U.S. generally accepted accounting principles." *See* Interagency Statement on the ALLL (December 13, 2006).
Practices and Procedures	Supervisors have established criteria for identifying problem assets based on their degree of risk and likelihood of repayment. The criteria are included in supervisory guidance issued for various types of credit extensions and involve an analysis of the creditworthiness of the borrower. Supervisors expect the analysis to identify the borrower, document the borrower's current and past

EC 9	Principle 18: Problem assets, provisions and reserves
	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. Supervisors have established loan sampling procedures to evaluate an institution's internal classification system and the accuracy of ratings. For example, *see* the Federal Reserve's Commercial Bank Examination Manual Sections 2040.1 Loan Portfolio Management, 2060.1 Classification of Credits, and SR 06-17, Attachment 1, Loan Review Systems. U.S. federal banking supervisors evaluate assets considered for impairment, the impairment evaluation processes, and the impairment amounts taken under the ALLL review process. Deficiencies in the process are identified and corrective action is expected. The accounting guidance defines impairment for assets in several pronouncements – individual loans under ASC310-10 and loans assessed collectively (as part of a pool) under ASC 450-20. Under U.S. generally accepted accounting principles, "a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." Banks and holding companies have the discretion to determine which individual loans are considered for evaluation of impairment under ASC 310-10-35. 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. Once an individual loan is identified as impaired, an estimate of the amount of impairment is determined. 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. *See* 2001 Policy Statement; Federal Reserve SR letter 01-17, pp. 13 – 16; OCC Bulletin 2001-37 (July 20, 2001); and FDIC FIL-63-2001 (July 25, 2001).

EC 10	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	Pursuant to the sources identified under EC 10 and the interagency guidelines on safety and soundness, banks and holding companies should have policies and procedures in place to ensure that the board of directors receives timely and appropriate

EC 10	Principle 18: Problem assets, provisions and reserves
	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. *See* 12 CFR 30, appendix A, § II(G); 12 CFR 170, subpart B, appendix A, § II(G); 12 CFR 208, appendix D-1, § II(G); 12 CFR 364, appendix A, § II(G); and 12 CFR 391, subpart B, appendix A, § II(G).
Practices and Procedures	During the course of examinations, a bank's or holding company's management provides supervisors with full access to all records and employees. This includes access to internal and external audit reports and other material, such as board or committee report and meeting minutes. Banks and holding companies that do not supply requested information or access to premises and personnel are subject to supervisory sanctions and prosecution. U.S. federal banking agencies utilize the quarterly regulatory financial reports, as well as reports from the bank's or holding company's management, to monitor and assess the condition of banks and holding companies and to identify trends in loan and asset performance. This information also assists supervisors in identifying potential areas for further supervisory review. Agency supervisors determine whether bank management provides clear, concise, and timely information about the loan portfolio and its attendant risks to the board of directors. Supervisors determine that management has clearly communicated strategic objectives and risk limits to the board and that the board has approved them. 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. This evaluation is normally part of loan review or audit activities. If concerns exist about internal testing, supervisors conduct sufficient testing to reach an independent assessment. As clarified in the Interagency Statement on the ALLL, the agencies require bank management to submit quarterly reports, at a minimum, to the board of directors, summarizing the results of the loan review process. The agencies expect management to make reports more frequently to the board of directors when material adverse trends are noted. The agencies expect management to provide the board of directors with comparative reports that identify significant changes in the level and trend of credit risk in the portfolio. Such reports should address the adequacy of, and adherence to, internal policies and procedures, as well as compliance with laws and regulations, in order to facilitate timely correction. These management reports are also provided to supervisors. During on-site examinations, supervisors evaluate the effectiveness of bank corporate governance, including the type and quality of information provided to the board of directors. *See* Interagency Statement on ALLL, Attachment 1, for a brief synopsis of federal banking agencies examination handbook/manual sections on boards of directors' duties and responsibilities.

EC 11	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	Pursuant to the Interagency Statement on the ALLL (December 13, 2006), banks are expected to review large exposures on an individual item basis as required under U.S. GAAP to determine if they are impaired. Loans determined to be impaired under ASC 310 must be individually reviewed for appropriate impairment measurement and provisioning. The safety and soundness regulations (12 CFR 30, Appendix A; 12 CFR 364, Appendix A; and regulation, 12 CFR 208, Appendix D), requires institutions to establish and maintain a system to identify problem assets.
Practices and Procedures	U.S federal banking agencies expect management to focus attention on, and consider capital allocations for, concentrations of credit, including large individual exposures. As most recently clarified in the Interagency Statement on the ALLL, the agencies require banks to review significant credits at each reporting period to determine if they are impaired. Loans determined to be impaired under ASC 310 must be individually reviewed for appropriate valuation and provisioning. Classification of significant exposures is consistent with classification practices for all credit exposures and involves identifying potential or well-defined weaknesses in an individual credit that may impact the ability of the borrower to repay the credit facility.

EC 12	Principle 18: Problem assets, provisions and reserves
Criterion	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.
Legal Framework	Under the safety-and-soundness provision of the FDI Act, 12 U.S.C. § 1831p-1(b) and the agencies examination authority cited in EC 6 above, the agencies examines banks and holding companies to develop vertical and horizontal assessments of concentration in risk at particular institutions and across the banking sectors, respectively. Pursuant to the Interagency Statement on the ALLL (December 13, 2006), banks are expected to consider trends in risks and concentrations of credit when evaluating adequacy of the provisions and reserves. *See* Section 2130 of the Federal Reserve Commercial Bank Examination Manual and SR 07-01, CRE Concentration Guidance for requirement to assess credit concentrations.
Practices and Procedures	Supervisors expect bank management to identify measure, monitor and control credit concentrations. Banks are also directed to adjust their allowance for loans and lease losses to incorporate risk due to credit concentrations. The risk management of credit concentrations is discussed in the Section 2050 of the Federal Reserve Commercial Bank Examination Manual which defines concentrations as extensions of credit that exceed 25 percent of capital. Supervisors have also issued guidance on risk management expectations for concentrations in commercial real estate which established concentration limits for supervisory oversight specifically for commercial real estate and construction lending. *See* Section 2130 of the CBEN and SR 07-01, CRE Concentration Guidance; and Comptroller's Handbook on Concentrations of Credit.

Assessment of Principle 18	Compliant
Comments	

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.[171]

(Reference documents: Joint Forum *Cross-sectoral review of group-wide identification and management of risk concentrations*, April 2008; *Sound credit risk assessment and valuation for loans*, June 2006; *Principles for managing credit risk*, September 2000; and *Measuring and controlling large credit exposures*, January 1991.)

EC 1	Principle 19: Concentration risk and large exposure limits
Criterion	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.[172] Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Legal Framework	Banks, including branches and agencies of foreign banking organizations, are subject to bank-wide limits on exposures to a single counterparty or a group of connected counterparties, as described below. These limits take into account on-balance sheet exposures and off-balance sheet exposures, including derivatives exposures. The U.S. federal banking agencies expect banks to adhere to legal lending limits and to have policies and processes to ensure that the lending limits are followed. In 2011, the Federal Reserve, OCC, FDIC, and OTS issued *Interagency Counterparty Credit Risk Management Guidance* (Guidance), setting forth sound practices and supervisory expectations for an effective counterparty credit risk (CCR) management

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

[172] 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.

EC 1	Principle 19: Concentration risk and large exposure limits
	framework[173]. The guidance indicates that banking organizations should consider the full range of credit risks in combination with CCR to manage concentration risk, including; risks from on- and -off-balance-sheet activities, contractual and non-contractual risks, contingent and non-contingent risks, as well as 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 concentrations among counterparties where potential exposure is driven by the same or similar market factors, collateral concentrations, including both risk concentrations with a single counterparty, and risks associated with portfolios of counterparties. As set forth in the Guidance, the board of directors or a board committee is expected to articulate 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. Senior management is expected to establish and implement a comprehensive risk measurement and management framework, including policies and procedures, consistent with this risk tolerance that provides for the ongoing monitoring, reporting, and control of CCR exposures. Policies should be detailed and contain a clear escalation process for review and approval of policy exceptions, especially those pertaining to transaction terms and limits. With respect to counterparty limits, the guidance indicates that a banking organization should incorporate limits into an exposure monitoring system on a bank-wide basis, independent of business lines, and have adequate risk controls that require action to mitigate limit exceptions. The guidance sets forth the expectation that banking organizations employ a range of risk measurement metrics to promote a comprehensive understanding of CCR and how it changes in varying environments, including both off-balance sheet and on-balance sheet metrics. In 2013, the Federal Reserve, OCC, and FDIC issued supervisory guidance on sound practices for leveraged finance activities, titled *Interagency Guidance on Leveraged Lending*[174]. This guidance sets forth the expectation that banking organizations have a credit limit and concentration framework consistent with the institution's risk appetite and MIS that enable management to identify, aggregate, and monitor leveraged exposures to ensure compliance with policy across all business lines. It further provides that an institution's limit framework should include limits or guidelines for single obligors and transactions, and industry and geographic concentrations. The limit framework should also identify the related management approval authorities and exception tracking provisions. The legal authorities and supervisory guidance cited in the overview to Principle 15 provide for active board involvement in the approval, periodic review, and oversight of senior management's implementation of a bank's and holding company's overall

[173] The agencies issued this guidance through transmittals to their respective supervised institutions on July 5, 2011: Federal Reserve issued SR-11-10, FDIC used FIL-53-2011, and OCC issued OCC Bulletin 2011-30.

[174] The guidance was published in the Federal Register on March 22, 2013 and communicated by the agencies to their respective supervised institutions via agency specific transmittals: Federal Reserve's SR-13-3, FDIC's FIL-13-2013, or the OCC's OCC Bulletin 2013-9.

EC 1	Principle 19: Concentration risk and large exposure limits
	business strategies and significant policies —including strategies and policies related to taking and managing credit risk. Under supervisory guidance, banks and holding companies are expected to establish internal thresholds for acceptable concentrations of credit and to report all material concentrations to the board for review. <u>Description of lending limits</u>. National banks are subject to a single-counterparty lending limit based on their unimpaired capital and surplus. *See* 12 U.S.C. § 84. A bank's total outstanding "loans and extensions of credit" to one borrower are typically limited to 15 percent of the bank's capital and surplus. A bank can extend an additional 10 percent of its capital and surplus to one borrower if the loan is fully secured by readily marketable collateral on which a perfected security interest has been obtained (i.e., there is an aggregate limit of 25 percent of a bank's capital). *See* 12 U.S.C. § 84. The Dodd-Frank Act extended the definition of "loans and extensions of credit" for purposes of lending limits to include credit exposure arising from repurchase agreements, reverse repurchase agreements, securities lending transactions and securities borrowing transactions and credit exposure arising from derivatives. *See* 12 U.S.C. 84(b)(1)(C). Regulations issued by the OCC specify the methods for calculating credit exposure arising from "loans and extensions of credit," including exposures arising from derivatives and securities financing transactions, as defined in 12 U.S.C. 84(b)(1)(C). In calculating its exposure to a counterparty, the OCC's rules set forth "combination rules," under which a loan made to one borrower is attributed to another. *See* 12 CFR 32.5. In addition to the 15 percent and 10 percent restrictions for loans to one borrower, a bank may not loan more than 50 percent of its capital and surplus to corporate groups. *See* 12 CFR 32.5(d). By statute, the limits in section 84 applicable to national banks apply to all savings associations, with narrow exceptions. *See* 12 U.S.C. 1464(u). Federal branches and agencies of foreign banks are subject to the same lending limits as national banks, except that limits are based on the U.S. dollar equivalent of the foreign bank's capital. *See* 12 U.S.C. 3102(b); CFR 28.14. State-licensed U.S. branches and agencies of foreign banks are subject to the same lending limits applicable to federal branches and agencies. *See* 12 U.S.C. 3105(h)(2); 3102(b). . In addition, the Dodd-Frank Act provides that an insured state-chartered bank may engage in derivative transactions only if "the law with respect to lending limits of the state in which the insured state bank is chartered takes into consideration credit exposure to derivative transactions." *See* 12 U.S.C. 84 note. <u>Single counterparty credit limits</u> Section 165(e) of the Dodd-Frank Act requires the Federal Reserve to prescribe standards to limit the exposure of a bank holding company and foreign banking organization with total consolidated assets of $50 billion or more to another counterparty. The Federal Reserve's regulations must prohibit credit exposure of a bank holding company with total consolidated assets of $50 billion or more

EC 1	Principle 19: Concentration risk and large exposure limits
	to any unaffiliated company that exceeds 25 percent of capital stock and surplus of the company, or such lower amount as the Federal Reserve may prescribe by regulation if necessary to mitigate risks to U.S. financial stability. Credit exposure is defined to include all extensions of credit to the company, including loans, lines of credit, all repurchase agreements, reverse repurchase agreements, securities borrowing, and lending transactions with the company. The Federal Reserve sought public comment in December 2011 on a proposal to apply the single counterparty credit limits to U.S. bank holding companies with total consolidated assets of $50 billion or more and in December 2012 to apply to foreign banking organizations with total consolidated assets of $50 billion or more. The Federal Reserve's proposals would establish a general limit prohibiting covered companies from having an aggregate net credit exposure to any single unaffiliated counterparty in excess of 25 percent of the company's regulatory capital.[175] It would also establish a more stringent net credit exposure limit between a major covered company and any other major counterparty. After the Board began its rulemaking process to limit exposures to single counterparties, the Basel Committee on Banking Supervision began developing a similar large exposure regime that would apply to internationally active banks. The Federal Reserve, OCC, and FDIC participated in that initiative, which concluded on April 15, 2014. The Board is currently considering how to take the Basel Committee's effort into account in implementing the single counterparty credit limits under the Dodd-Frank Act. The Federal Reserve also intends to take into account information gained through its quantitative impact study on the effects of the limit and comments received on the domestic and foreign proposals when formulating its final rule implementing single counterparty credit limits.
Practices and Procedures	See above.

EC 2	Principle 19: Concentration risk and large exposure limits
Criterion	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[176] to single counterparties or groups of connected counterparties.

[175] The Federal Reserve's proposal for foreign banking organizations would limit the exposures of the foreign banking organization's U.S. operations, and would measure the limit as a percentage of the foreign banking organization's capital on a consolidated basis.

[176] 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

EC 2	Principle 19: Concentration risk and large exposure limits
Legal Framework	As described in the Interagency Counterparty Credit Risk Management Guidance, the federal banking agencies expect banking organizations to have the capacity to measure their exposure at various levels of aggregation (for example, by business line, legal entity, or consolidated by industry). Systems should be sufficiently flexible to allow for timely aggregation of all CCR exposures (including OTC derivatives, securities financing transactions, and other pre-settlement exposures), as well as aggregation of other forms of credit risk to the same counterparty (for example, loans, bonds, and other credit risks). As discussed in the guidance, a banking organization's systems infrastructure should keep up with changes in the size and complexity of its CCR exposures and the OTC derivatives market in general, and should capture and measure the risk of transactions that may be subject to CCR. The guidance notes that management should strive for a single comprehensive CCR exposure measurement platform, or if not possible, minimize the number of platforms and methodologies, and manual adjustments to exposure calculation. When using multiple exposure measurement systems, the guidance notes that management should ensure that transactions whose future values are measured by different systems are aggregated conservatively. Guidance also notes that banking organizations should have strong operational processes across all derivatives markets, consistent with supervisory and industry recommendations including, for instance, recommendations made by the Senior Supervisors Group (SSG) and the Counterparty Risk Management Policy Group (CRMPG). Through the examination process, the federal banking agencies review a bank's policies, procedures, and systems to control, measure, and remediate concentration risk and large exposure risk in order to determine whether those systems are consistent with the expectations set forth in the guidance[177].
Practices and Procedures	The U.S. federal banking agencies have directed banks and holding companies to maintain adequate records that identify large borrower relationships. The degree of sophistication of a bank's or holding company's reporting systems and records will vary depending on the size, complexity, and global footprint of the bank or holding company. All new and existing large borrowers should be reported regularly to the board of directors or other appropriate committee for review. U.S. federal banking supervisors review, evaluate, and verify these reports during on-site examinations. Supervisors assess the timeliness and quality of management reporting to ensure that absolute and relative changes in exposure to individual counterparties and groups of connected counterparties is clearly identified. In addition, supervisors assess whether management reporting includes a well-defined process through which management reviews and evaluates large borrower and risk-management reports. Supervisors also determine if a bank or holding company should have a more advanced practice that includes measures of these exposures relative to internal and regulatory capital measures, not just notional exposures.

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).

[177] Refer to federal agencies' examination guidance manuals: for the Federal Reserve, Commercial Bank Examination Manual, § 2025; for FDIC, the Risk Management Manual of Examination Policies; for OCC, the Comptrollers Handbook "Bank Supervision Process" and "Concentrations of Credit" booklets.

EC 3	Principle 19: Concentration risk and large exposure limits
Criterion	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.
Legal Framework	The legal authorities and supervisory guidance cited above provide for active board involvement in the approval, periodic review, and oversight of senior management's implementation of a bank's and holding company's overall business strategies and significant policies —including strategies and policies related to taking and managing credit risk. Under supervisory guidance, banks and holding companies are expected to establish internal thresholds for acceptable concentrations of credit and to report all material concentrations to the board for review. As stated in the Interagency Counterparty Credit Risk Management Guidance, banking organizations should report counterparty exposures to the board and senior management at a frequency commensurate with the materiality of exposures and the complexity of transactions. Reporting should include concentration analysis and CCR stress testing results, to allow for an understanding of exposures and potential losses under severe market conditions. Reports should also include an explanation of any measurement weaknesses or limitations that may influence the accuracy and reliability of the CCR risk measures. In addition, the Federal Reserve issued final rules (Regulation YY) in January 2014, implementing enhanced prudential standards for risk management for bank holding companies with total consolidated assets of $50 billion or more that require the board to oversee and senior management to implement a risk-management framework that is commensurate with the bank holding company's structure, risk profile, complexity, activities, and size. The framework must include policies and procedures establishing risk-management governance, risk-management procedures, and risk-control infrastructure for the bank holding company's global operations. Similarly, in January of 2014, the OCC proposed guidelines for the OCC's "Heightened Expectations," establishing standards for the design and implementation of an institution's risk governance framework and provide minimum standards for oversight of that framework by the board of directors. These guidelines address, among other things, roles and responsibilities of those organizational units that are fundamental to the design and implementation of the risk governance framework, and provide that policies should ensure that risks are effectively identified, measured, monitored, and controlled consistent with the bank's risk appetite statement and concentration risk limits.
Practices and Procedures	The U.S. federal banking supervisors confirm that management identifies, defines, measures, monitors, and controls concentrations. Concentrations are generally defined by the agencies as direct or indirect extensions of credit and contingent obligations (both off- and on-balance sheet) that, when aggregated, exceed 25 percent of the bank's tier 1 capital plus the allowance for loan and lease losses. The U.S. federal banking agencies expect that the bank and holding company board of directors establish prudent concentration control processes in relation to the level and complexity of its lending activities, its risk appetite and sophistication, and its capital levels. These processes should include escalation procedures and approval processes for exceptions to policy limits. Supervisors verify that new and existing concentrations are reported regularly to the board of directors or other appropriate

EC 3	Principle 19: Concentration risk and large exposure limits
	management committees for review. Supervisors review policies, management reports, and audit reports dealing with aggregate exposures and concentrations to ensure that the policies and practices are sufficient to control concentrations and that reports are sufficiently detailed to provide appropriate information to the board of directors or other appropriate committee to take appropriate action.

EC 4	Principle 19: Concentration risk and large exposure limits
Criterion	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Legal Framework	The U.S. federal banking agencies regularly obtain, through regulatory financial reports and on-site examinations, information that enables review of concentrations within a bank's and holding company'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 concentrations that present significant risks. The agencies may take more formal action as necessary to protect the safety and soundness of the bank and holding company. *See* 12 U.S.C. § 1818(b) & (c).
Practices and Procedures	Supervisors regularly obtain information from banks regarding credit concentrations. There are numerous factors for determining concentrations within a loan portfolio, including by collateral support, geography, risk characteristics, industry or economic sector, product type, or by factors that link performance to similar economic, financial, or business developments. *See* manuals noted in footnote 1 of EC 1 and Uniform Bank Performance Report page 07B, *Analysis of Concentrations of Credit*. If a supervisor identifies weaknesses, the agencies have the authority to require a bank or holding company to take remedial actions in cases where concentrations present significant risks. Generally, these actions require institutional evaluation of concentrations relative to risk-management ability and capital levels. Supervisory recommendations on concentrations are included in the agency's report of examination, and the agency may require a formal written response on the action to be taken. The agency monitors the corrective actions to ensure that deficiencies have been addressed. The six largest U.S. BHCs also report exposure to top counterparties (individually) across a broad range of categories to the Federal Reserve on a weekly basis using the template developed by the Senior Supervisors Group.

EC 5	Principle 19: Concentration risk and large exposure limits
Criterion	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.

EC 5	Principle 19: Concentration risk and large exposure limits
Legal Framework	OCC regulations define those individuals and entities whose interests will be attributed to the single borrower for purposes of computing the lending limits under 12 U.S.C. §84. Under the regulations, the OCC generally has discretion to apply the attribution rules in a manner that reflects actual risk exposure, and corporate groups are defined for purposes of the lending limits. *See* 12 CFR 32.5. As discussed above, the Federal Reserve is developing a large exposures limit regime for large bank holding companies and foreign banking organizations. In addition, concentrations at holding companies are monitored and subject to limits through the supervisory process.
Practices and Procedures	The U.S. federal banking agencies confirm, as part of the normal supervisory process, that senior management: establishes reasonable credit and issuer limits; monitors the bank's and holding company's exposures; and has implemented adequate controls and management information systems to ensure that these limits are not exceeded on an individual legal entity or consolidated basis. The agencies expect management to define, identify, measure, monitor, and control borrower limits, which are defined as direct or indirect extensions of credit and contingent obligations (both on- and off-balance sheet). U.S. federal banking supervisors determine whether a bank's or holding company's lending policies and practices adhere to applicable laws and regulations and initiate corrective action when policies, practices, procedures, or internal controls are deficient or when violations of laws or regulations have been noted. The supervisor is charged with understanding and evaluating the effectiveness of the internal policies, systems, and controls that the bank or holding company uses to monitor and manage the risk associated with asset limitations. The supervisor also assesses the accuracy of large borrower relationships identified by the bank or holding company.[178]

EC 6	Principle 19: Concentration risk and large exposure limits
Criterion	Laws, regulations or the supervisor set prudent and appropriate[179] 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.
Legal Framework	The sources cited in EC 1 establish limits on "loans and extensions of credit" to a single counterparty or a group of connected counterparties. In general, on-balance-sheet as well as off-balance-sheet extensions of credit are included in calculating the limit. In 2010, the lending limits were amended to include counterparty credit risk from derivatives and securities financing transactions.

[178] *See* Banking Manuals, *supra* note 7.

[179] Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. The Basel Committee on Banking Supervision finalized its Standard for a large exposure regime that would apply to all global banks on April 15, 2014.

EC 6	Principle 19: Concentration risk and large exposure limits
	As discussed above, the combination rules apply to determine whether extensions of credit to one borrower will be attributed to another person, such that each person will be deemed a borrower. *See* 12 CFR 32.5. For example, under the combination rules, loans will be attributed to another person when proceeds of a loan or extension of credit are to be used for the direct benefit of the other person or when a common enterprise is deemed to exist between the persons. *Id.* When the agencies identify overages to the legal lending limit, they may seek restitution and civil money penalties against officers, directors and agents of the bank. *See* 12 U.S.C. § 1818(b) and (c) and 12 U.S.C. § 93. While generally subject to the same lending limits as a bank, a federal savings association's total investment in commercial paper and corporate debt securities of any one issuer, or issued by any one person or entity affiliated with that issuer, together with other loans, may not exceed the general lending limit. *See* 12 CFR 160.40(a)(3). In addition, the Federal Reserve is developing a large exposures limit regime that would limit the exposure of a bank holding company or foreign banking organization with $50 billion or more in assets to another counterparty. In the Federal Reserve's December 2011 and 2012 proposals, the Federal Reserve proposed to treat exposure to a group of counterparties under common control as exposure to a single counterparty.
Practices and Procedures	The U.S. federal banking agencies have directed banks and holding companies to maintain adequate records to identify large borrower relationships. The degree of sophistication of a bank's or holding company's reporting systems and records will vary depending on the size, complexity, and global footprint of the bank or holding company. All new and existing large borrowers should be reported regularly to the board of directors or other appropriate committee for review. U.S. federal banking supervisors are responsible for reviewing, evaluating, and verifying these reports during the on-site examination. Supervisors determine whether management reporting is timely and in a format that clearly indicates absolute and relative changes in the exposure to individual counterparties and groups of connected counterparties. In addition, supervisors assess if management reporting includes a well-defined process through which management reviews and evaluates large borrower and risk-management reports. Supervisors also evaluate if a bank or holding company should have a more advanced practice that includes measures of these exposures relative to internal and regulatory capital measures, not just notional exposures.

EC 7	Principle 19: Concentration risk and large exposure limits
Criterion	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.

EC 7	Principle 19: Concentration risk and large exposure limits
Legal Framework	As described in the Interagency Counterparty Credit Risk Management Guidance, the federal banking agencies expect that large banking organizations with significant CCR exposures maintain a comprehensive stress-testing framework, which is integrated into the banking organization's CCR management. The guidance provides that a sound stress testing framework should include measurement of the largest counterparty-level impacts across portfolios and relevant portfolio- and counterparty-specific trends and consideration, at least quarterly, of stressed exposures resulting from the joint movement of exposures and related counterparty creditworthiness. The guidance provides that regularly, but no less than quarterly, senior management should evaluate stress test results for evidence of potentially excessive risk, and take risk reduction strategies as appropriate. The guidance also indicates that stress test results should be communicated to the board and senior management at a frequency commensurate with the materiality of exposures and the complexity of transactions. In addition, the Federal Reserve has implemented a comprehensive stress test framework for bank holding companies and state member banks in its Regulation YY (12 CFR 252 Parts E, F, and G). Under this framework, the Federal Reserve annually develops scenarios for use in its supervisory stress tests for large bank holding companies, and requires these bank holding companies and state member banks to use the same scenarios in their company run stress tests. The Federal Reserve may also specify additional components for these scenarios. In 2014, the Federal Reserve required eight large, interconnected bank holding companies to apply a counterparty default scenario component to their securities lending, and repurchase/reverse repurchase agreement and derivative exposures. The counterparty default scenario component involves the instantaneous and unexpected default of the bank holding company's counterparty with the largest net stressed losses. Community banks are not required or expected to conduct the enterprise-wide stress tests required of larger organizations under the capital plan rule, the rules implementing Dodd-Frank Act stress testing requirements, or as described in the stress testing guidance for organizations with more than $10 billion in total consolidated assets. The agencies continue to emphasize that all banking organizations, regardless of size, should have the capacity to analyze the potential impact of adverse outcomes on their financial condition. Certain portions of existing interagency guidance applicable to all banking organizations discuss addressing potential adverse outcomes as part of sound risk management practices. The agencies note that such existing guidance, including that covering interest rate risk management, commercial real estate concentrations, and funding and liquidity management (among others), continues to apply.
Practices and Procedures	The supervisory and company-run stress test in 2014 required eight firms with significant trading and custodial operations to include a large counterparty default scenario component. The component required firms to assume the default, during a stressed market environment, of the counterparty that represented the largest loss given default across the company's securities financing transaction and derivatives exposures. The Federal Reserve has indicated in guidance and instructions that it expects large bank holding companies to consider material risk concentrations in their stress tests and in developing stress scenarios.

EC 7	Principle 19: Concentration risk and large exposure limits
	• Large banking organizations are expected to establish a stress testing framework that covers their material risk concentrations. *See* SR Letter 11-7. • Assuming the default of a significant counterparty is provided as an example of a strong practice for designing a stress scenario that captures specific risks to a firm. See Capital Planning at Large Bank Holding Companies: supervisory Expectations and Current Range of Practice – Washington: Board of Governors of the Federal Reserve System, August 19, 2013. • The Federal Reserve reviews whether the company-developed stress scenario is appropriate to the company's businesses, operations, and risk profile – including idiosyncratic risks like large concentrations – as part of its process for making a decision on the company's planned capital distributions.

EC 8	Principle 19: Concentration risk and large exposure limits
Additional Criterion	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) ten per cent or more of a bank's capital is defined as a large exposure; and (b) twenty-five per cent 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. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.
Legal Framework	As discussed above, under existing lending limit regulations, a bank's total outstanding loans and extensions of credit to one borrower are typically limited to 15 percent of the bank's capital and surplus. A bank can extend an additional 10 percent of its capital and surplus to one borrower if the loan is fully secured by readily marketable collateral on which a perfected security interest has been obtained (i.e., there is an aggregate limit of 25 percent of a bank's capital). *See* 12 U.S.C. § 84. Other limits apply in special situations. In addition to the 15 percent and 10 percent restrictions for loans to one borrower, a bank may not loan more than 50 percent of its capital and surplus to corporate groups. *See* 12 CFR 32.5(d). In addition to the credit exposure limits discussed above, under the OCC's investment securities rules at 12 CFR part 1, there are separate limits on the amount of securities issued by any one obligor that can be held by one bank. The aggregate par value of securities issued by one obligor and held by a bank may not exceed 10 percent of the bank's capital and surplus for Type II securities (*e.g.*, obligations issued by individual states or by certain international and multinational development banking organizations); 10

EC 8	Principle 19: Concentration risk and large exposure limits
	percent of capital and surplus for Type III securities (*e.g.*, certain corporate or municipal bonds); and 25 percent of capital and surplus for Type V securities (*e.g.*, certain investment-grade rated, marketable securities). *See* 12 CFR 1.3. While generally subject to the same lending limits as a bank, a federal savings association's total investment in commercial paper and corporate debt securities of any one issuer, or issued by any one person or entity affiliated with that issuer, together with other loans, may not exceed the general lending limit. *See* 12 CFR 160.40(a)(3). In addition, as noted above, the Federal Reserve is developing a large exposure limit regime that would limit the exposure of a bank holding company with $50 billion or more in assets to an unaffiliated counterparty. The Federal Reserve's proposal would establish a general limit prohibiting covered companies from having an aggregate net credit exposure to any single unaffiliated counterparty in excess of 25 percent of the company's regulatory capital. It would also establish a more stringent credit exposure limit between a major covered company and any other major counterparty.
Practices and Procedures	Lending limits, investment limits, and requirements for internal operating limits effectively identify the maximum amounts that can be provided to one entity, and by so doing define "large exposure." The U.S. federal banking agencies expect that all banks and holding companies define, identify, measure, monitor, and control concentrations. Compliance with all lending limits is monitored and reviewed by supervisors. Moreover, as noted above, supervisors have broad authority to assess the risk posed by a credit risk concentration and consider the adequacy of a bank's capital to absorb the risk posed by the concentration.

Assessment of Principle 19	Largely Compliant
Comments	The Federal Reserve is in process of developing a large exposures limit regime that would limit the exposure of a bank holding company or foreign banking organization with $50 billion or more in assets to another counterparty.

Principle 20: Transactions with related parties

In order to prevent abuses arising in transactions with related parties[180] and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties[181] on an arm's length basis; to monitor these 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.

(Reference documents: *Principles for the management of credit risk*, September 2000.)

Overview

Two major sets of laws establish limits on transactions with "related parties" covered by the Overview to this principle. (The Overview defines related parties to include "the bank's subsidiaries and affiliates, and any party that the bank exerts control over or that exerts control over the bank. It may also include the bank's major shareholders, directors, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.")

Limits on Transactions with Affiliates. Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. §§ 371c and 371c-1), and their implementing regulation, the Federal Reserve's Regulation W (12 CFR part 223), are designed to prevent the misuse of a bank's resources through preferential transactions with its affiliates and otherwise to limit the risks posed to the bank from transactions with affiliates. Section 23A (12 U.S.C. § 371c) prohibits a member bank (state or national) from engaging in "covered transactions" with an "affiliate" unless the bank limits the aggregate amount of such transactions with that particular affiliate generally to 10 percent of the bank's capital and surplus. In addition, the aggregate amount of covered transactions with all affiliates is limited to 20 percent of the bank's capital and surplus. Moreover, any loan or extension of credit by a bank to an affiliate (or guarantee or letter of credit issued by a bank on behalf of an affiliate) generally must be fully secured and purchases of "low-quality assets" are generally prohibited. Sections 23A and 23B also apply to all savings associations (12 U.S.C. § 1468(a)) and to state nonmember insured banks (12 U.S.C. § 1828(j)).

In general, "covered transactions" include loans and extensions of credit to an affiliate, investments in securities issued by an affiliate, a purchase of assets from an affiliate, and the issuance of a guarantee or letter of credit on behalf of an affiliate. The credit exposure resulting from derivative transactions and securities borrowing and lending transactions between a bank and an affiliate also are covered transactions. Sections 23A and 23B and Regulation W also have an attribution rule, which provides that a transaction between a bank and a third party where funds are transferred to—or used for the benefit of—an affiliate is considered a covered transaction with that affiliate.

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[180] 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. Regarding subsidiaries of banks, only insured depository institutions and financial subsidiaries of banks would be covered as "affiliates" under sections 23A and 23B of the Federal Reserve Act. Most subsidiaries of banks are not affiliates for purposes of section 23A.

[181] 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 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.

Under section 23A, the term "affiliate" is defined broadly to include any entity that directly or indirectly controls, or is under common control with, the bank. Control of a company is defined to include ownership of 25 percent or more of the voting securities of the other company or exercise of a controlling influence over the management or policies of the other company. The definition of affiliate also includes certain investment funds that are advised by the bank or by an affiliate of the bank. The definition of affiliate generally does not cover subsidiaries of the bank – operating subsidiaries (not financial subsidiaries) of the bank are treated as part of the bank for purposes of sections 23A and 23B and Regulation W.

Safety and soundness is an overriding principle of the U.S. transactions with affiliate regime. All covered transactions, including those that qualify for available exemptions from the requirements of sections 23A and 23B and Regulation W, must be consistent with safe and sound banking practices. Even if transactions are structured in a manner that is fully consistent with the requirements of the statute and regulation, supervisors can still criticize the transactions if they are abusive, involve undue transfer of risk or circumvent the purpose of the regulation.

Section 23B (12 U.S.C. § 371c-1) covers a wider range of activities than section 23A. It covers virtually any type of financial transaction between a bank and an affiliate. Section 23B provides that transactions between a bank and its affiliates must be on terms and under circumstances, 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 nonaffiliated companies.

The OCC's *Comptroller's Handbook* booklet, "Related Organizations" (August, 2004) provides guidance to bankers and examiners in understanding the various types of related organizations, risks that may be associated with these organizations, and the responsibilities of a bank's board of directors and management to institute strong and effective corporate practices governing the bank's relationships with these organizations.

The OCC has also issued guidance on third party relationships, OCC BULLETIN 2013-29 Risk Management Guidance, which include activities that involve outsourced products and services, use of independent consultants, networking arrangements, merchant payment processing services, services provided by affiliates and subsidiaries, joint ventures, and other business arrangements where the bank has an ongoing relationship or may have responsibility for the associated records.

Limits on Transactions with Insiders. Sections 22(g) and (h) of the Federal Reserve Act (12 U.S.C. §§ 375a and 375b) impose a number of restrictions on extensions of credit by a member bank to its insiders and to insiders of its affiliates. Insiders include executive officers, directors, and principal shareholders of a bank or an affiliate of the bank, as well as companies controlled by such insiders.

12 CFR 215 (the Federal Reserve's Regulation O) implements the restrictions imposed under sections 22(g) and (h) of the Federal Reserve Act (12 USC 375a and 375b). 12 CFR 31, Extensions of credit to insiders and transactions with affiliates, requires that national banks comply with the insider lending provisions in 12 CFR 215. The FDIC's Regulation O rules are provided in 12 CFR 337.3 (state nonmember insured banks) and 12 CFR 390.337 (state savings associations). These provisions implement 12 U.S.C. § 1828(j) (state nonmember insured banks) and 12 U.S.C. § 1468(b) (state savings associations).

In general, 12 CFR 215 provides that extensions of credit by a bank to an insider must be made on the same terms and conditions as extensions of credit to non-insiders and must not represent more than the normal risk of repayment. *See* 12 CFR 215.4(a). In addition, the regulation imposes on extensions of credit to insiders the single borrower limits discussed under Principle 19. *See* 12 CFR 215.2(i) and 215.4(c). The regulation also places an aggregate

quantitative limit on extensions of credit by a bank to all its insiders. Extensions of credit to insiders that exceed a certain threshold must be reviewed and approved by a majority of the bank's board of directors prior to disbursement. *See* 12 CFR 215.4(b). Extensions of credit by a bank to its executive officers are subject to an additional set of restrictions. *See* 12 CFR 215.5. Notably, other than certain loans with a residential housing or educational purpose, a bank may not extend more than $100,000 in credit to an executive officer.

Although the regulatory restrictions on transactions with insiders or affiliates apply only to extensions of credit and covered transactions made by a bank, rather than by any entity with a depository holding company structure, the U.S. federal banking agencies encourage 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 agencies still may consider them "unsafe and unsound." In addition, as consolidated supervisor, the Federal Reserve monitors material intra-group transactions and exposures. The Federal Reserve also ensures that holding companies have adequate risk-management processes in place for the banking organization pertaining to such transactions.

The OCC's Comptroller's Handbook booklet, "Insider Activities" (November 2013), provides guidance to bankers and examiners on how national banks and federal savings associations may legally and prudently engage in transactions with insiders and implement risk management processes that provide for the appropriate control and monitoring of insider activities. The booklet also includes guidance on how examiners review and assess insider activities during the supervisory process.

EC 1	**Principle 20: Transactions with related parties**
Criterion	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.
Legal Framework	The statutes and regulations cited in the overview to this principle carefully define the individuals and entities to which the affiliate and insider transaction limits apply. The definitions are broad and provide discretion to the supervisor in individual cases to determine whether a particular individual or entity is considered a related party subject to the restrictions.
Practices and Procedures	The U.S. federal banking agencies regularly review bank exposure to affiliates, insiders, and other related parties in order to assess compliance with the statutes and regulations such as sections 22(g), 22(h), 23A and 23B of the Federal Reserve Act, as well as Regulation O and Regulation W. The agencies train their supervisors extensively to facilitate their understanding of the rules governing these transactions, and supervisory guidance contains detailed information regarding the rules, inspection and examination objectives, and procedures for reviewing transactions between a bank and its affiliates, insiders, and related parties.

EC 2	Principle 20: Transactions with related parties
Criterion	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.[182]
Legal Framework	Under the statutes and regulations cited in the overview to this principle, exposures to affiliates and insiders may not be granted on more favorable terms (i.e., for credit assessment, tenor, interest rates, amortization schedules, requirement for collateral) than corresponding exposures to non-affiliates or non-insiders.
Practices and Procedures	Section 23A (12 U.S.C. § 371c) requires that all covered transactions between a bank and an affiliate be on terms and conditions that are consistent with safe and sound banking practices and imposes quantitative and qualitative restrictions on covered transactions between a bank and its affiliates. Section 23B (12 U.S.C. § 371c-1) requires that financial transactions between a bank and an affiliate be on terms and under circumstances, including credit standards, that are at least as favorable to the bank, as those prevailing at the time for comparable transactions with nonaffiliates. U.S. federal banking supervisors are directed to determine if affiliate transactions are on terms and conditions that are consistent with safe and sound banking practices and if the terms and conditions of affiliate transactions are the same as or more favorable than those that would be offered or applied to nonaffiliated companies in comparable transactions. *See* FRB SR letter 03-2, OCC Comptroller's Handbook booklets, "Related Organizations" and "Insider Activities", FDIC Risk Management Manual of Examination Policies, "Related Organizations". Related training materials provide extensive supervisor guidance to facilitate review and verification of compliance with the market terms requirement of the statutes. Sections 22(h) of the Federal Reserve Act and Regulation O require that extensions of credit by a bank to an insider (1) 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 (2) not involve more than the normal risk of repayment. Regulation O requires banks to maintain records to document compliance with its restrictions, including its market terms requirement[183]. Violations of Regulation O or section 23B can give rise to reimbursement and formal enforcement actions against a bank. A 23A violation also can give rise to an enforcement action. Violations of Regulation O, Section 23A, and Section 23B may be subject to civil money penalties. For example, a Cease and Desist order was issued against a bank requiring approval from the supervisor prior to transactions with inside or related parties.

[182] An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favourable rates).
[183] *See* also the OCC's *Comptroller's Handbook* booklet "Insider Activities" (November 2013).

EC 3	Principle 20: Transactions with related parties
Criterion	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.
Legal Framework	Regulation O requires that extensions of credit by the bank to an insider be reviewed and approved by the bank's board of directors if the aggregate credit exposure of the bank to the insider would exceed $500,000 upon consummation of the new credit facility. A lower review threshold applies to smaller banks. *See* 12 CFR 215.4(b). Extensions of credit to insiders above the review threshold must be pre-approved by a majority of the bank's board of directors, and the insider who is obtaining the credit must abstain from participating either directly or indirectly in the vote. Participation in the discussion or any attempt to influence the voting would be regarded as indirect participation. Except for certain securities and asset purchases, the U.S. bank regulatory framework does not, however, require board pre-approval of transactions between a bank and an affiliate. In addition, the U.S. bank regulatory framework does not impose a board approval requirement on write-offs of related party transactions. However, under the OCC's Heightened Expectations, board members are expected to exercise proactive oversight of independent risk management to ensure safe and sound banking practices, which would include compliance risk coverage on affiliate transactions.
Practices and Procedures	U.S. federal banking supervisors review a bank's policies and procedures to ensure that the bank properly identifies and documents approvals of certain transactions with related parties and that the bank's board of directors approves material transactions with related parties. For example, a bank or its subsidiary cannot knowingly purchase or acquire any security during the existence of an underwriting or selling syndicate for that security, if an affiliate of the bank is a principal underwriter in the syndicate. An exception to this would require that the purchase was approved by a majority of the bank's directors before the security was initially offered for sale to the public, based upon a determination that it is a sound investment for the bank, irrespective of the fact that an affiliate is a principal underwriter of the securities. Certain corporate reorganizations that result in a purchase of assets can be exempt from the quantitative restrictions of section 23A if they meet certain criteria, including board approval. In general, under federal regulations and supporting guidance, and as a matter of sound corporate governance, board members with conflicts of interest must recuse themselves from consideration of any matter in which they have an interest. Supervisors are directed to identify and criticize any situation in which an interested director involves himself or herself in the consideration of a matter in which he/she has an interest.

EC 4	Principle 20: Transactions with related parties
Criterion	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.

EC 4	Principle 20: Transactions with related parties
Legal Framework	The regulatory provision discussed under EC 3 prevents persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure. Banks are expected to have policies and procedures in place to ensure compliance with these restrictions.
Practices and Procedures	U.S. federal banking supervisors are directed to identify and criticize any situation in which an interested director involves himself or herself in the consideration of a matter in which he/she has an interest. Supervisors review policies and procedures established to facilitate compliance with the laws and regulations governing affiliate transactions. Supervisors also review compliance with Regulation O for extensions of credit to insiders. As noted above, under Regulation O, the insider who is obtaining credit must abstain from participating either directly or indirectly in any related votes. Violations of these regulations or weaknesses in policies and procedures to ensure compliance with the regulations may subject a bank to formal enforcement action or civil money penalties.

EC 5	Principle 20: Transactions with related parties
Criterion	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.
Legal Framework	The sources cited in the overview to this principle establish quantitative limits on affiliate and insider transactions and collateral requirements on certain affiliate transactions. The aggregate limits on exposures to a group of affiliates or insiders generally are equivalent or stricter than those applicable to groups of connected counterparties that are not affiliates or insiders. As with any other extension of credit, the supervisor can address problems identified with such exposures by requiring their deduction from capital when assessing capital adequacy and, consistent with section 23A and Regulation W, requiring the posting of collateral.
Practices and Procedures	Each bank's credit transaction with an affiliate must be fully collateralized as required by Regulation W (12 CFR 223.14); U.S. Federal banking supervisors may request a list of transactions with affiliates, including the terms of any collateral, to assess compliance with the regulation. Affiliate transactions in excess of regulatory limits are prohibited unless the appropriate federal supervisory authority, with the concurrence of the FDIC and the Federal Reserve, has exempted a transaction upon a finding that such exemption would be in the public interest and consistent with the purposes of section 23A. Approval of such requests is rare and, if granted, is subject to any conditions that the Federal supervisors might wish to apply. Moreover, investments by a bank in subsidiaries that are not consolidated for accounting or supervisory purposes and, on a case-by-case basis, investments in other designated subsidiaries or associated companies at the discretion of the Federal Reserve, are deducted from total capital components (for more information *see* Principle 6). Investments by a bank in a financial subsidiary (that is, a subsidiary that is engaged in activities that are not permissible for the lead bank to conduct directly) generally are deducted from total capital components as well.

EC 6	Principle 20: Transactions with related parties
Criterion	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.
Legal Framework	Banks must identify, through an annual survey, all insiders of the bank and maintain records of all extensions of credit to insiders (12 CFR 215.8(b)). All banks that are in holding companies must report their covered transactions with affiliates on a quarterly basis to the Federal Reserve. *See* Practices and Procedures for EC7.
Practices and Procedures	Banks must establish policies and procedures for compliance with all applicable laws, rules, and regulations, including Regulation O and Regulation W. These policies, as well as individual transactions, are reviewed during the examination process. U.S. federal banking agencies require banks to develop policies to ensure that credit decisions are based on an independent and complete credit evaluation. The agencies expect that a bank's management information system identifies and quantifies credits to related parties and that these transactions are routinely reviewed by loan review and management. U.S. federal banking supervisors determine whether loans to insiders and affiliates exceed the imposed lending limits and that appropriate board approvals were obtained if prior approval by the bank's board was required for a loan to an insider. In addition, supervisors determine the adequacy of the bank's procedures used to ensure that loans to related parties are not made on conditions indicating preferential treatment. As previously discussed, violations of these regulations or weaknesses in policies and procedures may subject the bank to formal enforcement action and civil money penalties.

EC 7	Principle 20: Transactions with related parties
Criterion	The supervisor obtains and reviews information on aggregate exposures to related parties.
Legal Framework	Pursuant to section 5 of the Bank Holding Company Act (12 U.S.C. § 1844), all top-tier bank holding companies and foreign banking organizations that own a U.S. insured depository institution must file the FR Y-8 report, *Bank Holding Company Report of Insured Depository Institutions' Section 23A Transactions with Affiliates*. The information in this quarterly report is used to enhance the Federal Reserve's ability to monitor the holding company's exposure to affiliates and to ensure compliance with section 23A of the Federal Reserve Act.
Practices and Procedures	All top-tier bank holding companies and foreign banking organizations that own a U.S. subsidiary bank must file the FR Y-8 report, Bank Holding Company Report of Insured Depository Institutions' Section 23A Transactions with Affiliates. The information in this quarterly report is used to enhance the Federal Reserve's ability to monitor the holding company's exposure to affiliates and to ensure compliance with section 23A of the Federal Reserve Act. The FR Y-8 report contains multiple items requiring filers to

EC 7	Principle 20: Transactions with related parties
	disclose their aggregate exposures to affiliates – both transactions that are subject to and transactions that are not subject to section 23A's collateral requirements. The U.S. federal banking agencies also require reporting of insider lending transactions, and federal banking supervisors ensure that the amount of credit extended to an insider, both to a single insider borrower and in the aggregate to all insiders, conforms to the provisions of Regulation O. As supervisors review individual transactions, as discussed in EC 5 above, they note any transactions with affiliated organizations and insiders that do not appear in the bank's or holding company's reports of related exposures.

Assessment of Principle 20	Compliant
Comments	

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[184] and transfer risk[185] in their international lending and investment activities on a timely basis.

(Reference documents: *Management of banks' international lending*, March 1982.)

Overview

The U.S. federal banking agencies 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).[186] The agencies also must ensure that these risks are taken into account in evaluating a bank's or holding company's capital adequacy. *See id.* § 3903(b). 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. Id. § 3906. 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

[184] Country risk is the risk of exposure to loss caused by events (economic, social, or political) 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.
[185] 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.)
[186] The statute that imposes a requirement for banks and bank holding companies does not apply to savings associations and SLHCs, which typically do not have foreign country exposures.

country in which the borrowers are located. Necessarily, 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.

Representatives of three of the federal banking agencies (the Federal Reserve, OCC, and the FDIC) are part of the "Interagency Country Exposure Review Committee" (ICERC), which 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, as evidenced by failure to pay principal and interest timely and fully, arrearages, forced restructuring, or rollovers 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. *See* 12 CFR 28.52, 211.43 and *Guide to the Interagency Country Exposure Review Committee Process* (November 2008).[187] The agencies also support the Basel Committee on Bank Supervision's paper *Management of banks' international lending*, March 1982.[188]

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 United States as a reporting country. The ICERC also issued clarifications to the reporting instructions, specified reporting requirements for savings and loan holding companies (SLHCs), and expanded the level of public disclosure, which is an important step towards greater transparency of institutions' country risk information. 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 ATRR pursuant to the ICERC's guidelines. Most of the discussion below includes any SLHC with foreign country exposure. *See* footnote 3.

EC 1	**Principle 21: Country and transfer risks**
Criterion	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 and 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.

[187] www.occ.treas.gov/ftp/bulletin/2009-8b.pdf.
[188] www.bis.org/publ/bcbsc122.pdf?noframes=1.

EC 1	Principle 21: Country and transfer risks
Legal Framework	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. The federal banking agencies have also implemented enhanced guidance concerning the elements of an effective 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*," available at: http://www.newyorkfed.org/banking/circulars/11426.pdf. Moreover, the Federal Reserve requires a bank holding company with greater than $50 billion in total assets to have a risk management framework commensurate with the company's structure, risk profile, complexity, activities, and size, and must include policies and procedures establishing risk management governance, risk management practices, and risk control infrastructure for the company's global operations and processes and systems for implementing and monitoring compliance with such policies and procedures. The processes and systems must include those for identifying and reporting risks and risk management deficiencies, including with respect to emerging risks and ensuring effective and timely implementation of corrective actions to address risk management deficiencies for the company's global operations; processes and systems for specifying managerial and employee responsibility for risk management, for ensuring the independence of the risk management function; and processes and systems to integrate management and associated controls with management goals and the company's compensation structure for the company's global operations. *See* 12 CFR 252; 79 Fed. Reg. 17240. The OCC likewise requires national banks to have a risk management framework commensurate with the bank's structure, risk profile, complexity, activities, and size, and must include policies and procedures establishing risk-management governance, risk management practices, and risk control structure for the banks cross-border operations, as well as processes and systems for implementing and monitoring compliance with such policies and procedures.
Practices and Procedures	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. federal banking agencies 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. During examinations, supervisors assess the bank's or holding company's overall identification and management of country and transfer risk. *See* Federal Reserve CBEM, section 7040.3; OCC's *Country Risk Management Booklet, Comptroller's Handbook;* FDIC's *Risk Management Manual of Examination Policies (Section 11.1 – International Banking),*[189] *and* FDIC's FIL 23-2002 *Country Risk Management.*[190] 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

[189] FDIC: Risk Management Manual of Examination Policies
[190] http://www.fdic.gov/news/news/financial/2002/fil0223.html

EC 1	Principle 21: Country and transfer risks
	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). 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. As part of the ICERC process, the U.S. federal banking agencies employ representatives with experience in international supervision to consult within the ICERC process, to evaluate the risk to cross-border and cross-currency exposures in countries to which U.S. banks and holding companies have exposures exceeding certain thresholds, and to establish reserve requirements (ATRR) for different types of exposures for countries that have defaulted.

EC 2	Principle 21: Country and transfer risks
Criterion	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.
Legal Framework	Through the interagency safety and soundness guidelines and their examination authority, the federal banking agencies assess the risk management framework of banks and holding companies to ensure they are commensurate with the companies' structure, risk profile, complexity, activities, and size, and must include policies and procedures establishing risk management governance, risk management practices, and risk control infrastructure for the company's global operations and processes and systems for implementing and monitoring compliance with such policies and procedures. References: 12 U.S.C. §§ 161, 325-26, 481, 483, 602, 625, 1464(d) and (v), 1467(h), 1467a(b), 1817(a), 1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 1867, 3102(b), 3105(c). As a part of this process, 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.

EC 2	Principle 21: Country and transfer risks
Practices and Procedures	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 country and transfer risk management is appropriately integrated in an institution's enterprise-wide risk management system.

EC 3	Principle 21: Country and transfer risks
Criterion	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.
Legal Framework/ Practices and Procedures	U.S. federal banking supervisors assess a bank's or holding company's information and risk management systems to evaluate whether a bank or holding company has appropriate risk controls, information systems, and monitoring structure to ensure that cross-border exposures are managed consistently with the bank's or holding company's strategy and risk management philosophy. Supervisors evaluate whether banks and holding companies have comprehensive reporting systems to accurately capture country-risk exposure, ensure adherence to the directives of the board, provide for at least an annual review of portfolio composition by country, and establish a methodology for reporting exceptions. As part of the examination process, supervisors evaluate the frequency and size of exceptions to country limits imposed by banks and holding companies and, if appropriate, discuss issues with management if weaknesses are noted. Banks and BHCs are 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)[191] 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. In assessing the quality of a bank's or BHC's country risk exposure management systems, supervisors verify the accuracy of data submitted on the FFIEC 009 report. Supervisors also obtain and review country risk reports provided to the board of directors to ensure completeness and accuracy of information.

[191] http://www.ffiec.gov/E16.htm

EC 4	Principle 21: Country and transfer risks
Criterion	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: (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.
Legal Framework	The requirements of the U.S. federal banking agencies 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 includes provisions affecting both the international lending activities of U.S. banks and bank holding companies and the federal banking agencies' supervision of those activities. The ILSA requires banks and bank holding companies, in certain circumstances, to set up an allocated reserve for assets subject to more severe transfer risk. The three federal banking agencies 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. *See* 12 CFR 28, subpart C (OCC); 12 CFR 211, subpart D (Federal Reserve); or 12 CFR 347, Subpart C (FDIC) However, the ATRR requirement does not apply to U.S. branches, agencies, or commercial lending company subsidiaries of foreign banking 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. *See* Guide to the Interagency Country Exposure Review Committee Process, at 26 (November 2008), available at: http://www.federalreserve.gov/boarddocs/srletters/2008/sr0812a2.pdf
Practices and Procedures	U.S. federal banking agencies 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. The minimum threshold for ICERC consideration for review of a country is an aggregate exposure by U.S. banking organizations of $1 billion or more for at least two consecutive quarters. In addition, countries to which U.S. banking organizations' aggregate exposure is between $200 million and $1 billion are reviewed by the ICERC if the exposure at five or more U.S. banks or bank holding companies exceeds 25 percent of tier 1 capital plus the allowance for loan and lease losses. 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. 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

EC 4	Principle 21: Country and transfer risks
	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.

EC 5	Principle 21: Country and transfer risks
Criterion	The supervisor requires banks to include appropriate scenarios into their stress testing programmes to reflect country and transfer risk analysis for risk management purposes.
Legal Framework	The agencies, in coordination, have developed rules establishing a framework for conducting annual stress tests for institutions that they supervise. *See* 12 CFR parts 46 (OCC), 252 et seq. (Federal Reserve), and 325 (FDIC) (Annual Stress Test rules). 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 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. 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.
Practices and Procedures	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. *See* the OCC's *Country Risk Management Booklet*, Comptroller's Handbook. *See* also authorities cited in EC 2 above: 12 U.S.C. §§ 161, 325-26, 481, 483, 602, 625, 1464(d) and (v), 1467(h), 1467a(b), 1817(a), 1817(a)(2), 1817(a)(3), 1820(b), 1844(c), 1867, 3102(b), and 3105(c).

EC 6	Principle 21: Country and transfer risks
Criterion	The supervisor regularly obtains and reviews sufficient information on a timely basis on 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).

EC 6	Principle 21: Country and transfer risks
Legal Framework	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). Under the U.S. federal banking agencies' statutory examination authority cited in response to EC 2 above, supervisors may review all books and records maintained by a bank (and its affiliates) subject to the agencies' supervision. This includes access to the employees involved in a matter under review and bank service companies and independent servicers that are subject to the Bank Service Company Act. The agencies also evaluate significant third-party service providers and can examine such service providers pursuant to their authority under 12 U.S.C. § 1867(c). The agencies require banks and holding companies, in their contracts with third-party service providers, to include agency access to the books, records, and operations of these entities. (*FFIEC Information Technology Examination Handbook*). Supervisory guidance specifies the information that is expected to be maintained by banks and holding companies with respect to credit management, including details on credit and investment portfolios. Supervisors are allowed and generally given full access to this information, and to all employees involved in assuming, managing, controlling and reporting on risks during examinations. Section 4 of the International Banking Act of 1978 provides the OCC with examination authority over the federal branches and agencies of a foreign bank. Likewise, section 5 of the Bank Holding Company Act of 1956authorizes the Federal Reserve to examine each BHC and nonbank subsidiary thereof and section 7 of the International Banking Act of 1978 authorizes the Federal Reserve to examine each branch or agency of a foreign bank; moreover, Section 25(a) of the Federal Reserve Act and Section 211.7 of Regulation K authorizes the Federal Reserve to examine Edge and agreement corporations. The Federal Reserve now has authority under the Home Owners' Loan Act to examine each SLHC and its savings associations and other subsidiaries, except banks. *See* 12 U.S.C. § 1467a(b)(4), while the OCC is responsible for examining federal savings associations and subsidiaries under 12 U.S.C. 1463.
Practices and Procedures	The federal banking agencies obtain the completed FFIEC 009 reports for individual banks and BHCs on a quarterly basis. These 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. The agencies expect banks and holding companies under their supervision to continue to monitor their cross-border exposure to all countries closely; to have robust country risk assessment systems; to have appropriate exposure limits in place; to perform analysis on the sovereign entities to which the bank or holding company is exposed; and generally to continue to apply sound risk management to all their country exposures, not just to the countries rated by ICERC.

EC 6	Principle 21: Country and transfer risks
	The federal banking agencies may use information sharing arrangements to obtain information bilaterally and/or through supervisory colleges and crisis management groups with foreign supervisors in large banks. These groups meet on a periodic basis and facilitate the exchange of relevant information.

Assessment of Principle 21	Compliant
Comments	

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.

(Reference documents: *Revisions to the Basel II market risk framework*, February 2011; *Interpretive issues with respect to the revisions to the market risk framework*, February 2011; *Guidelines for computing capital for incremental risk in the trading book*, July 2009; *Supervisory guidance for assessing banks' financial instrument fair value practices*, April 2009; and *Amendment to the Capital Accord to incorporate market risks*, January 2005.)

EC 1	Principle 22: Market risk
Criterion	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 supervisors determine 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 identifying, measuring, monitoring and controlling or mitigating market risk.
Legal Framework	U.S. federal banking agencies expect all banks and holding companies to have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks, including market risk. The

EC 1	Principle 22: Market risk
	authority to impose and enforce risk-management requirements stems from the safety and soundness and capital adequacy statutes. *See* for safety and soundness: 12 U.S.C. § 1831p-1 and 12 CFR parts 30, 208, 364, and 390 subpart B; and for capital adequacy: 12 U.S.C. §§ 1831o(c), 1467a(g)(1), 1844(b), 3907 and 3909. The agencies (Federal Reserve, OCC, and FDIC) have implemented the market risk amendments to the Basel framework (including the 2011 revisions) through their market risk capital requirements. Until January 1, 2015, banking organizations that are not subject to the advanced approaches (IRB) framework (see below), but that are subject to the market risk capital requirements, are required to calculate these requirements using 12 CFR part 3 appendix B (national banks); 12 CFR part 208 appendix E (state member banks); 12 CFR part 225 appendix E (bank holding companies), 12 CFR part 325, appendix C (state nonmember banks). These requirements include the 2011 Basel revisions. As of January 1, 2014, for banking organizations subject to the advanced approaches framework, and as of January 1, 2015, and thereafter for all other banking organizations subject to the agencies' capital regulations, 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 in the appendices referenced above. The requirements do not include references to credit ratings, consistent with section 939A of the Dodd Frank Wall Street and Consumer Protection Act of 2010, but include alternative standards of creditworthiness. *See* 12 CFR part 3, subpart F; 12 CFR part 217, subpart F; 12 CFR part 324, subpart F. The market risk capital requirements under the new rule apply to those banks and savings associations, bank holding companies (BHCs), and savings and loan holding companies (SLHCs) subject to the new capital rule that have significant trading or foreign exchange exposures.[192] In addition, the Federal Reserve and OCC have jointly issued guidance on model risk management, including for market risk, describing the key aspects of effective model risk management for banking organizations supervised by the Federal Reserve and OCC. *See* SR 11-7, Guidance on Model Risk Management (April 4, 2011); OCC Bulletin 2011-12, *Supervisory Guidance on Model Risk Management* (April 4, 2011) *available at*: http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-12a.pdf 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 SR 09-1 *Application of the Market Risk Rule in Bank Holding Companies and State Member Banks* (January 14, 2009) and SR 97-18 *Application of Market Risk Capital Requirements to Credit Derivatives* (June 13, 1997). In addition, each agency supplements these

[192] Generally, the market risk capital requirements apply to banks, BHCs, and SLHCs with aggregate trading assets and trading liabilities equal to 10 percent or more of their total assets, or $1 billion or more. SLHCs are subject to the new capital rule if they are not substantially engaged in insurance underwriting activities or commercial activities.

EC 1	Principle 22: Market risk
	requirements and guidance with procedures and programs that set forth more specific supervisory guidance on risk-management expectations.[193]
Practices and Procedures	The US agencies have targeted examinations and ongoing supervisory monitoring programs to assess the effectiveness of banking organizations' market risk management processes in providing a bank-wide view of market risk exposures as part of the mandatory safety and soundness inspection. Additionally, the agencies have targeted examination to ensure each bank's compliance with the market risk capital requirements and the SR 11-7 Model Risk Management guidance. FDIC practices are two-fold. As the primary federal regulator for State Non-Member banks, it has dedicated staff to monitor and assess the banks' market risk management process. Additionally, it has periodic target examinations of the market risk areas that include transaction testing. Transaction testing typically includes the comprehensiveness of risk capture, accuracy and completeness of market risk exposures, bank self-assessment and ability to identify risks not in VaR and stress tests, and any compensating controls given the weaknesses. As the back-up regulator for National Banks and State-Member banks, the FDIC participates in OCC and Federal Reserve led market risk qualification examinations through the Trading Book Qualification Team and review of banks' model risk management process based on the SR 11-7 guidance.

EC 2	Principle 22: Market risk
Criterion	The supervisor determines that banks' strategies, policies and processes for the management of market risk are appropriate for the level of risks assumed, 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.
Legal Framework	As described above, (see EC 1) 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. The Federal Reserve's and OCC's guidance in SR 11-7 and OCC Bulletin 2011-12, respectively, specify that the board of directors and senior management oversee model risk governance, including for market risk. Under this guidance, as part of their overall responsibilities, a banking organization's board and senior management is expected to establish a strong model risk management framework that fits into the broader risk management of the organization.
Practices and Procedures	OCC Bulletin 2014-8 specifies 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 Bulletin outlines the minimum scope procedures performed annually, and the ongoing monitoring procedures done on a daily, weekly, or as frequently as needed, basis. The procedures require examiners to evaluate the bank's board of directors' ability to understand oversee risks related to end-user

[193] *See* OCC's *Community Bank Supervision, Large Bank Supervision, and Risk Management of Financial Derivatives* booklets of the Comptroller's Handbook series, OCC Bulletin 2014-8 (End-User Derivatives and Trading Activities), and the Federal Reserve's *Trading and Capital Markets Activities Manual* and *Bank Holding Company Supervision Manual*.

EC 2	Principle 22: Market risk
	derivatives and trading activity. Examiners evaluate the board's effectiveness in implementing the bank's risk appetite framework and determine whether the board clearly communicates the relevant risk appetites to senior management using the appropriate qualitative statements and quantitative measures.

EC 3	Principle 22: Market risk
Criterion	The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment, including: (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.
Legal Framework	The agencies' market risk capital requirements provide that banking organizations subject to the requirements 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 ongoing basis in accordance with the various parameters set forth in the agencies' new capital rule. Subpart F of the agencies' new capital rule 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. *See* 12 CFR part 3, subpart F; 12 CFR part 217, subpart F; 12 CFR part 324, subpart F. In addition, SR 11-7 and OCC Bulletin 2011-12 specify supervisory expectations that relate to this criterion. 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. Under SR 11-7 and OCC Bulletin 2011-12, it is expected that as part of their overall responsibilities, a bank's board and senior management should establish a strong model risk management framework that supports the broader risk management of the organization. That framework should be grounded in an understanding of model risk—not just for individual models but also in the aggregate. The framework should include standards for model development, implementation, use, and validation. Senior management, directly and through relevant committees, is responsible for regularly reporting to the board on significant model risk, from individual models and in the aggregate, and on compliance with policy. Board members should ensure that the level of model risk is within their tolerance and direct changes where appropriate. *See* SR 11-7, p. 17; OCC Bulletin 2011-12, p. 17.

EC 3	Principle 22: Market risk
Practices and Procedures	The OCC's Bulletin 2014-8 requires examiners to evaluate the bank's market risk management information system and determine whether the reports are appropriate for effective supervision. Examiners 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, for models banks use to calculate risk-based capital requirements under the market risk rule, prior to making any material changes, or extension of a model to a new business or product type.

EC 4	Principle 22: Market risk
Criterion	The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued daily. 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 observable market prices, internal or industry-accepted models). To the extent that the bank relies on modelling 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.
Legal Framework	The agencies' 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. *See* 12 CFR 3.203; 12 CFR 217.203; 12 CFR 324.203. 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. Periodic, and at least annual review of models is expected, as is validation of vendor models. In addition, the guidance sets forth the supervisory expectation that an effective validation framework should include three core elements: • Evaluation of conceptual soundness, including developmental evidence

EC 4	Principle 22: Market risk
	• Ongoing monitoring, including process verification and benchmarking • Outcomes analysis, including back-testing. *See* SR 11-7, pp. 9-16; OCC Bulletin 2011-12, pp. 9-16.
Practices and Procedures	The U.S. agencies have targeted examinations and ongoing supervisory monitoring programs to determine that there are systems and controls to ensure that banks' marked-to-market positions are revalued daily and compliance with regulatory requirements. The target 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 levels of pricing variance thresholds and proper procedures for the escalation and resolution of disagreements. 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 review 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. 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.

EC 5	Principle 22: Market risk
Criterion	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.
Legal Framework	The agencies' market risk requirements in subpart F of the new capital rule requires a banking organization subject to the rule 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, close-out costs, early termination costs, investing and funding costs, liquidity, and model risk. *See* 12 CFR 3.203, 12 CFR 217.203; 12 CFR 324.203. The federal banking agencies also published final rules implementing section 165(i)(2) of the Dodd-Frank Act, which require financial companies with more than $10 billion in assets to conduct annual company-run stress tests using scenarios provided by the federal banking agencies.

EC 5	Principle 22: Market risk
Practices and Procedures	*See* the detailed description under EC 6.

EC 6	Principle 22: Market risk
Criterion	The supervisor requires banks to include market risk exposure into their stress testing programmes for risk management purposes.
Legal Framework	Under subpart F of the new capital rule, a banking organization must 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. *See* 12 CFR 3.203(d)(3), 12 CFR 217.203(d)(3); 12 CFR 324.203(d)(3). In addition, banking organizations must calculate a stressed VaR under subpart F. *See* 12 CFR 3.206, 12 CFR 217.206; 12 CFR 324.206. 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 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. In addition, under the Federal Reserve's stress testing rules for BHCs with over $50 billion in total consolidated assets (as well as nonbank financial companies designated for Federal Reserve supervision by the Financial Stability Oversight Council), 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 BHCs subject to the Federal Reserve's market risk capital requirements and that have total consolidated assets greater than $500 billion. *See* 77 FR 62378, 62384-62387 (October 12, 2012) and 78 FR 71435, 71442 (November 29, 2013). The federal banking agencies also published final rules implementing section 165(i)(2) of the Dodd-Frank Act, which require financial companies with more than $10 billion in assets to conduct annual company-run stress tests using scenarios provided by the federal banking agencies. The federal banking agencies may require such financial companies with significant trading activity to include a market shock component into their stress tests. *See* 12 CFR 325, Appendix C. Under the Federal Reserve's stress testing rule for BHC's with total consolidated assets of between $10 billion and $50 billion, as well as for state member banks and SLHCs with total consolidated assets greater than $10 billion, the Board may similarly require

EC 6	Principle 22: Market risk
	BHCs and SLHCs 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. *See* 77 FR 62396, 62404 (October 12, 2012). 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 United States and key foreign countries. For banks with significant trading activities, the OCC may require a "market shock" scenarios to estimate projected losses in the trading portfolio. The OCC annually will determine scenarios that are appropriate for use for each annual stress test. *See* 12 CFR Part 46.
Practices and Procedures	As a primary regulatory for State Non-member banks, the FDIC is responsible for assessing the adequacy of the bank's stress test, which includes stress testing of market risk exposures. As the backup regulator for national banks and state member banks, the FDIC participates in the CCAR stress test exercise for the trading book.

Assessment of Principle 22	Compliant
Comments	

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[194] 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.

[194] 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.

Principle 23: Interest rate risk in the banking book

(Reference documents: *Principles for the management and supervision of interest rate risk*, July 2004.)

Overview

The U.S. federal banking agencies have emphasized that banks[195] and holding companies should carefully assess the risk to earnings and the economic value of their capital from adverse changes in interest rates. The 1996 "Joint Agency Policy Statement: Interest Rate Risk"[196] , the 2010 "Interagency Advisory on Interest Rate Risk Management"[197] and subsequent "FAQs on 2010 Interagency Advisory on Interest Rate Risk Management"[198] provide guidance on this issue. The guidance stresses the importance of assessing interest rate risk to the economic value of a bank's or holding company's capital and, in particular, sound practice in selecting appropriate interest rate scenarios to be applied for capital adequacy purposes. Banks and holding companies are directed to establish limits on their interest rate risk exposures that are appropriate to the size, complexity and capital adequacy and that address the potential impact of changing interest rates on both reported earnings and economic value of equity. The agencies also refer to the BCBS's document "Principles for the Management and Supervision of Interest Rate Risk, July 2004" for guidance.

As noted in EC 1 below, each agency has examination manuals and programs that supervisors use to assess the level and management of interest rate risk exposure.

EC 1	Principle 23: Interest rate risk in the banking book
Criterion	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.
Legal Framework	Compliance with the interest rate exposure provisions of the interagency safety-and-soundness guidelines necessitates the development and adoption by the board of a strategy and policies and processes for identifying, measuring, monitoring, and

[195] The OCC is currently in the process of integrating its rules, policies and handbooks applicable to national banks and Federal savings associations. At this time not all rules, policies and handbooks may have been updated; however, throughout this Principle where appropriate in the context, references to banks, with regard to national banks should be construed to be generally be applicable to Federal savings associations.
[196] *See* FRB SR letter 96-13; FDIC: FIL-52-96; *see also Comptroller's Handbook, Interest Rate Risk* (June 1997).
[197] *See* FRB SR letter 10-1, OCC Bulletin 2010-1, FDIC: FIL 2-2010.
[198] *See* FRB SR letter 12-2, OCC Bulletin 2012-5, FDIC: FIL 2-2012.

EC 1	Principle 23: Interest rate risk in the banking book
	controlling interest rate risk. Consistent with principles of safety-and-soundness outlined above, it is expected that strategy and policies would be reviewed and revised appropriately to reflect an organization's changing risk profile.
Practices and Procedures	The U.S. federal banking agencies have a principals-based approach to interest rate risk examinations and rely on the interagency policy statement from 1996, the 2010 interagency Advisory on Interest Rate Risk Management[199], and the FAQs on 2010 Interagency Advisory on Interest Rate Risk Management. The agencies 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. Examiners utilize the interagency policy statement from 1996 and advisory from 2010 to assess the quality of risk management. The following is evaluated and considered in the overall S component and management comments in the CAMELS scheme: • 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. federal banking agencies to prescribe standards for banks, savings associations and holding companies relating to interest rate exposure. *See* 12 U.S.C. § 1831p-1(a)(1)(D). The interagency safety-and-soundness guidelines specify that a bank should (a) manage interest rate risk in a manner appropriate to the size and

[199] *See* interagency Advisory on Interest Rate Risk January 6, 2010 and FAQ issued January 12, 2010

EC 1	Principle 23: Interest rate risk in the banking book
	complexity of its assets and liabilities and (b) 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. *See* 12 CFR 208, appendix D-1, § II(E), 12 CFR 30, appendix A § II(E) (OCC), 12 CFR 364, Appendix A § II(E) (FDIC). Interest rate risk management also is integral to ensuring compliance with regulatory capital standards imposed under 12 U.S.C. §§ 1831o and 3907 and the interagency capital rules, *see* 12 CFR 208, appendixes A, E, and F (FRB); and 12 CFR 3.402 and 12 CFR part 3 (OCC) (national banks) and 12 CFR parts 324, subject to timing, 325, and 390, subpart Z (FDIC) (state nonmember banks and state savings associations). Interest rate risk is 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 risk in the banking book are repricing risk, yield curve risk, basis risk, and the option features embedded in many financial instruments.

EC 2	Principle 23: Interest rate risk in the banking book
Criterion	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.
Legal Framework	*See* response to EC 1 above. Compliance with the interest rate exposure provisions of the interagency safety-and-soundness guidelines necessitates the development and adoption by the board of a strategy and policies and processes for identifying, measuring, monitoring, and controlling interest rate risk.
Practices and Procedures	As stated in the Joint Agency Policy Statement: Interest Rate Risk and the interagency Advisory on Interest Rate Risk, 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 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: • Appropriate policies, procedures and internal controls addressing IRR management, including limits and controls over risk taking to stay within board-approved tolerances;

EC 2	Principle 23: Interest rate risk in the banking book
	• Comprehensive systems and standards for measuring IRR, valuing positions, and assessing performance, including procedures for updating IRR measurement scenarios and key underlying assumptions driving the institution's IRR analysis; and, • Sufficiently detailed reporting processes to inform senior management and the board of the level of IRR exposure." In assessing the strategy, policies, procedures and processes for the identification, measurement, monitoring, and control of interest rate risk, U.S. federal banking supervisors perform off-site risk assessments and on-site examinations. While each U.S. federal banking agency utilizes their own examination procedures and guidance for their supervised banks and holding companies[200], the guidance remains consistent across the agencies. For example, the agencies' 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[201].

EC 3	Principle 23: Interest rate risk in the banking book
Criterion	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: (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

[200] See the FRB's CBEM - section 4090 and the Trading and Capital Markets Activities Manual - section 3010; see *Comptroller's Handbook, Interest Rate Risk* (June 1997); *Comptroller's Handbook: Community Bank Supervision* (January 2010); *Comptroller's Handbook: Large Bank Supervision* (updated May 2013); see the FDIC's Risk Management Manual of Examination Policies - section 7.1.

[201] Interagency guidance notes that limits and measurements of interest rate risk should address the potential impact of changes in market interest rates on both a bank's and holding company's reported earnings and economic value of equity (EVE). From an earnings perspective, a bank and holding company should explore limits on net income as well as net interest income. A bank's and holding company's EVE limits should reflect the size and complexity of its underlying positions. For non-complex banks and holding companies, simple limits on permissible holdings or allowable repricing mismatches in intermediate- and long-term instruments may be adequate. At more complex banks and holding companies, more extensive limit structures may be necessary.

EC 3	Principle 23: Interest rate risk in the banking book
	(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.
Legal Framework	See response to EC 1above.
Practices and Procedures	The interest rate exposure provisions of the interagency safety-and-soundness guidelines require banks and holding companies to establish policies and procedures for assessing the level of interest rate risk and for reporting on interest rate risk to the board of directors and management. Banks and holding companies, as appropriate to their size and level of sophistication of operations, are required to establish comprehensive interest rate risk measurement systems and regularly validate any models and assumptions. The Interagency Advisory on Interest Rate Risk Management discussed the above requirements and stated "limit controls should be in place to ensure positions that exceed certain predetermined levels should receive prompt management attention." U.S. federal banking supervisors confirm that the board and senior management ensure that the level of interest rate risk is effectively managed and that appropriate policies and practices are established to control and limit risks. Also, supervisors review policies to ensure they include the delineations of clear lines of responsibility and authority for identifying the potential interest rate risk arising from existing or new products or activities; establishing and maintaining an interest rate risk measurement system; formulating and executing strategies to manage interest rate risk exposures; and authorizing policy exceptions. Also, supervisors confirm that the specific procedures and approvals are necessary for exceptions to policies, limits, and authorizations and that all interest rate risk policies are defined, periodically reviewed and revised as needed. In addition, U.S. federal banking agency guidance outlines the need for banks and holding companies to have a system for identifying and measuring interest rate risk; a system for monitoring and controlling interest rate risk exposures; and a system of internal controls, reviews, and audits to ensure the integrity of the overall risk-management process. The Joint Agency Policy Statement: Interest Rate Risk and the interagency Advisory Statement on Interest Rate Risk also require an independent review of an interest rate model by a person(s) independent of the model function and savings associations are encouraged to have their risk-measurement systems reviewed by knowledgeable outside parties. In order to evaluate the bank's or holding company's risk-measurement systems and interest rate risk exposures, supervisors utilize examination procedures which are incorporated in the respective agencies guidance. The procedures direct supervisors to review and assess the data inputs and data integrity; to review and assess the model assumptions and methodology; and determine if there are appropriate controls and if the assumptions are regularly reviewed. The procedures also call for supervisors to evaluate the model's structure and capabilities to determine if the model is adequate to accurately assess the risk exposure of the banking organization; to support the bank's and holding company's risk-management process; and serve as a basis for internal limits and authorizations. The FRB and OCC have addressed the use of models, with particular focus on model validation. *See* OCC Bulletin 2011-12 (Sound Practices for Model Risk Management) and SR Letter 09-01 (highlighting various concepts pertinent to model risk management, including standards for validation and review, model validation documentation, and back-testing). The FRB's *Trading and Capital-*

EC 3	Principle 23: Interest rate risk in the banking book
	Markets Activities Manual also discusses validation and model risk management. Based on supervisory and industry experience, the FRB and OCC have expanded upon existing guidance—most importantly by broadening the scope to include other key aspects of model risk management. *See* SR 11-7. The new guidance also outlines the core elements of the validation process.

EC 4	Principle 23: Interest rate risk in the banking book
Criterion	The supervisor requires banks to include appropriate scenarios into their stress testing programmers to measure their vulnerability to loss under adverse interest rate movements.
Legal Framework	The agencies developed coordinated rules establishing a framework for conducting annual stress tests that implement forward looking evaluations of large banks, savings associations, BHCs and nonbank financial companies and requiring these companies to annual company-run stress tests. *See* 12 CFR parts 46 (OCC), 252.151 et seq. (FRB), and 325.206 (FDIC) (annual stress testing rules); See also, *Guidance on Stress Testing for Banking Organizations with Total Consolidated Assets of more than $10 Billion* (FRB SR Letter 12-7; FDIC Financial Institution Letter FIL-47-2011; OCC Bulletin 2012-14) and *Supervisory Guidance on Dodd-Frank Act Company-Run Stress Testing for Banking Organizations with Total Consolidated Assets of More than $10 Billion10Billion but Less than $50 Billion* (FRB SR Letter 14-3; OCC Bulletin 2014-5; 79 FR 14153 (March 13, 2014) (FDIC). It is expected that banks and holding companies would include appropriate scenario analysis of their vulnerability to interest rate risks in their internal company stress tests as applicable and consistent with the nature and scope of their operations.
Practices and Procedures	U.S. federal banking agencies agree that the bank's or holding company's management should include both scenario and sensitivity analysis, as an integral component of IRR management. In general, scenario analysis uses the 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[202]. When conducting scenario analyses, institutions are expected to assess a range of alternative future interest rate scenarios in evaluating IRR exposure. This range should 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 IRR exposure. As a result, institutions should regularly assess IRR 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 should ensure their scenarios are severe but plausible in light of the existing level of rates and the interest rate cycle. For example, in low-rate environments, scenarios involving significant declines in market rates can be deemphasized in favor of increasing the number and size of alternative rising-rate scenarios. Depending on an institution's IRR profile, stress scenarios should include but not be limited to:

[202] Basel Committee on Banking Supervision, "Principles for Sound Stress Testing Practices and Supervision," May 2009.

EC 4	Principle 23: Interest rate risk in the banking book
	• 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).

EC 5	Principle 23: Interest rate risk in the banking book
Additional Criterion	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.
Legal Framework	Under the U.S. federal banking agencies' statutory examination authority, supervisors may review all books and records maintained by a bank (and its affiliates) subject to the agencies' supervision. This includes access to the employees involved in a matter under review and bank service companies and independent servicers that are subject to the Bank Service Company Act. The agencies also evaluate significant third-party service providers (the U.S. federal banking agencies may exercise its authority under 12 U.S.C. § 1867(c) to examine a third-party service provider). The agencies require banks and holding companies, in their contracts with third-party service providers, to include agency access to the books, records, and operations of these entities. (*FFIEC Information Technology Examination Handbook*). Also, section 5 of the Bank Holding Company Act of 1956, which authorizes the FRB to examine each BHC and nonbank subsidiary thereof; section 7 of the International Banking Act of 1978, which authorizes the FRB to examine each branch or agency of a foreign bank; and Section 25(a) of the Federal Reserve Act and Section 211.7 of Regulation K, which authorize the FRB to examine Edge and agreement corporations. The FRB has authority under the Home Owners' Loan Act to examine each SLHC and its savings associations and other subsidiaries. *See* 12 U.S.C. § 1467a(b)(4).
Practices and Procedures	The U.S. federal banking agencies utilize 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 repricing 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. At the largest banks and holding companies, the agencies maintain on-site examination staffs who receive more detailed information on those banks' and holding companies' portfolios and risk exposures. 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. 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 IRR associated with its assets, liabilities, and off-balance-sheet positions

EC 5	Principle 23: Interest rate risk in the banking book
	over an appropriate range of interest rate scenarios; use generally accepted financial concepts and risk-measurement techniques; and have well documented assumptions and parameters.

EC 6	Principle 23: Interest rate risk in the banking book
Additional Criterion	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book**.**
Legal Framework	Consistent with longstanding practice, supervisory assessment of capital adequacy will take into account whether the banking organization plans to appropriately maintain an adequate level of capital given its activities and risk profile, as well as risks and other factors that can affect a banking organization's financial condition, including, for example, the level and severity of problem assets and its exposure to operational and interest rate risk, and significant asset concentrations. *See* 12 CFR parts 208, 217, and 225 (FRB); 12 CFR parts 3, 5, 6, 165, and 167 (OCC) 12 CFR parts 324, 325, and 390, subpart Z (FDIC); *see* also 78 Fed. Reg. 62018 (Oct. 11, 2013) and 79 Fed. Reg. 20754 (April 14, 2014). The FRB also has implemented capital planning requirements for large BHCs that require identification of the company's material changes in their risk profile since they adopted their plans. In considering whether a change is material the company will be required to consider a variety of risks, including credit, market, operational, liquidity, and interest rate risks. *See* 12 CFR 225.8; 76 Fed. Reg. 74631. Guidance on capital planning for banks similarly direct formal plans to regularly assess capital adequacy and to ensure that capital levels remain adequate not just at a point in time, but over time, and recognizes both short- and longer-term capital needs in relation to a variety of risks, including interest rate risk. *See* OCC Bulletin 2012-16 (Guidance for Evaluating Capital Planning and Adequacy).
Practices and Procedures	The 1996 Joint Agency Policy Statement: Interest Rate Risk (*footnote 3*) 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.

Assessment of Principle 23	Compliant
Comments	

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.

(Reference documents: *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013); *Basel III: International framework for liquidity risk measurement, standards and monitoring*, (December 2010); and *Principles for Sound Liquidity Risk Management and Supervision*, (September 2008).)

Overview

Liquidity risk has been a primary concern and an important component of the supervisory efforts of the U.S. federal banking agencies because effective liquidity risk management is essential to ensuring the safety and soundness of banks[203] and holding companies. The U.S. federal banking agencies expect banks and holding companies, at a minimum, to implement liquidity management programs that (a) assess, on an ongoing basis, the current and expected future needs for funds and ensure that sufficient funds or access to funds exist to meet those needs at the appropriate time; (b) provide for an adequate cushion of liquidity to meet cash-flow needs that range from high-probability/low-severity events that occur in daily operations to low-probability/high severity events that occur less frequently but could significantly affect a bank or holding company's safety and soundness; and (c) strike an appropriate balance between the benefits and costs of holding liquid assets to mitigate potential adverse events. The primary role of liquidity risk management is to prospectively assess the need for funds to meet obligations and to ensure that sources of cash or collateral are available to fulfill those needs at the appropriate time. Failure to implement and enforce adequate liquidity risk management can trigger an enforcement action and an array of other remedial measures.

Safety and soundness and enhanced prudential standards statutes and supervisory guidance provide the legal basis for the imposition and enforcement of liquidity-risk management requirements by the U.S. federal banking agencies. *See* for safety and soundness: 12 U.S.C. § 1831p-1, § 1844, § 1467a and 12 CFR parts 30, 225, 208, 364 (Appendix A), and 584, and for enhanced prudential standards for bank holding companies (BHCs) and foreign banking organizations, see 12 U.S.C. § 5365 and 12 CFR part 252. Specific expectations are enumerated in supervisory guidance listed below. This guidance incorporates many international standards and principles for liquidity risk management from the Basel Committee on Banking Supervision's ("BCBS") *Sound Practices for Managing Liquidity in Banking Organizations* (February 2000), *Principles for Sound Liquidity Risk Management and Supervision* (September 2008), *Basel III: International framework for liquidity risk measurement, standards and monitoring*, (December 2010); *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013) ("Basel III LCR"), *Frequently Asked Questions on Basel III's January 2013 Liquidity Coverage Ratio* (April 2013), and the Net Stable Funding Ratio ("NSFR") consultative document (January 2014).

In March 2010, the U.S. federal banking agencies issued guidance titled *The Interagency Policy Statement on Funding and Liquidity Risk*

[203] For purposes of this document, the term "bank" refers to banks, savings associations, and other depository institutions subject to the jurisdiction of the U.S. federal banking agencies.

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Management (75 FR 13656 (March 22, 2010)) ("Liquidity Risk Policy Statement"). The Liquidity Risk Policy Statement incorporates elements of the BCBS's *Principles for Sound Liquidity Risk Management and Supervision* ("Basel Liquidity Principles") and is supplemented by other liquidity risk management principles previously issued by the U.S. federal banking agencies. Existing supervisory guidance can be found in various agency publications. For national banks and federal savings associations, *see* the *Liquidity, Community Bank Supervision, and Large Bank Supervision* booklets of the Comptroller's Handbook series. For state member banks, BHCs, and savings and loan holding companies (SLHCs), *see* the Federal Reserve's *Commercial Bank Examination Manual* - section 4020.1; *Bank Holding Company Supervision Manual* - section 4010; and *Trading and Capital Markets Activities Manual* - section 3005.1 & appendixes (Trading Manual). For state non-member banks and state savings associations, *see* the FDIC's *Risk Management Manual of Examination Policies* -- section 6.1 Liquidity and Funds Management. The Federal Reserve similarly evaluates holding companies' management of liquidity risk. The Liquidity Risk Policy Statement specifies supervisory expectations for fundamental liquidity risk management practices, including a comprehensive management process for identifying, measuring, monitoring, and controlling liquidity risk. It also emphasizes the central role of corporate governance, cash-flow projections, stress testing, ample liquidity resources, and formal contingency funding plans as necessary tools for effectively measuring and managing liquidity risk.

Additionally, the Federal Reserve adopted Regulation YY (12 CFR part 252) to implement the enhanced prudential standards required to be established under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") (12 U.S.C. § 5365) for BHCs, including foreign-based BHCs, with total consolidated assets of $50 billion or more (covered companies). These enhanced prudential standards included requirements related to liquidity risk management and liquidity sufficiency. The Regulation YY liquidity requirements, which come into effect in 2015 for the relevant domestic BHCs and 2016 for the relevant foreign banking organizations, provide a regulatory framework for large banking institutions to establish and maintain robust liquidity risk management practices, perform internal stress tests for determining the adequacy of liquidity resources, and maintain a buffer of highly liquid assets to cover cash flow needs over a 30 day stress period, or 14 days in the case of a branch of a foreign banking organization operating in the United States.

In October 2013, the U.S. federal banking agencies issued a proposed rule that would implement a liquidity coverage ratio ("LCR") requirement, consistent with the Basel III LCR, for large, internationally active banking organizations, nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for Federal Reserve supervision that do not have substantial insurance activities, and their consolidated subsidiary depository institutions with total assets greater than $10 billion (78 FR 71818 (November 29, 2013)). Currently, the U.S. federal banking agencies are working toward issuing a final rule implementing the LCR.

Lastly, the U.S. federal banking agencies adhere to the Uniform Financial Institution Rating System (UFIRS), and U.S. federal banking supervisors evaluate every bank against UFIRS guidelines. UFIRS has a component to rate Liquidity (L) in the CAMELS ratings. Liquidity is also evaluated in the financial component of the holding company ratings system[204]. U.S. federal banking supervisors consider the current level and prospective sources of

[204] See Federal Reserve SR 04-18, www.federalreserve.gov/boarddocs/press/bcreg/2004/20041201/attachment.pdf. See also, *Comptroller's Handbook; Bank Supervision Process* (updated May 2013), and *Comptroller's Handbook; Liquidity* (June 2012).

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liquidity compared to 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 during each full scope examination. Factors evaluated by an institution's primary federal supervisor when rating liquidity include, but are not limited to:

- The adequacy of liquidity sources compared to present and future needs and the ability of a bank and holding company to meet liquidity needs without adversely affecting its operations or condition;
- The availability of assets readily convertible to cash without undue loss;
- The ability to access money markets and other sources of funding;
- The level of diversification of funding sources, both on- and off-balance sheet;
- The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer term assets;
- The trend and stability of deposits;
- The ability to securitize and sell certain pools of assets; and
- The capability of management to properly identify, measure, monitor, and control the bank's and holding company's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

Each federal banking agency evaluates a bank or holding company's liquidity risk and risk-management systems as part of its ongoing supervisory programs. The Federal Reserve has proposed enhanced liquidity reporting requirements for large, internationally active banking organizations to banking supervisors (*See* 78 Fed. Reg. 57634 (September 19, 2013)) and has been conducting coordinated horizontal examinations of liquidity risk across several large BHCs.

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Criterion	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.
Legal Framework	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. federal banking agencies. *See* 12 U.S.C. § 1831p-1, § 1844, § 1467a and 12 CFR parts 30, 225, 208, 364 (Appendix A), and 584. In addition, section 165 of the Dodd-Frank Act requires the Federal Reserve to establish enhanced liquidity standards (among other enhanced prudential standards) for BHCs with more than $50 billion in total consolidated assets, as well as nonbank financial companies designated by the FSOC for supervision by the Federal Reserve. These enhanced liquidity standards must be more stringent than those standards applicable to other BHCs and to nonbank financial companies that do not present similar risks to U.S. financial stability. *See* 12 U.S.C. 5365(a).

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	The U.S. federal banking agencies have issued final guidance through the Liquidity Risk Policy Statement that summarizes the principles of sound liquidity-risk management that the U.S. federal banking agencies have established as supervisory expectations and reflect, where appropriate, the Basel Liquidity Principles. The Liquidity Risk Policy Statement applies to all depository institutions and BHCs. The U.S. operations of foreign banking organizations are also expected to follow the principles set forth in the guidance. The guidance articulates the process banking organizations should follow in appropriately identifying, measuring, monitoring, and controlling their funding and liquidity risks, including cash flow projections, diversified funding sources, stress testing, a cushion of liquid assets, and a formal, well-developed contingency funding plan as primary tools for measuring and managing funding and liquidity risks. Other supervisory guidance related to liquidity and liquidity risk management can be found in the following publications: For national banks, see the *Liquidity, Community Bank Supervision and Large Bank Supervision* booklets of the Comptroller's Handbook series. For state member banks and BHCs, see the Federal Reserve's *Commercial Bank Examination Manual* - section 4020.1; *Bank Holding Company Supervision Manual* - section 4010; and *Trading and Capital Markets Activities Manual* - section 3005.1 & appendixes (Trading Manual). For state non-member banks, *see* the FDIC's *Risk Management Manual of Examination Policies* – Section 6.1 Liquidity and Funds Management. *See also* SR 12-7 *Supervisory Guidance on Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets* (May 14, 2012). As noted above, the Federal Reserve has implemented the enhanced liquidity standards for covered companies required by section 165 of the Dodd-Frank Act through Regulation YY.[205] Covered foreign banking organizations with combined U.S. assets of $50 billion or more must apply the enhanced liquidity standards to their U.S. operations (in part to an intermediate holding company in the U.S., which is also a requirement under the rule, and in part to their U.S. branches) similar to those applicable to U.S. BHCs.[206] As discussed above in the overview, Regulation YY is effective June 14, 2014, and has various transition periods. *See* 12 CFR part 252. The enhanced liquidity standards in Regulation YY that apply to U.S. BHCs (and some foreign banking organizations) incorporate many aspects of the Liquidity Risk Policy Statement as regulatory requirements, with some enhancements for liquidity risk management and the contingency funding plan in particular. *Se*e 12 CFR 252.34 and 12 CFR 252.156. In addition, Regulation YY requires these institutions to conduct internal liquidity stress tests at regular intervals that incorporate adverse market and idiosyncratic liquidity scenarios over different planning horizons. These institutions must hold a buffer of highly liquid assets that would, if liquidated, cover the net outflows estimated under the internal stress tests over a 30-day planning horizon (or the first 14

[205] The Federal Reserve did not subject nonbank financial companies it supervises to the enhanced liquidity standards at the time of adoption of Regulation YY. The Federal Reserve intends thoroughly to assess the business model, capital structure, and risk profile of the designated company to determine how the proposed enhanced prudential standards should apply, and if appropriate, would tailor application of the standards by order or regulation to that nonbank financial company or to a category of nonbank financial companies. *See* 79 FR 17240, 17245 (March 27, 2014).

[206] Other foreign banking organizations that are subject to the rule but with less than $50 billion in combined U.S. assets must report to the Federal Reserve the results of internal liquidity stress tests that are consistent with the Basel Liquidity Principles

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	days of the horizon, for U.S. branches of foreign banking organizations subject to this requirement). *See* 12 CFR 252.35 and 12 CFR 252.157. The U.S. federal banking agencies are also in the process of implementing in the United States an LCR requirement consistent with the Basel III LCR (as modified).[207] On November 29, 2013, the U.S. federal banking agencies jointly published a proposed rule to implement an LCR requirement in the United States (proposed rule or proposed LCR). The proposed rule would apply to all internationally active banking organizations (depository institutions, BHCs, and those SLHCs 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. *See* 78 Fed. Reg. 71818, 71859. 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. *See* 78 Fed. Reg. 71818, 71860. 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. 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 BHCs and SLHCs that are not internationally active, but have $50 billion or more in total consolidated assets. *See* 78 FR 71818 (November 29, 2013).
Practices and Procedures	The supervisory process of the U.S. federal banking agencies includes a review of bank compliance with the liquidity laws, regulations, and guidance described in the overview section above. Among these laws, regulations, and guidance, the U.S. federal banking agencies have implemented requirements prescribed by the BCBS in an equivalent, and in certain areas, in a more stringent manner. The frequency of the supervision conducted by the U.S. federal banking agencies varies depending on the size and complexity of the institution in question. More frequent supervisory examination occurs with larger and more complex institutions. Subjecting banks to this recurring supervision requires that they maintain policies and procedures for internal liquidity risk monitoring to identify and address any degree of noncompliance. In fact, some of the laws, regulations, and guidance contain corporate governance provisions pertaining to a bank's management of its liquidity risk.

[207] *See Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2014).

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Criterion	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.
Legal Framework	U.S. BHCs and foreign banking organizations with significant U.S. operations that 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 liquidity risk of the company is within the liquidity risk tolerance established by the board of directors. *See* 12 CFR 252.34(e) and 12 CFR 252.156(d). 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 (or U.S. operations). 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 (or U.S. operations). *See* 12 CFR 252.35(a) and 12 CFR 252.157(a). As explained above, 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. *See* 12 CFR 252.35 and 12 CFR 252.157. In addition, under the Liquidity Risk Policy Statement, banks and BHCs 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 BHCs 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. *See* Liquidity Risk Policy Statement, pp. 4-8. In addition, under the proposed LCR, banking organizations and other institutions subject to the 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. *See* 78 Fed. Reg. 71818, 71862-71865 (November 29, 2013). In September, 2013, the Federal Reserve proposed two new reporting forms to facilitate on going supervisory efforts with respect to liquidity risk management issues: 1) the "Complex Institution Liquidity Monitoring Report" (From FR 2052a) and 2) the "Liquidity Monitoring report" (Form FR 2052b). These new reports will facilitate additional information on the firm's liquidity risk profile.
Practices and Procedures	The U.S. federal banking agencies' historical approach to supervising liquidity risk has been qualitative in nature – focusing on sound practices instead of specific quantitative standards and tests. However, the U.S. federal banking agencies are in the process of

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	finalizing the LCR for larger banking organizations, a quantitative liquidity risk metric consistent with the Basel III LCR, to supplement qualitative evaluations of institutions' liquidity risk. As it pertains to the qualitative aspects of liquidity risk supervision, U.S. federal banking agencies do not have a one-size-fits-all standard for assessing liquidity risk. In general, U.S. federal banking 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. federal banking agencies assess each bank and holding company's liquidity as part of the UFIRS or holding company rating systems. The rating system directs that: "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." 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 U.S. federal banking agencies 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 ("SPOE") approach under Dodd-Frank Act's Title II – FDIC resolution planning. The U.S. federal banking agencies' regulatory Call Reports collect information on each bank and holding company's liability and deposit mix, including information on deposit maturities and repricing 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. In addition, the daily 4-G reports represent an important vehicle for collecting funding and liquidity data for banks and BHCs.

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	As part of its supervision, the Federal Reserve has collected detailed daily liquidity information from the most systemically important institutions that includes funding risks as well as liquidity buffers. For firms that are less systemically important but have greater than $50 billion in total assets, the Federal Reserve has collected monthly liquidity information that is less detailed than the reports from the most systemically important institutions, but still provides information on each firm's unencumbered liquidity buffer and funding structure.

EC 3	Principle 24: Liquidity risk
Criterion	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' board of directors. 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.
Legal Framework	Regulation YY requires companies 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 of a company subject to the rule (or the U.S. risk committee, in the case of foreign banking organizations) must establish the liquidity risk tolerance for the company (or the U.S. operations). Senior management must establish and implement strategies, policies and procedures designed to effectively manage the liquidity risk of the company (or U.S. operations in the case of foreign banking organizations) and determine whether the company (or U.S. operations) is operating in accordance with those policies and procedures. *See* 12 CFR 252.34(c) and 12 CFR 252.156(b). Senior management (or the U.S. chief risk officer) 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 (or U.S. risk committee) 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. *Se*e 12 CFR 252.34(a), (c) and 12 CFR 252.156 (a), (b). As discussed above, under Regulation YY, companies subject to the rule (except for foreign banking organizations with less than $50 billion in total U.S. assets) must conduct internal liquidity stress tests in accordance with the rule and must hold liquid assets sufficient to cover net outflows over 30 days as identified by the stress tests. Similarly, the Liquidity Risk Policy Statement establishes the supervisory expectation that banks and BHCs 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. *See* Liquidity Risk Policy Statement, p. 3. In addition, as discussed

EC 3	Principle 24: Liquidity risk
	above, under the guidance, banks and BHCs are expected to conduct liquidity stress tests and adjust their liquidity position taking into account the results of those tests. 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. *See* 78 Fed. Reg. at 71861.
Practices and Procedures	Through a combination of ongoing monitoring and an annual comprehensive liquidity assessment review (CLAR), U.S. federal banking agencies 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. 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. 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. For institutions subject to the enhanced liquidity requirements in Regulation YY, the rule provides that they 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.

EC 4	Principle 24: Liquidity risk
Criterion	The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including: (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;

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	(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.
Legal Framework	As discussed in EC 3, Regulation YY requires a robust and comprehensive liquidity risk management framework that requires the board of directors (or U.S. risk committee in the case of foreign banking organizations) to establish a liquidity tolerance for the company (or U.S. operations) and requires policies and procedures to conform to that liquidity risk tolerance. Also as discussed in EC 3, the board of directors or U.S. risk committee 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. *See* 12 CFR 252.34(d), 12 CFR 252.156(c). 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 (or U.S. operations') funding position. *See* 12 CFR 252.34 (g), (h) and 12 CFR 252.156 (f), (g). With regard to intraday risk, Regulation YY provides that procedures must be established and maintained for monitoring intraday liquidity risk exposure of the company (or U.S. operations). 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. *See* 12 CFR 252.34 (h)(3) and 12 CFR 252.156(g)(3). Similarly, as discussed in EC 3, under the Liquidity Risk Policy Statement, banks and BHCs are expected 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 institution. 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 BHCs are expected to clearly identify the individual or committees responsible for implementing and making liquidity risk decisions. *See* Liquidity Risk Policy Statement pp. 3-4.

EC 4	Principle 24: Liquidity risk
	Under the Liquidity Risk Policy Statement, 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 actively manage their intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under normal and stressed conditions. *See* Liquidity Risk Policy Statement, pp. 7-8. The Federal Reserve has also proposed supervisory liquidity reporting requirements to facilitate the effective monitoring by institutions and supervisors of the liquidity risk of larger BHCs (U.S. BHCs with $50 billion or more in total consolidated assets and FBOs with large U.S. broker dealer subsidiaries). *See* 78 Fed. Reg. 57634 (September 19, 2013).
Practices and Procedures	In the Liquidity Risk Policy Statement, the U.S. federal banking agencies articulate the process that institutions should follow to appropriately identify, measure, monitor, and control their funding and liquidity risk. The statement sets forth the expectation that institutions manage liquidity risk using processes and systems that are commensurate with the institution's complexity, risk profile, and scope of operations. Liquidity risk management processes and plans should be well documented and available for supervisory review. Moreover, the Liquidity Risk Policy Statement provides that an institution's board of directors is ultimately responsible for the liquidity risk assumed by the institution. As a result, the board should ensure that the institution's liquidity risk tolerance is established and communicated in such a manner that all levels of management clearly understand the institution's approach to managing the trade-offs between liquidity risk and short-term profits. The Liquidity Risk Policy Statement also provides that processes should be in place to ensure that senior management actively monitors and quickly responds to all material liquidity developments and reports them to the boards of directors as appropriate. The U.S. federal banking agencies evaluate these processes as part of the supervisory activities described in the Overview. Failure to maintain an adequate liquidity risk management process is considered an unacceptable practice and will result in supervisory action. The U.S. federal banking agencies expect that institutions will meet liquidity requirements and guidance on a continual basis. If the institution is exposed to intraday liquidity risk, that institution must have the processes and procedures in place to make sure that risk is being handled appropriately. The U.S. federal banking agencies have increased data collection requirements on many institutions, especially the largest institutions. Data collection on the largest institutions occurs on a daily basis. Once the proposed LCR has been finalized, it is expected that additional data relevant to liquidity will be collected by institutions and provided to regulators. For large institutions, Regulation YY requires that the board of directors must establish the liquidity risk tolerance at least annually. The regulation also provides that this liquidity risk tolerance should reflect the board of directors' assessment of tradeoffs between the costs and benefits of liquidity, and should be articulated in a way that all levels of management can clearly understand and properly apply the articulated approach to all aspects of liquidity risk management throughout the organization. Regulation YY

EC 4	Principle 24: Liquidity risk
	liquidity requirements provide that the board of directors oversee the company's liquidity risk management processes, and to review and approve the liquidity risk management strategies, policies, and procedures established by senior management.

EC 5	Principle 24: Liquidity risk
Additional Criterion	The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing 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: (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.
Legal Framework	Regulation YY requires U.S. BHCs subject to the rule and covered foreign banking organizations with more than $50 billion in total U.S. assets 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. Regulation YY requires that the contingency funding plan include identification of liquidity stress events and their potential impact on the company's liquidity (or U.S. operations), 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. *See* 12 CFR 252.34(f) and 12 CFR 252.156(e). As discussed above, Regulation YY also requires U.S. BHCs subject to the rule and foreign banking organizations with more than $50 billion in total U.S. assets 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

EC 5	Principle 24: Liquidity risk
	related to the risk of the company, except with respect to U.S. Treasuries and securities issued by U.S. government-sponsored entities. *See* 12 CFR 252.35(b) and 12 CFR 252.157(c). In addition, Regulation YY provides that assets used as cash flow sources during a liquidity stress test planning horizon must be diversified. In addition, the fair value of the asset must be discounted to reflect any credit risk and market volatility of the asset. As discussed above, under the Liquidity Risk Policy Statement, banks and BHCs are expected to establish a funding strategy that provides effective diversification in the sources and tenor of funding. Institutions should maintain an ongoing 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. *See* Liquidity Risk Policy Statement, p.9. In addition, under the Liquidity Risk Policy Statement, banks and BHCs are expected to maintain a buffer of highly liquid assets available to be sold or pledged to obtain funds in a range of stress scenarios. *See* Liquidity Risk Policy Statement, p 10. 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. *See* Liquidity Risk Policy Statement, pp. 10-14. As discussed above, the proposed LCR would also require those institutions that would be subject to the rule 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, the proposed LCR would require that assets in the buffer be diversified and that an institution have the operational capacity to monetize the assets during a crisis by implementing and maintaining appropriate procedures and systems for monetization and by periodically testing access to the market through actual monetization of a sample of the assets held in the buffer. *See* 78 Fed. Reg. at 71861.
Practices and Procedures	The U.S. federal banking agencies 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, the U.S. federal banking 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. For the largest banks and holding companies, the

EC 5	Principle 24: Liquidity risk
	U.S. federal banking agencies maintain on-site examination teams that review and assess a variety of risk management and funding reports on an ongoing basis. 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. As indicated in the U.S. federal banking agencies' examination manuals, 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. The Liquidity Risk Policy Statement provides 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. As discussed above, 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. Lastly, under the proposed LCR, institutions subject to the rule 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 monetize a representative sample of high-quality liquid assets in order to demonstrate that they are under management control and liquid and readily marketable. The U.S. federal banking agencies anticipate that they will propose regulatory reporting requirements, which will provide supervisors with additional data related to liquidity risk management. The Liquidity Risk Policy Statement provides that 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 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. Regulation YY also requires that the buffer of unencumbered highly liquid assets be sufficiently diversified

EC 5	Principle 24: Liquidity risk
	by instrument type, counterparty, geographic market, and other liquidity risk identifiers for institutions subject to the enhanced liquidity requirements under that rule. The Liquidity Risk Policy Statement provides that institutions should maintain an ongoing presence in their chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources.

EC 6	Principle 24: Liquidity risk
Criterion	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.
Legal Framework	As discussed in EC 5, Regulation YY requires U.S. BHCs subject to the rule and covered foreign banking organizations with more than $50 billion in total U.S. assets to establish comprehensive and robust contingency funding plans that meet this criterion. Refer to EC 5 for a description of those requirements and see 12 CFR 252.34(f) and 12 CFR 252.156(e). In addition, as discussed in EC 5, the Liquidity Risk Policy Statement sets forth a comprehensive set of supervisory expectations for contingency plans that all banks and BHCs are expected to establish. *See* the discussion of these expectations in EC 5 and Liquidity Risk Policy Statement, pp. 10-14. The proposed LCR prescribes a process for reporting when a covered company falls below the minimum liquidity coverage ratio. Also, for large banks, strategy for addressing liquidity shortfalls is an important component of the DFA Title I Resolution Plan.
Practices and Procedures	Consistent with Regulation YY (in the case of institutions subject to the rule) and the Liquidity Risk Policy Statement, U.S. federal banking agencies expect banks and holding companies to have an appropriate contingency funding plan ("CFP") in place. Supervisors review and assess a bank's or holding company's CFP during examinations. These assessments consider whether the CFP 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 CFP is commensurate with the complexity, risk profile, and scope of operations of the bank and holding company and aligned with its

EC 6	Principle 24: Liquidity risk
	business and risk-management objectives, strategies, and tactics. Supervisors confirm that senior management periodically reviews the CFP 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 CFP with the bank's and holding company's liquidity risk management efforts for disaster, contingency, and strategic planning. The CFP should also provide a reasonable timeframe to monetize the liquidity buffer and address intercompany transactions. 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 or the BHC's subsidiary depository institution(s) to be less than "well capitalized" for purposes of the U.S. federal banking agencies' Prompt Corrective Action (PCA) regulatory scheme (*See* 12 U.S.C. § 1831o). For example, a bank that relies upon brokered deposits should also incorporate PCA-related downgrade triggers into its CFP 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, 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. 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. *See* 12 U.S.C. § 1831o(e). 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. *See* section 29 of the FDI Act, 12 U.S.C. § 1831f. Critically undercapitalized banks generally may not borrow from the discount window. *See* 12 U.S.C. § 1831o, as well as Principle 23.

EC 7	Principle 24: Liquidity risk
Criterion	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 programmes 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.
Legal Framework	As discussed above in EC 2, Regulation YY requires U.S. BHCs subject to the rule and covered foreign banking organizations with more than $50 billion in total U.S. assets to conduct internal liquidity stress tests at least monthly. The stress tests must take into consideration various aspects of the company and its activities (or U.S. operations) 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 (or U.S. operations). The company must also establish controls and oversight that ensure that

EC 7	Principle 24: Liquidity risk
	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 profile, complexity, activities, size, business lines, legal entity or jurisdiction, and other relevant factors of the company (or the U.S. operations). *See* 12 CFR 252.35(a) and 12 CFR 252.157(a). 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. *See* 12 CFR 252.34 (f)(2)(i)(F) and 12 CFR 252.156 (e)(2)(i)(F); 12 CFR 252.35(b) and 12 CFR 252.157(c). As discussed in EC 2, under the Liquidity Risk Policy Statement, banks and BHCs 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. *See* Liquidity Risk Policy Statement pp. 6-7.
Practices and Procedures	The U.S. federal banking agencies 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. 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. Similarly, as discussed, Regulation YY 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.

EC 8	Principle 24: Liquidity risk
Criterion	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.
Legal Framework	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

EC 8	Principle 24: Liquidity risk
	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 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. BHCs or foreign banking organization's liquidity buffer for its U.S. operations under the rule. *See* 79 Fed. Reg. at 17301.
Practices and Procedures	U.S. federal banking agencies 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 (ICERC), the U.S. federal banking agencies 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 (ATRR). Agencies also evaluate cross-border concentrations. *See* Supervisory Guidance publications noted in the Overview.

EC 9	Principle 24: Liquidity risk
Additional Criterion	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.
Legal Framework	Under Regulation YY, U.S. BHCs subject to the rule and covered foreign banking organizations with $50 billion or more in total U.S. assets 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 (or U.S. operations) and must reflect the capital structure, risk profile, complexity, activities, and size of the company (or U.S. operations). Senior management must review the company's compliance with the limits at least quarterly, or more often as conditions warrant. *See* 12 CFR 252.34(g) and 12 CFR 252.156(f). Under the Liquidity Risk Policy Statement, institutions are expected to establish appropriate limits to mitigate their liquidity risks, including ensuring sufficient unencumbered liquidity resources, as discussed above. 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,

EC 9	Principle 24: Liquidity risk
	compliance with risk limits, consistency between management's strategies and tactics, and consistency between these strategies and the board's expressed risk tolerance. *See* Liquidity Risk Policy Statement, p. 4-5. 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. 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 BCBS. 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.
Practices and Procedures	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. For large institutions, the 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. Lastly, the proposed LCR would require certain institutions to hold a measurable amount of unencumbered assets, and the U.S. federal banking agencies would collect additional data on those unencumbered assets.

Assessment of Principle 24	Compliant
Comments	

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[208] on a timely basis.

[208] 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.

Principle 25: Operational risk

(Reference documents: *Principles for the Sound Management of Operational Risk*, June 2011; *Recognizing the risk-mitigating impact of insurance in operational risk modelling*, October 2010; *High-level principles for business continuity*, August 2006; and Joint Forum *Outsourcing in financial services*, February 2005; OCC 2013-29: *Third-Party Relationships – Risk Management*, October, 2013.)

Legal Framework Overview

Many banks and holding companies increasingly view operational risk as being closely related to, integrated with, and significantly comparable to all other risk categories. This view has become more widely held 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. As a result, the U.S. federal banking agencies 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 on certain banking organizations.

The U.S. federal banking agencies issued new risk-based capital rules (78 *Fed. Reg*. 62018 (October 11, 2013, OCC and Federal Reserve); 79 *Fed. Reg*. 20754 (April 14, 2014, FDIC)), effective January 1, 2014 for advanced approaches banks, which establish an integrated regulatory capital framework that addresses shortcomings in capital requirements, particularly for larger, internationally active banking organizations, that became apparent during the recent financial crisis. The rules implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. 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. These requirements were implemented pursuant to the agencies' statutory authority to impose capital adequacy requirements. *See* 12 U.S.C. §§ 1831o, 3907, and 3909*; see also*, 12 U.S.C. 5371. While section 171 of the Dodd-Frank Act 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, 12 U.S.C. 1, *et seq.*, Federal Reserve Act, FDI Act, 12 U.S.C. 1811, *et seq*, Bank Holding Company Act, International Lending Supervision Act, 12 U.S.C. 3901, *et seq.*, and Home Owners Loan Act, 12 U.S.C. 1461, *et seq.* The operational risk aspects of the new risk-based capital rules parallel the U.S. federal banking agencies' rules implementing the advanced approaches published in December 2007 (72 *Fed. Reg.* 69288).

In addition, in June 2011, the U.S. federal banking agencies 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. federal banking agencies 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.

Principle 25: Operational risk

Consistent with the longstanding approach employed by the agencies in their supervision of banking organizations, the capital rules maintain and reinforce supervisory expectations by requiring that a banking organization maintain capital commensurate with the level and nature of all risks to which it is exposed—including its strategic plans, its ability to access capital markets, and the potential for economic stresses–and that a banking organization has a process for assessing its overall capital adequacy in relation to its risk profile, as well as a comprehensive strategy for maintaining an appropriate level of capital. Further, all banking organizations are subject to leverage capital requirements. Although these leverage capital requirements do not explicitly address operational risk, they provide an important backstop against operational and other risks. 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.

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*. The federal banking agencies 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. federal banking agencies have also issued extensive 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. The safety-and-soundness statutes, rules, and guidelines are the principal legal bases for the imposition and enforcement of these operational-risk management standards. *See* 12 U.S.C. § 1831p-1 and 12 CFR parts 30, 208, 364, and 391, subpart B. The federal banking agencies have also integrated principles set forth in the Basel Committee on Banking Supervision's *Principles for the Sound Management of Operational Risk*, (June 2011); and *Outsourcing in financial services*, Joint Forum (February 2005) into their overall supervisory programs. Additionally, the federal banking supervisors meet periodically to discuss operational risk issues through, for example, an interagency operational risk group. The interagency Basel Qualification Team meets monthly to discuss Basel II Advanced Measurement Approach issues.

The Federal Reserve has issued numerous guidelines and policy statements on operational risk management. *See* http://www.federalreserve.gov/bankinforeg/topics/op_risk_mgmt.htm#Operational%20Risk%20Management.

The OCC external website contains several topical articles and guidance on operational risk management: http://www.occ.gov

EC 1	Principle 25: Operational risk
Criterion	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,

EC 1	Principle 25: Operational risk
	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).
Legal Framework	*See* Overview above. U.S. federal banking agencies expect all banks and holding companies to have in place comprehensive risk-management policies and processes for identifying, evaluating, monitoring, and controlling or mitigating all material risks, including operational risk. The authority to impose and enforce risk-management requirements stems from the safety and soundness and capital adequacy statutes. *See* for safety and soundness: 12 U.S.C. § 1831p-1 and 12 CFR parts 30, 208, 364, and 390 subpart B; and for capital adequacy: 12 U.S.C. §§ 1831o(c), 1467a(g)(1), 1844(b), 3907 and 3909.
Practices and Procedures	The federal banking agencies expect a banking organization to implement an appropriate risk-management program, corresponding to its 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 ongoing 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. The supervision process also addresses how a banking organization addresses operational risks in its capital planning process. *See* Principle 7 for additional background on U.S. supervisors' expectations for the necessary elements of a sound risk-management program. 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. 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. *See* the *Bank Supervision Process*, *Community Bank Supervision*, and *Large Bank Supervision* booklets of the OCC Comptroller's Handbook series.

EC 1	Principle 25: Operational risk
	The U.S. federal banking agencies implemented the advanced measurements approaches (AMA) for operational risk based on the advanced approaches from the Basel Framework. In addition, the agencies have formal enforcement authority to address risk-management deficiencies at a banking organization and routinely exercise this authority when identified deficiencies materially threaten a banking organization's safe and sound operations. The following are examples of formal enforcement actions taken by U.S. supervisors to direct adequate management of operational risks at banking organizations: Example Bank of America, N.A., Charlotte, North Carolina and FIA Card Services, N.A. Wilmington, Delaware: Consent Order for a Civil Money Penalty ($25 million) dated April 7, 2014. The OCC identified deficiencies in the Bank's practices that resulted in a violation of Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45(a)(1), related to billing practices with regard to identity protection products.

EC 2	Principle 25: Operational risk
Criterion	The supervisor requires that the bank's 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.
Legal Framework	*See* Overview above.
Practices and Procedures	U.S. federal banking agencies evaluate the risk-management processes and programs of a banking organization, including an assessment of board of director and senior management oversight, a key element of such programs. Boards have ultimate accountability for the level of risk taken by their banking organization, and supervisors evaluate 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, U.S. federal banking agencies' 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, is universal. With respect to a banking organization that is required to use, or choses to opt-in and use, the advanced approaches under the new risk-based capital rules, the board must at least annually review the effectiveness of and approve the organization's advanced systems. 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

EC 2	Principle 25: Operational risk
	organization's actual operating characteristics, and have been formally approved by the board. Additionally, supervisors evaluate the board oversight of management's effectiveness in implementing operational risk-management policies. This assessment is conducted in several ways: 1) review of board and committee minutes; 2) evaluation of the frequency, coverage, and quality of external and internal audit reports; and 3) assessment of the reporting frequency, nature, and integrity of applicable management information systems that reflect effective policy/control implementation through reported residual risk levels (For more information, also *see* Principle 7, Principle 17, Principle 22, and EC 1 above). Supervisors also assess the oversight and controls applied to operational risk models used for the CCAR capital adequacy assessment. The OCC's *Large Bank Supervision* and *Community Bank Supervision* 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 or policies, processes, personnel, and controls; this includes periodic review and approval of policies by the board or an appropriate committee of the board. *See* also BCP 8 & 9 for additional details.

EC 3	Principle 25: Operational risk
Criterion	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.
Legal Framework	*See* Overview above. In addition to the advanced approaches risk management framework, banking institutions also reference the COSO framework and SOX 404 control review and attestation processes when implementing operational risk policies and processes.
Practices and Procedures	U. S. federal banking 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. For more information, also *see* Principle 7, Principle 17, and EC 1 and EC 2 above. 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.

EC 4	Principle 25: Operational risk
Criterion	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 which 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.
Legal Framework	*See* Overview above.
Practices and Procedures	U.S. federal banking agencies 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 1) the size and nature of the organization's current operations and activities, considering any significant changes since the previous regulatory review; 2) the scope/breadth and findings of previous regulatory reviews; and 3) 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. federal banking agencies. When applicable, supervisors require banks to periodically test Business Continuity Plans and review the results with supervisors. *See* FFIEC IT Examination Handbook on Business Continuity Planning. Various supervisory policies, standards, and/or guidance statements relevant to business resumption and contingency planning have been issued on an interagency basis. *See* March 2008 *FFIEC Business Continuity Planning Booklet*, which is 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. In addition, the federal banking agencies 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. *See*, for example, OCC Bulletin 2013-29 "Risk Management Guidance – Third Party Relationships" and FDIC FIL-44-2008, Guidance for Managing Third Party Risk. 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 ongoing 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 *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System*. 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.

EC 4	Principle 25: Operational risk
	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 ongoing 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 *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System*. 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. The following outstanding formal enforcement action serves as an example of the authority to direct development and implementation of a business continuity plan: Jack Henry & Associates, Inc., Monett, Missouri: Formal Agreement dated December 4, 2013 identifying unsafe and unsound practices relating to the firm's operational risk practices regarding disaster recovery and business continuity planning and processes.

EC 5	Principle 25: Operational risk
Criterion	The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks, including cybersecurity. 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.
Legal Framework	*See* Overview above. Pursuant to statute 15 U.S.C. § 6801(b), the U.S. federal banking agencies published the *Interagency Guidelines Establishing Information Security Standards* in May 2001. This requires that banks and holding companies develop and implement a comprehensive written information security program that includes administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information. *See* 12 CFR part 30, Appendix B (OCC); 12 CFR part 364, appendix B, and 12 CFR part 391, Appendix B to subpart B (FDIC); 12 CFR part 208, Appendix D-2, and 12 CFR part 225, Appendix F (Federal Reserve).
Practices and Procedures	U.S. federal banking agencies 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

EC 5	Principle 25: Operational risk
	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 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. 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 Subcommittee (ITS), a standing subcommittee of the FFIEC Task Force on Supervision. *See* http://www.ffiec.gov/PDF/annrpt13.pdf, p. 18, for a description of roles and responsibilities. The FFIEC's *Information Security* booklet provides extensive guidance and examination procedures to evaluate IT security practices. The ITS develops and publishes IT-related risk-management policies and guidance statements based on industry/market trends or developments in the broader IT environment. This includes the *Information Security* booklet of the FFIEC's *IT Examination Handbook*, as well as other more targeted guidance such as *Interagency Guidance on Authentication in an Internet Banking Environment (October 2005), Guidance on the Use of Free and Open Source Software (December 2004), Internet "Phishing" Informational Brochure (October 2004*), *Uniform Rating System for Information Technology (March 1999), Interagency Supervisory Statement on Risk Management of Client/Server Systems (October 1996*), *Interagency Guidance on Authentication in an Internet Banking Environment – Supplement (June 2011), Interagency Joint Statement - Windows XP Operating System (October 2013), Interagency Joint Statement - Cyber Attacks on Financial Institutions' Automated Teller Machine and Card Authorization Systems(April 2014), and Interagency Joint Statement on Distributed Denial of Service Attacks (April 2014).*

EC 6	Principle 25: Operational risk
Criterion	The supervisor determines that banks have appropriate and effective information systems to: (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.
Legal Framework	*See* Overview above.
Practices and Procedures	As described in EC 1, EC 2, and EC 5, as part of the supervisory process the U.S. federal banking agencies evaluate the quality of a banking organization's management information systems and their ability to facilitate appropriate board and senior management risk

EC 6	Principle 25: Operational risk
	management. Banking organizations subject to the advanced measurement approaches are subjected to targeted examinations of their AMA implementation, including data and management information system quality. Banking organization 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.

EC 7	Principle 25: Operational risk
Criterion	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Legal Framework	*See* Overview above.
Practices and Procedures	U.S. federal banking agencies 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 applicable to publicly held firms) to keep apprised of developments affecting operational risk at their supervised entities. 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. As an example, under the Bank Services Company Act, U.S. banks are required to provide regulatory notice upon entering into a third-party contract outsourcing the performance of certain functions or services. *See*, 12 USC 1867. Such notices indicate developments in outsourcing risk and potentially in other categories of operational risk. The agencies also maintain on- and off-site supervisory monitoring of firms' current and planned activities on an ongoing 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.

EC 7	Principle 25: Operational risk
	Under the U.S. federal banking agencies' operational and managerial safety and soundness standards (12 CFR part 30, appendix A (OCC); 12 CFR part 364, appendix A, and 12 CFR part 391, subpart B (FDIC); 12 CFR 208, Appendix D-1 (Federal Reserve)), banking organizations' internal controls and information systems must ensure compliance with applicable laws and regulations. Supervisors assess a banking organization's compliance with applicable laws and regulations as part of their supervision activities.

EC 8	Principle 25: Operational risk
Criterion	The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers: (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. 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.
Legal Framework	*See* Overview above.
Practices and Procedures	U.S. federal banking agencies strictly 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. U.S. federal banking agencies' 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; and establishing and testing back-up plans. Interagency guidance on this topic has been issued through the FFIEC. While both *Guidance on the Risk Management of Outsourced Technology Services (Federal Reserve, November 2000)* and the *Outsourcing Technology Services Booklet (FFIEC, June 2004)* 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. For example, see *Risk Management Guidance – Third Party Relationships (OCC 2013-29, October 2013), Guidance for Managing Third Party Risk (FDIC, June 2008),* and *Guidance on Managing Outsourcing Risk (FRB SR 13-21, December*

EC 8	Principle 25: Operational risk
	2013). The *Interagency Information Security Standards (May 2001)* are applicable to customer information maintained by banks and holding companies themselves or maintained on their behalf by outsourced service providers.

EC 9	Principle 25: Operational risk
Additional Criterion	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).
Legal Framework	*See* Overview above.
Practices and Procedures	Supervisors regularly assess and evaluate potential common points of exposure to operational risk or potential vulnerability. Supervisory stress tests are structured to identify individual bank and systemic exposure to pre-determined macroeconomic events. In addition, resolution plan documents required under 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 CCP membership concentrations. The OCC publishes its *Semiannual Perspective on Risk*, which provides a public assessment of significant risk exposures, including operational risks. The FDIC publishes *Supervisory Insights*, a journal which promotes sounds principles and practices for bank supervision. Deriving authority and jurisdiction from the Bank Service Company Act (12 USC §§ 1861et seq.), the U.S. federal banking agencies pool supervisory 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.

Assessment of Principle 25	Compliant

Comments	

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[209] internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

(Reference documents: *The internal audit function in banks*, June 2012; *Enhancements to the Basel II framework*, July 2009; *Compliance and the compliance function in banks*, April 2005; and *Framework for internal control systems in banking organisations*, September 1998.)

Overview

The effectiveness of internal controls, information systems, and audits is essential to a bank's and holding company's ability to comply with prudential and other legal requirements. The safety-and-soundness provision of the FDI Act explicitly requires the U.S. federal banking agencies to prescribe standards relating to internal controls, information systems, and audits. Refer to section 39 of the FDI Act, codified as 12 U.S.C. § 1831p-1(a)(1)(A). Furthermore, section 112 of the FDIC Improvement Act (FDICIA) added section 36 of the FDI Act to provide greater specificity to the requirements of section 39, and these must conform with statutory requirements concerning (a) the submission of annual reports; (b) the submission of financial statements with appropriate attestations by management regarding the effectiveness of internal controls and legal compliance, among other matters; (c) an evaluation and attestation regarding the effectiveness of internal controls by an independent public accountant meeting certain qualification standards; (d) an annual independent audit of the bank's and holding company's financial statements, prepared by an independent public accountant meeting certain qualification standards, in accordance with generally accepted accounting and auditing principles; (e) the establishment and independence of, and reporting to, an audit committee by larger banks and holding companies; and (f) the sharing of information with external auditors and supervisors. *See* 12 U.S.C. § 1831m. In general, smaller banks and holding companies s (i.e., those with total assets of $150 million or less) are exempt from these specific requirements but still must adhere to the general requirements of the safety-and-soundness provision regarding the establishment of internal controls, information systems, and audits. With respect to audited financial statements, section 36 of the FDI Act currently requires audited financial statements for banks with $500 million or more in consolidated total assets. In addition, for banks with consolidated total assets of $1 billion or more, management must perform an assessment of the effectiveness of internal control over financial reporting and the independent public accountant who audits the bank's financial statements must report separately on management's assertion concerning the effectiveness of the bank's internal control over financial reporting.

The interagency safety-and-soundness guidelines implement the foregoing requirements. *See*12 CFR 208, appendix D-1, § II(A) and (B); 12 CFR 30, appendix A, § II(A) and (B). They specify that a bank and holding company should have internal controls and information systems that are appropriate

[209] 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.

Principle 26: Internal control and audit

to the size of the bank and holding 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 procedures to safeguard and manage assets; and (e) compliance with applicable laws and regulations. A bank and holding company also should have an internal audit system that is appropriate to the size of the bank and holding 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 (or, in the case of smaller or noncomplex banks and holding companies, 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 audit committee or board of directors of the effectiveness of the internal audit systems. The agencies have issued supervisory guidance elaborating on these requirements. *See* "Interagency Policy Statement on the Internal Audit Function and its Outsourcing" (March 17, 2003).[210] These policies align with BCBS's documents *Framework for internal control systems in banking organisations*, September 1998; *Internal audit in banks and the supervisor's relationship with auditors*, August 2001; and *Compliance and the compliance function in banks*, April 2005.

Additional audit requirements are set forth for national banks and federal savings associations acting in a fiduciary capacity. *See* 12 CFR 9.9 (national banks); 12 CFR 550.440-480 (federal savings associations). The Federal Financial Institution Council (FFIEC) Information Technology Examination Handbook (IT Handbook), provides guidance to examiners and financial institutions on the characteristics of effective risk management relative to technology. This FFIEC IT Handbook is comprised of several booklets which include, but not limited to, Audit, Information Security, and IT Management.

As discussed under Principle 5, the effectiveness of internal controls, information systems, and audits is evaluated at the time a bank or holding company charter is granted and as part of the supervisory process.[211] If an agency determines that a bank or holding company fails to meet any safety or soundness standard established under the interagency guidelines, the agency may require the bank and holding company to submit an acceptable plan to achieve compliance. In the event that a bank or holding company fails to submit an acceptable plan within the time allowed or fails in any material respect to implement an accepted plan, the agency must order the bank or holding company to correct the deficiency. The agency may, and in some cases must, take other supervisory actions until the deficiency is corrected. *See* 12 U.S.C. § 1831p-1(e).

Since the enactment in 2002 of the Sarbanes-Oxley Act (the Act),[212] the federal securities law have established internal control and audit requirements for internal controls over financial reporting for companies, including banks, savings associations, and their holding companies, that have securities registered under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78c *et seq.*, ("public companies").[213] Section 301 of the Act, 15 U.S.C. § 78j-1 requires that all members of the audit committee of a public company must be independent and also subjects them to other requirements. The audit

[210] *See* Federal Reserve SR letter 03-5; OCC Bulletin 2003-12; and FDIC FIL-21-2003.

[211] Each agency's examination manual includes procedures to evaluate internal controls and audit. *See*, for example, OCC Comptroller's Handbook series and the FFIEC IT Handbook.

[212] Pub. L. No. 107-204, 116 Stat. 745 (2002).

[213] As a general matter, the U.S. federal banking supervisors apply the SEC's regulations implementing the Sarbanes-Oxley Act to banks that are public companies and enforce the Act with respect to banks. *See* 15 U.S.C. § 78*l*(i). (The SEC has enforcement authority with respect to holding companies.)

committee must establish procedures to handle complaints regarding accounting matters that are received by the public company, including from its employees, or the company's securities may be delisted from securities exchanges. *Id.* Section 302 of the Act, 15 U.S.C. § 7262(a), requires the principal executive and financial officers of a public company to make certain representations about the veracity and accuracy of annual and quarterly reports. Section 404 of the Sarbanes-Oxley Act, 15 U.S.C. § 7262(b), requires an auditor of a public company annually to render an opinion on the effectiveness of the company's internal control over financial reporting. Pursuant to section 406 of the Act, 15 U.S.C. § 7264, a public company must disclose in its periodic reports if it has adopted a code of ethics for senior financial officers and, if not, why not.

In addition to creating a new registration requirement for auditors of public companies, the Act established requirements designed to further the independence of auditors from the public companies that they audit. A registered auditor cannot perform certain specific nonaudit services for a public company. Also, a registered auditor cannot provide services for a public company if the lead audit partner has performed such services in each of the last five years. In addition, the registered auditor must report certain information to the audit committee concerning the company's accounting policies and practices. Finally, a registered auditor cannot perform audit services for a public company if the auditor employed certain persons in the company's management during the previous year. 15 U.S.C. § 78j-1.

Through FDIC Rules (Part 363), these independence requirements are applied to an independent public accountant who audits a bank that is required under the banking laws to have an annual independent audit, or to the auditor of its holding company if the bank satisfies the requirement through an independent audit at the holding company level. *See* 12 CFR Part 363, Section 363.3(f).

The "Interagency Policy Statement on the Internal Audit Function and Its Outsourcing" (March 17, 2003) encouraged banks and holding companies that are neither subject to Section 36 of the FDI Act nor the Sarbanes-Oxley Act auditor independence requirements not to use their external auditor to perform internal audit services.[214]

Guidance established by the federal banking agencies, applicable to insured national banks, insured federal savings associations, and insured federal branches outlines the responsibilities of a bank's board and senior management. In particular, the OCC's *Comptroller's Handbook on Management and Board Processes*, and the Heightened Expectations for Large Banks (NPRM issued for comment January 2014). This proposal provides that each member of the board has a duty to oversee a covered bank's compliance with safe and sound banking practices.

See also discussion concerning required corporate and risk governance, control environment, internal control testing/financial reporting and risk management framework under Principles 14, 15, and 27.

EC 1	Principle 26: Internal control and audit
Criterion	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

[214] *See* Federal Reserve SR letter 03-5; OCC Bulletin 2003-12; and FDIC FIL-21-2003.

EC 1	Principle 26: Internal control and audit
	responsibility of the bank's Board and/or senior management and deal with organisational 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, unauthorised trading and computer intrusion). More specifically, these controls address: (a) organisational structure: definitions of duties and responsibilities, including clear delegation of authority (eg 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.
Legal Framework	*See* the authorities cited in the overview to this principle, along with those cited in relation to risk management and internal controls assurance for risk specific principles (17, and 18, and 21-25) and supervisory related principles (5 and 8).
Practices and Procedures	U.S. federal banking agencies establish corporate governance and risk management expectations of boards of directors and senior t through various interagency statements. These statements and guidance outline roles and responsibilities of board of directors, board designated committee, senior management, and lines of business. 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. Directors and senior management oversight of the enterprise-wide compliance program, including approval of risk-management policies and monitoring of internal processes, is essential. *See* "Interagency Statement on Application of Recent Corporate Governance Initiatives to Non-Public Banking Organizations" (May 2003), [215] "Amended Interagency Guidance on the Internal Audit Function and its Outsourcing" (April 2003)[216], Federal Reserve "Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing" (January 2013),[217] "Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities" (January 2007)[218], FDIC "Statement of Policy Concerning the Responsibilities of Bank Directors and Officers." (October 2005).

[215] *See* Federal Reserve SR letter 03-8; OCC Bulletin 2003-21; FDIC FIL-17-2003;
[216] *See* Federal Reserve SR letter 03-5; OCC Bulletin 2003-12; FDIC FIL-21-2003;
[217] *See* Federal Reserve SR letter 13-1
[218] *See* Federal Reserve SR letter 07-5; OCC Bulletin 2007-1; FDIC p. 5369 "Pocket Guide Directors" (1988)

EC 1	Principle 26: Internal control and audit
	There are also separate corporate governance requirements with regard to managing risks of internal controls for banks and holding companies under the FDI Act, (Part 363), FDIC insured banks that are subject to Part 363 must have an audit committee comprised of outside directors. For banks with total assets of $500 million or more but less than $1 billion as of the beginning of its fiscal year, the majority of the audit committee members must also be independent of management. For banks with total assets of $1 billion or more, as of the beginning of its fiscal year, all of the audit committee members must be independent of management. The audit committees of banks with assets of more than $3 billion, measured as of the beginning of each fiscal year, must include members with banking or related financial management expertise, have access to its own outside counsel, and not include any large customers of the bank. If a large bank is a subsidiary of a holding company and relies on the audit committee of the holding company to comply with this rule, the holding company audit committee shall not include any members who are large customers of the subsidiary bank.[219] OCC heightened expectation, relating to systemically large banks, calls for the board to actively oversee a covered bank's risk-taking activities and hold management accountable for adhering to the framework. U.S. federal banking agencies evaluate the adequacy of bank and bank holding company'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.

[219] *See* FDIC FIL-119-2005

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	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 ongoing examination processes. Supervisors conduct horizontal examinations and utilize this information in assessing the risks of the bank and/or holding company relative to its peers. *See* Amended "Interagency Guidance on the Internal Audit Function and its Outsourcing", Federal Reserve Supplemental Guidance on the Internal Audit Function and its Outsourcing, Federal Reserve CBEM, section 1010, and SR letter 95-51; OCC Internal Control, Internal and External Audit, and Bank Supervision Process booklets of the OCC's Handbook series; and FDIC Risk Management Manual of Examination Policies, section 4.2. U.S. federal banking agencies assess a bank's and holding company's compliance with the Interagency Policy Statement on the Internal Audit Function and Its Outsourcing and the Federal Reserve's Supplemental Guidance on the Internal Audit Function and its Outsourcing. 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 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. Supervisors review various external assurance reports (i.e. external audit reports, SSAE16 reports, SOX related reports) 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.

EC 2	Principle 26: Internal control and audit
Criterion	The supervisor determines if there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines if the staff of the back office and control functions have sufficient expertise and authority within the organisation (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.
Legal Framework	As noted in the overview to this principle, the U.S. federal banking agencies assess the adequacy of a bank's and holding company's corporate governance framework, including the competence and qualifications of its employees, at licensing and as part of the supervisory process.
Practices and Procedures	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

EC 2	Principle 26: Internal control and audit
	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 leverage their work 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. *See* OCC Comptroller's Handbook series; Federal Reserve CBEM, section 1010; and FDIC Risk Management Manual of Examination Policies, sections 4.2. The OCC's Heightened Expectations guidance for large institutions to have a well-defined personnel management program that ensures appropriate staffing levels, provides for orderly succession, and provides for compensation tools to appropriately motivate and retain talent that does not encourage imprudent risk taking. (See Principle 8 & 9 for further detail of supervision approach and techniques).

EC 3	Principle 26: Internal control and audit
Criterion	The supervisor determines if banks have an adequately staffed, permanent and independent compliance function[220] that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines if staffs 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 if the bank's Board exercises oversight of the management of the compliance function.
Legal Framework	As noted in the overview to this principle above, the interagency safety-and-soundness guidelines encompass compliance with applicable laws and regulations, including the agencies' authority to assess the adequacy of a bank's and holding company's compliance function. In addition to these general guidelines, under the agencies' Bank Secrecy Act (BSA) regulations, every bank must establish a BSA compliance program. *See* 12 CFR 21.21
Practices and Procedures	U.S. federal banking agencies' guidance and examination procedures direct supervisors 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.

[220] 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.

EC 3	Principle 26: Internal control and audit
	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 establish and maintain an effective compliance management system including: • 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 compliance in specialty areas such as leverage leasing, insurance and private banking); • conducting periodic compliance audits; • ensuring that business lines have appropriate personnel with compliance expertise; and • providing for recurrent reports by the compliance officer. *See* FDIC Compliance Handbook and Risk Management Manual of Examination Policies, section 4.2; Federal Reserve Consumer Compliance Handbook, CBEM sections 1000 and 2115.1, and CA letter 06-8; and OCC Compliance Management System booklet of the Comptroller's Compliance Handbook series and Internal Control booklet.

EC 4	Principle 26: Internal control and audit
Criterion	The supervisor determines if banks have an independent, permanent and effective internal audit function[221] charged with: (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.
Legal Framework	As noted in the overview to this principle above, the interagency safety-and-soundness guidelines, among other authorities, contemplate that most banks and holding companies will establish a permanent internal audit unit responsible for (a) ensuring compliance with policies and procedures and (b) assessing the continued adequacy of the policies and procedures.
Practices and Procedures	As noted in 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.

[221] The term "internal audit function" does not necessarily denote an organisational unit. Some countries allow small banks to implement a system of independent reviews, eg conducted by external experts, of key internal controls as an alternative.

EC 4	Principle 26: Internal control and audit
	Supervisors determine the adequacy of the internal audit function through their ongoing supervisory activities. Current guidance suggests annual evaluation of changes to Internal Audit through continuous monitoring and a full scope review of Internal Audit every three years, except for particularly large complex banks and holding companies ($50 billion or more). The OCC's Heightened Expectations guidance expects institutions to develop and maintain a strong audit functions taking appropriate action to address material gaps. It also calls for the establishment of an Internal Audit QAIP department. *See* Principle 8 & 9 for further detail of supervision approach and techniques. 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; • Workpapers 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 (IIA) 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.

EC 5	Principle 26: Internal control and audit
Criterion	The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;

EC 5	Principle 26: Internal control and audit
	(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.
Legal Framework	As noted in the overview to this principle in above, the supervisory assessment of the adequacy of a bank's and holding company's internal audit function, including the competence and qualifications of its employees, is encompassed in the interagency safety-and-soundness guidelines and is determined as part of the supervisory process.
Practices and Procedures	In addition to supervisory guidance, U.S. federal banking supervisors also use industry standards (e.g., those of the Institute of Internal Auditors (IIA)) to assess the adequacy of their work against these standards. 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. 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: • 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 company's independent public accountant; and • 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. 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. See Federal Reserve SR letter 03-5 and SR 13-

EC 5	Principle 26: Internal control and audit
	1/CA-1; section 1010 of the CBEM; and section 2060 of the BHC Supervision Manual; OCC Internal and External Audit booklet of the Comptroller's Handbook – Safety & Soundness, Objective 6; and the FDIC Risk Management Manual of Examinations Policies section 4.2.

Assessment of Principle 26	Compliant
Comments	

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.

(Reference documents: *Supervisory guidance for assessing bank' financial instruments fair value practices*, April 2009; *External audits of banks*, March 2014)

Overview

Section 36 of the FDI Act, 12 U.S.C. § 1831m, requires, each bank exceeding a minimum asset threshold to submit an annual report to the appropriate U.S. federal and state banking agencies containing a report signed by the chief executive officer and the chief accounting or financial officer of the bank which includes a statement of management's responsibilities for preparing financial statements, establishing and maintaining an adequate internal control structure and procedures for financial reporting; and complying with safety-and-soundness laws and regulations. *See* 12 U.S.C. § 1831m(b)(2) and 12 CFR 363.2(b). The report must include an assessment, as of the end of the bank's most recent fiscal year, of (a) the effectiveness of such internal control structure and procedures, and (b) the bank's compliance with applicable safety-and-soundness laws and regulations. *See* 12 U.S.C. § 1831m(b)(2)(A) and (B). An independent public accountant must attest to and report separately on management's assertion regarding the effectiveness of internal control over financial reporting. *Id.* at § 1831m(c).

The banks exceeding the minimum asset threshold are required to prepare annual financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP). *See* 12 U.S.C. § 1831m(b)(1) and section 37 of FDI Act, 12 U.S.C. § 1831n. However, the appropriate federal banking agency may determine that the application of any U.S. GAAP principle to any bank is inconsistent with the objectives of section 37 of the

Principle 27: Financial reporting and external audit

FDI Act, and may, with respect to reports or statements required to be filed with such agency, prescribe an accounting principle which is applicable to such banks and holding companies which is no less stringent than U.S. GAAP. An independent public accountant must audit these financial statements in accordance with U.S. GAAP. § 1831m(d)(1). The accountant is required to determine and report whether the financial statements are presented fairly under U.S. GAAP. *See* 1831m(d)(2). Publicly traded institutions registered with the SECs 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 accountant's report to any appropriate federal or state banking agency. § 1831m(g)(2).

Independent public accountants providing these services to banks must meet certain statutory qualifying criteria. *See* 12 U.S.C. § 1831m(g)(3). The FDIC or an appropriate U.S. federal banking agency may remove, suspend, or bar an independent public accountant, upon a showing of good cause, from performing the audit services described above. *See* § 1831m(g)(4) and, for national banks, 12 CFR 19.243. In addition, an accountant, as an institution-affiliated party (IAP), may be subject to enforcement actions such as section 8 actions under the FDI Act, cease and desist (C&D) proceedings, the imposition of civil monetary penalties (CMP), and suspension or industry-wide debarment in connection with services provided to a bank. *See* 12 U.S.C. §§ 1813(u)(4), 1818(b). FDIC regulations elaborate on the duties of the independent public accountants. *See* 12 CFR 363.

Statutes and regulations address the applicability of the foregoing requirements to banks that are part of a holding company. In certain instances the audit requirements applicable under 12 U.S.C. § 1831m may be satisfied at the holding company level. In addition, the federal banking agencies have issued an interagency policy statement addressing external auditing programs. *See* "Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations," 64 *Fed. Reg.* 52319 (Sept. 28, 1999). The agencies apply this statement to all banks and holding companies. *See* Federal Reserve SR letter 99-33 (SUP) and OCC Bulletin 99-37, "Interagency Policy Statement on External Auditing Program" (Oct. 7, 1999).[222] The agencies apply this statement to encourage all banking organizations not subject to other audit requirements to adopt an external auditing program, and they support BCBS's report "Enhancing Bank Transparency," September 1998, *available at* www.bis.org/publ/bcbs41.pdf?noframes=1. A savings association with a composite rating of 3, 4, or 5 or a SLHC that controls savings association subsidiaries with aggregate consolidated assets of $500 million or more are required by the OCC and the Federal Reserve, respectively, to conduct an independent audit by a qualified independent public accountant. *See* 12 CFR 162.4(b)-(d) and 12 CFR 238.5(b)-(d).

EC 1	Principle 27: Financial reporting and external audit
Criterion	The supervisor[223] 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.

[222] The OCC encourages all national banks to have independent external audits of their operations and financial records. *See* OCC Bulletin. 99-37 and the Comptroller's Handbook, *Internal and External Audits* (Apr. 2003).

[223] 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.

EC 1	Principle 27: Financial reporting and external audit
Legal Framework	The information required to be provided by banks and holding companies is required to be accurate. 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. As indicated in the overview to this principle, the federal banking agencies have broad remedial authority to take enforcement actions against a bank and its IAPs, including board members and management, if they provide misleading or false information.
Practices and Procedures	Banks exceeding a minimum asset threshold (currently, US$500 million or more) are required to prepare annual financial statements in accordance with U.S. GAAP. An independent public accountant must audit these financial statements to determine and report whether the financial statements are presented fairly under U.S. GAAP. 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 or holding company's audit committee. If a bank has assets of US$500 million or more, that committee, in turn, must provide the accountant's report to the relevant U.S. federal banking agencies. *See* 12 U.S.C. § 1831m. Each bank exceeding the minimum asset threshold is also required to submit an annual report to the appropriate U.S. federal banking agency containing a report signed by the CEO and the CFO of the bank which includes a statement of management's responsibilities for preparing financial statements, establishing and maintaining an adequate internal control structure and procedures for financial reporting; and complying with designated safety-and-soundness laws and regulations. S*ee, e.g.*, 12 U.S.C. § 1831m(b)(2) and 12 CFR 363.2(b). The report must include (i) an assessment by management of the bank's compliance with the designated safety-and-soundness laws and regulations during the fiscal year and (ii) for banks with assets of US$1 billion or more, assessments by management and the independent public accountant of the effectiveness of such internal control structure and procedures as of the end of the fiscal year. The requirements above do not apply to holding companies, although statutes and regulations provide that, in certain instances, the audit and reporting requirements may be satisfied at the holding company level. In addition, the U.S. federal banking agencies have issued an interagency policy statement addressing external auditing programs, which recommends that boards of directors establish and maintain such programs. *See Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations*," Sept. 1999 *available at* http://www.federalreserve.gov/boarddocs/srletters/1999/sr9933a1.pdf. The agencies apply this statement to all banks and holding companies. The agencies also apply this statement to encourage all banking organizations not otherwise subject to an audit requirement to have an external audit of the financial statements. U. S. federal banking agencies review of safety and soundness includes review of risk management and accounting and financial controls. If the U. S. supervisor determines management's risk management or control process to be deficient, the supervisor has a number of available responses to address such deficiencies, including requiring increased regulatory capital or other supervisory measures. Further discussion of the available supervisory measures is included in other principles, including Principle 10, EC 8.

EC 2	Principle 27: Financial reporting and external audit
Criterion	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.
Legal Framework	The broad remedial authority cited in the overview to this principle and referenced under EC 1 provides a sound basis for holding a bank's or holding company's board members and management responsible for ensuring that the 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 as described in this principle.
Practices and Procedures	U. S. federal banking agencies require independent external audits on annual financial statements and related internal control structure based on prescribed thresholds, regardless of whether the bank is public or non-public. Banks and holding companies that are publicly registered also must comply with SEC requirements, including the Sarbanes-Oxley Act, to obtain an annual audit of the financial statements and the internal control over financial reporting and are subject to the SEC's reporting requirements, including public reporting of quarterly and annual financial reporting. The audited annual financial statements, as well as quarterly financial statements, of public companies are made publicly available by the SEC. U. S. supervisors require banks and holding companies to file applicable financial 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 federal banking agencies with the exception of certain information deemed confidential (such as certain data related to Fiduciary and Related Services). As described in EC 1 for this principle, such financial statements are required to be certified by the bank's or holding company's CFO and a specified number of directors (trustees). U. S. federal banking agencies, through regulation and guidance, strongly endorse sound corporate governance and auditing policies and practices for all banks. Supervisory regulation and guidance require banking organizations, including management and its board, to have in place adequate governance and controls related to financial reporting. *See* Principle 14 for corporate governance and Principal 26 for internal controls.

EC 3	Principle 27: Financial reporting and external audit
Criterion	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.
Legal Framework	*See* Overview and EC 2, discussing the standards for accounting and reporting, which encompass valuation practices.

EC 3	Principle 27: Financial reporting and external audit
Practices and Procedures	As described in EC 1, the U.S. federal banking agencies generally require banks and holding companies to use U.S. GAAP which apply various valuation and reporting rules to different categories of assets and liabilities. The accounting rules allow for assets and liabilities to be reported on different accounting bases including historical cost, amortized cost, the lower of cost or fair value, and fair value. FASB ASC Topic 820 *Fair Value Measurement* (ASC 820), issued in September 2006, defines fair value, establishes a framework for measuring the fair value of assets and liabilities based on a three-level hierarchy, and expands disclosures about fair value measurements. The FASB's three-level fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date (*e.g.*, the reporting date). Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. As previously discussed, U. S. federal banking agencies require certain banks and holding companies to obtain annual external audits of financial statements prepared in accordance with U.S. GAAP and audits of internal control over financial reporting. Audit standards for non-public and public companies are prescribed by the American Institute of Certified Public Accountants (AICPA) (GAAS) and Public Company Accounting Oversight Board (PCAOB) (PCAOB auditing standards), respectively. U. S. federal banking agencies, through guidance and examination procedures, expect institutions to have robust controls and documentation on the accounting policies and processes surrounding the valuation processes.

EC 4	Principle 27: Financial reporting and external audit
Criterion	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.
Legal Framework	In general, external auditors must determine and report whether the financial statements of a bank are presented fairly in accordance with GAAP. *See* 12 U.S.C. § 1831m(d)(2). Further, the external audits must meet or exceed the scope and procedures required by GAAS or PCAOB auditing standards. S*ee* 12 U.S.C. § 1831m(f)(1).
Practices and Procedures	The U.S. supervisors require banks covered by section 36 of the FDI Act (12 U.S.C. § 1831m), as implemented by part 363 of the FDIC's regulations (12 CFR 363) (*i.e.*, banks with more than $500 million in total assets at the beginning of their fiscal year), to have an external financial statement audit by an independent public accountant. *See* 12 U.S.C. §§ 1831m(d)(1) and (g)(1). These banks and holding companies are required, and all other banks and holding companies are encouraged, to have an external audit performed in accordance with GAAS. The scope of the audit engagement shall be sufficient to permit an auditor to determine and report whether the financial statements taken as a whole are presented fairly and in accordance with U.S. GAAP. The audit shall

EC 4	Principle 27: Financial reporting and external audit
	be conducted in accordance with GAAS and section 37 of the FDI Act, which include the concepts of risk based auditing and materiality assessment in both the planning and implementation of an external audit. *See* 12 U.S.C. § 1831n. The "Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations" was issued in September 1999 to provide guidance to banks in maintaining effective systems and internal control to produce reliable and accurate financial reports. 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, be independent, and obtain reliable evidence.

EC 5	Principle 27: Financial reporting and external audit
Criterion	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 securitisations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal control over financial reporting.
Legal Framework	As noted under EC 4, external audits generally must meet or exceed the scope and procedures required by GAAS or the PCAOB auditing standards. External audits may have to comport with additional requirements, as determined by the supervisor by regulation, guideline, guidance, or other related materials.
Practices and Procedures	As previously discussed, U.S. federal banking agencies require certain banks and holding companies to obtain annual audits of financial statements and external audits of internal control over financial reporting. Financial statement audits cover areas such as loans, allowance for loan losses, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles as appropriate to enable the auditor to provide an opinion on whether the financial statements as a whole are presented fairly. For a smaller bank not subject to the audit requirements, a non-audit agreed-upon procedures engagement is commonly used. Alternatively, an attestation engagement may be performed for all internal controls relating to the preparation of annual financial statements or specified schedules of the bank's regulatory reports. This type of engagement is performed under generally accepted standards for attestation engagements.

EC 6	Principle 27: Financial reporting and external audit
Criterion	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.

EC 6	Principle 27: Financial reporting and external audit
Legal Framework	As noted in the overview to this principle, independent public accountants providing audit services to banks must meet certain statutory qualifying criteria. *See* 12 U.S.C. § 1831m(g)(3). The FDIC or an appropriate federal banking agency may remove, suspend, or bar an independent public accountant, upon a showing of good cause, from performing the required audit services for a bank. *See* 12 U.S.C. § 1831m(g)(4) and for national banks 12 CFR 19.243. "Good cause" would exist, for example, when the external auditor is determined to have inadequate expertise or independence or not to be subject to or follow established professional standards. Each bank is required to provide the FDIC and the appropriate federal banking agency with written notice, within a specified time period, of the engagement of an independent public accountant, or the resignation or dismissal of the independent public accountant previously engaged and must include a statement of the reason for such event. *See* 12 CFR 363.4(d). An independent public accountant performing an audit who ceases to be the accountant for a bank is required to notify the FDIC and the appropriate federal banking agency in writing of such termination within a specified time period and set forth the reasons for the termination. *See* 12 CFR 363.3(c).
Practices and Procedures	In the U.S., auditors are licensed by individual states and must comply with appropriate licensing requirements. Individual states can censure or remove auditors who have been deemed not to comply with appropriate auditing standards. In addition, auditors who audit public companies must register with the PCAOB. The PCAOB performs inspections annually to determine the registered public accounting firm's adherence to PCAOB auditing standards. Audits performed in accordance with AICPA auditing standards have inspections (commonly referred to as "Peer Reviews") at least every three years. Section 36 of the FDI Act indicates that all auditors who provide services under the FDI Act must be subject to an outside (peer) review. *See* 12 U.S.C. § 1831m(g)(3)(A). Banking agencies have the authority to remove, suspend or bar an independent public accountant upon showing of good cause from performing audit services under the act. For national banks, *see* 12 CFR 19.243. In addition, in 1999 the federal banking agencies issued rules of practice with respect to the FDI Act ("Interagency Policy Statement on External Auditing Programs of Banks and Savings Institutions," 64 *Fed. Reg*. 52319 (Sept. 28, 1999)), which include supervisor guidance with respect to external audits. *See* 12 CFR 363. The key is that the board or audit committee approve the external audit program, the firm is independent, the engagement letter is adequate, and the board exercises adequate due diligence. U.S. supervisors typically review board minutes and other documents to evaluate external audit's independence as well as review part 363 Annual Reports and Peer Review reports submitted by certain banks. In addition, the supervisors may review the audit work papers. If there is evidence that the work would not meet appropriate external audit standards, further action could be taken, including potentially disbarment of the accountant. If a supervisor concludes, based on the review of the specific work performed, discussions with the audit firm, or other documentation, that the external auditor does not have the requisite expertise, independence, or does not follow established professional standards, the supervisor discusses these findings and the actions the agency may talk with the bank's senior management, board of directors (or audit committee), and the external auditor. If the issue cannot be resolved, then the banking agency can bar the accountant from performing audits under the act.

EC 7	Principle 27: Financial reporting and external audit
Criterion	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Legal Framework	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 5 previous fiscal years of that issuer. *See* 15 U.S.C. § 78j-1.
Practices and Procedures	To strengthen auditor independence and improve audit quality, the Sarbanes-Oxley Act includes a provision regarding mandatory audit partner rotation for firms auditing public companies. The act requires the lead audit partner and audit review partner (or concurring reviewer) to be rotated every five years on all public company audits. *See* 15 U.S.C. § 78j-1. The Act requires a concurring review of all audits of issuers (as defined in the Act). *See* 15 U.S.C. § 7213(a)(2)(A)(ii). The SEC adopted rules to effectuate the statutory requirement of audit partner rotation found in section 203 of the Sarbanes-Oxley Act. *See* 17 CFR 210.2-01(c)(6). In addition to the five-year rotation requirement of the lead and concurring audit partners, the rules also mandate a five-year "timeout" period after rotation. The rules, as adopted, specify that certain other significant audit partners will be subject to a seven-year rotation requirement with a two-year "timeout" period. The rule provides an alternative for firms with fewer than five public audit clients and fewer than ten partners. The alternative requires the PCAOB to review all of the firm's engagements subject to the rule at least once every three years. As described in the "Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters," (*see* 71 *Fed. Reg.* 6847 (Feb. 9, 2006)), auditor independence standard-setters include the SEC, PCAOB, and the AICPA. Auditors of large banks are required to satisfy the independence requirements of the SEC, PCAOB and AICPA. Auditors of all other banks are required to comply with the independence standards issued by one or more of these standard-setters. For other non-public banks that are not required to have an annual independent audit pursuant to part 363 of the FDIC's regulations, an external auditor must meet only the AICPA independence standards.

EC 8	Principle 27: Financial reporting and external audit
Criterion	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Legal Framework	*See* the discussion in the "Practices and Procedures" section of EC 8 below.
Practices and Procedures	The federal banking agencies meet periodically with external audit firms as well as the FASB, the SEC, the AICPA, and the PCAOB to discuss 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 typically ask to speak to the supervisors before signing off on annual financial statements to ensure that the 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).

EC 9	Principle 27: Financial reporting and external audit
Criterion	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.
Legal Framework	Auditors of public companies are required to file reports with the SEC if company management fails to take remedial action. *See* 15 U.S.C. § 78j-1(b) and (c).
Practices and Procedures	Supervisors in the United States 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 management and the audit committee made by the external auditors. External auditors will also notify management and the audit committee (or board of directors) of any control issues noted as a result of the financial statement audit. An external auditor may also be engaged to audit or examine the effectiveness of a bank's internal control over financial reporting and express an opinion on it at the end of the fiscal year under section 112 of FDICIA. *See* 12 U.S.C. § 1831m or section 404 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7262). In connection with such an engagement, the auditor also has a responsibility to communicate certain information concerning internal control matters to management and the audit committee. Banks subject to part 363 of the FDIC rules and regulations must provide any management letter or other report from their auditor to the appropriate federal and state supervisors within 15 days of receipt of such communication. *See* guideline 25 of 12 CFR 363. Guidelines and professional standards related to the auditor's communication of internal control deficiencies are continually evolving. Standards are established by the AICPA for nonpublic company audits and attestation engagements and by the PCAOB for public company audits. Depending on a bank's size and whether it or its parent is a public company, internal control-related reports submitted pursuant to part 363 would include the auditor's report on the effectiveness of internal control over financial reporting, either as part of the part 363 annual report or separately; reports on significant deficiencies and material weaknesses; and reports on other internal control matters, which may be in the form of a management letter. Supervisory guidance requires audits of banking organizations to be performed in accordance with the PCAOB's or AICPA's auditing standards. Under those standards, when an auditor concludes that an illegal act (*i.e.*, violations of laws or government regulations) has or is likely to have occurred, the auditor is expected to consider the effect of the illegal act on the financial statements and to ensure that those charged with governance are adequately informed of the illegal act. The communication to those charged with governance may be conveyed either orally or in writing. However, if the communication is oral, the audit workpapers must document the communication. Supervisory guidance gives federal banking supervisors access to communications between the auditor and the bank client. In addition, federal banking supervisors have the authority to review auditors' workpapers.

EC 10	Principle 27: Financial reporting and external audit
Additional Criterion	The supervisor has the power to access external auditors' working papers, where necessary.
Legal Framework	External auditors of large banks are required to agree to provide related audit working 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 asset 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 or auditor's work papers and other material pertaining to the bank prepared in the course of performing the completed external auditing program.
Practices and Procedures	The independent public accountant or external auditor of a large bank is required to provide the supervisor with access to the audit working papers. As set forth in "Interagency Policy Statement on External Auditing Programs of Banks and Savings Institutions," 64 *Fed. Reg.* 52319 (Sept. 28, 1999), banks should obtain an engagement letter from their auditors which states that supervisors will be granted immediate and full access to the external auditing reports and related workpapers prepared by the auditor. Banks that fail to grant access of such audit working papers are subject to informal or formal enforcement actions.

Assessment of Principle 27	Compliant
Comments	

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.

(Reference documents: *Pillar 3 disclosure requirements for remuneration*, July 2011; *Enhancements to the Basel II framework*, July 2009; *Basel II: International measurement of capital measurement and capital standards*, June 2006; and *Enhancing bank transparency*, September 1998.)

EC 1	Principle 28: Disclosure and transparency
Criterion	Laws, regulations or the supervisor require periodic public disclosures[224] 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.
Legal Framework	Banks and holding companies are subject to reporting requirements that include financial and other information. All banks regardless of size must submit regulatory reports that include financial and other information, while holding companies with assets of $500 million or more and savings and loan holding companies of all sizes must submit 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). The federal banking agencies ensure the periodic public disclosure of information in these regulatory reports and require that these reports adequately reflect the true financial condition, including capital adequacy of the bank or bank holding company. The disclosure and reporting requirements are broadly applicable, subject to uniform submission deadlines, and ensure the timeliness and relevance of information. Uniform requirements ensure comparability of information. Accuracy and reliability are ensured by separate requirements regarding the adequacy of financial record-keeping systems; adherence to these requirements is reinforced by the specter of substantial remedial consequences for submitting misleading or false information. Under the Basel III Pillar 3 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 under Basel III will also be subject to the Pillar 3 public disclosure requirements. *See* 78 *Fed. Reg.* (October 11, 2013) (OCC and Board) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC). Each bank with consolidated total assets of $500 million or more is required to prepare a Part 363 Annual Report each year 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. For all such banks, the Part 363 Annual Report includes audited comparative financial statements, including footnotes, and the external auditor's opinion thereon, and a management report that contains (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; and (2) an assessment by management of the bank's compliance with such laws and regulations during the year. In addition, the Part 363 Annual Report for a bank with consolidated total assets of $1 billion or more must include reports by management and by the external auditor on their assessments of the effectiveness of internal control over financial reporting as of year-end. *See* 12 CFR part 363.

[224] 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.

EC 1	Principle 28: Disclosure and transparency
Practices and Procedures	As cited above, banking supervisors require banks and holding companies to complete and submit prescribed regulatory reports, which the supervisors make publicly available quarterly. These regulatory reports are based on regulatory reporting instructions that follow U.S. GAAP. These accounting principles and the required standardized regulatory reporting forms and instructions for required quarterly regulatory reporting promote the comparability, relevance, and reliability of information in a timely fashion. The federal banking agencies review regulatory reports on a periodic basis and if the agencies determine that the information or disclosures are incorrect, they may require that the bank or holding company restate regulatory reports. Information in regulatory reports may differ from that required in audited financial statements. Furthermore, holding companies with a class of equity securities registered with the U.S. Securities and Exchange Commission (SEC) and banks with securities registered with their primary federal banking agency (rather than the SEC) have additional quarterly and annual financial reporting and disclosure requirements under the federal securities laws. Under the Basel III Pillar 3 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 under Basel III will also be subject to the Pillar 3 public disclosure requirements. Pillar 3 is a set of disclosure requirements that will allow market participants to assess key information on the scope of application, capital, risk exposures, risk assessment processes, and the capital adequacy of the bank. Banks subject to the Pillar 3 disclosure requirements must provide timely public disclosures on a quarterly basis. Disclosure requirements under the Standardized Approach are required beginning on January 1, 2015. Disclosure requirements for banks adopting the Advanced Approaches are required upon exiting parallel run after January 1, 2014. Banks subject to the market risk rule must also provide market risk disclosures. *See* 78 *Fed. Reg.* 62018 (October 11, 2013) (OCC and Board) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC).

EC 2	Principle 28: Disclosure and transparency
Criterion	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.
Legal Framework	The U.S. federal banking agencies have a robust regulatory reporting framework. See Principle 10 for additional information. As noted in EC 1, under the Basel III Pillar 3 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 under Basel III will also be subject to the Pillar 3 public disclosure requirements. *See* 78 *Fed. Reg.* 62018 (October 11, 2013) (OCC and Board) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC).

EC 2	Principle 28: Disclosure and transparency
Practices and Procedures	The federal banking agencies require that banks follow U.S. GAAP in their financial reporting, including regulatory reporting. 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. Regulatory reports (such as the Call Report and the FR Y-9C) consider the size and complexity of a bank's or holding company's operations in the scope and content of required information and the commensurate level of disaggregation and detail. For example, banks with a significant amount of trading activity (trading assets and trading liabilities that exceed a prescribed threshold) are required to complete a detailed trading schedule. In addition, some of the regulatory reports provide the opportunity for the reporting banks and holding companies to provide footnotes or narrative disclosures, which may be either quantitative or qualitative in nature. As noted in EC 1, certain U.S. banks and holding companies adopting Basel III will be subject to the Pillar 3 disclosure requirements; these disclosures are both qualitative and quantitative in nature as well. *See* 78 *Fed. Reg.* 62018 (October 11, 2013) (OCC and Board) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC).

EC 3	Principle 28: Disclosure and transparency
Criterion	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Legal Framework/ Practices and Procedures	Pursuant to Regulation Y (12 CFR 225.5(b) (applicable to BHCs) and LL (12 CFR 238.4 (applicable to SLHCs)), FR Y-6 report is filed by all top-tier holding companies and consists of the requirement that top-tier holding companies not registered with the Securities and Exchange Commission (SEC) submit a copy of an annual report to shareholders if one is created. The FR Y-6 also 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, FR Y-10 provides data on organizational structural changes for the reportable companies listed in the respondent panel section below. There are eight schedules: Banking; Savings and Loan; Nonbanking; Merger; 4(k); Domestic Branch; Foreign Branches of U.S. Banking Organizations; and Branch, Agency, and Representative Office. The FR Y-7 and FFIEC 002 are required for foreign banking organizations (FBOs) that have a U.S. banking presence. The reports collect financial statements, organizational structure information, shares and shareholder information, and data on the eligibility to be a qualified FBO as defined in Regulation K.

EC 4	Principle 28: Disclosure and transparency
Criterion	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Legal Framework	As discussed under ECs 6 and 8 to Principle 10, U.S. federal banking agencies require by statute that banks comply with reporting requirements and ensure the disclosure of that financial information. Failure to comply can provide the basis for informal or formal

EC 4	Principle 28: Disclosure and transparency
	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. These measures help ensure compliance with the disclosure standards.
Practices and Procedures	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. If the supervisor determines management's risk management or control process to be deficient, the supervisor has a number of available responses to address such deficiencies, including requiring increased regulatory capital or other supervisory measures. Further discussion of the available supervisory measures is included in other principles, including Principle 10, EC 8. All regulatory reports that a bank or holding company files with its appropriate federal banking agency are reviewed for accuracy and completeness (*i.e.*, validity and quality checks; see EC 9 of Principle 10). Follow-up with reporting banks and holding companies is performed when necessary. 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.

EC 5	Principle 28: Disclosure and transparency
Criterion	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).
Legal Framework	The federal banking agencies 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.
Practices and Procedures	For each bank, the federal banking agencies publish quarterly Uniform Bank Performance Reports (UBPR) that are primarily based on the information reported on the Call Reports. These reports are also made publicly available by the banking supervisors. 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 Bank Holding Company Performance Report (BHCPR). 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,

EC 5	Principle 28: Disclosure and transparency
	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 also 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.

EC 6	Principle 28: Disclosure and transparency
Additional Criterion	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.
Legal Framework	Banks and holding companies are subject to reporting requirements that include financial and other information. All banks regardless of size must submit regulatory reports that include financial and other information on an entity-specific basis, while holding companies with assets of $500 million or more and savings and loan holding companies of all sizes must submit financial and other information on a consolidated basis. Banks must submit financial and other information to the appropriate federal banking agency, and each bank must submit reports on an entity-specific (solo) basis (but with its subsidiaries, if any, included on a consolidated basis). This reporting includes information about asset quality, loan loss provisioning, asset classifications, off-balance-sheet exposures, liquidity, capital adequacy, as well as some information on interest rate risk sensitivity and market risk. As noted in EC 1, under the Basel III Pillar 3 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 under Basel III will also be subject to the Pillar 3 public disclosure requirements. *See* 78 *Fed. Reg.* 62018 (October 11, 2013) (OCC and Federal Reserve) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC). The Pillar 3 disclosure requirements will allow market participants to assess key information on the scope of application, capital, risk exposures, risk assessment processes, and the capital adequacy of the bank. Banks and holding companies subject to Pillar 3 disclosure requirements must provide timely public disclosures on a quarterly basis. Disclosure requirements under the Standardized Approach are required for certain banks and holding companies beginning on January 1, 2015. Disclosure requirements for banks and holding companies adopting the Advanced Approaches are required upon exiting parallel run after January 1, 2014. Banks and holding companies subject to the market risk rule must also provide market risk disclosures. *See* 78 *Fed. Reg.* (October 11, 2013) (OCC and Board) and 78 *Fed. Reg.* 55340 (September 10, 2013) (FDIC).
Practices and Procedures	*See* Legal Framework, immediately above.

Assessment of Principle 28	Compliant
Comments	

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.[225]

(Reference documents: FATF *Recommendations*, February 2012; *Consolidated KYC risk management*, October 2004; *Shell banks and booking offices*, January 2003; *Basel Committee on Banking Supervision Sound management of risks related to money laundering and financing of terrorism*, January 2014; and *Customer due diligence for banks*, October 2001.)

Overview

Various statutes and regulations require the U.S. federal banking agencies to issue regulations and conduct periodic examinations to evaluate compliance by banks and holding companies with anti-money-laundering (AML) and suspicious activity reporting laws and regulations, and the agencies have authority to take enforcement actions, including cease and desist orders and civil money penalties. The agencies also ensure that the institutions they supervise have adequate policies and procedures in place and comply with applicable laws and regulations to prevent misuse of banks and holding companies for criminal purposes, including fraud, money laundering, and terrorist financing. For example, under 12 U.S.C. § 1818(s), the agencies are required and have prescribed regulations requiring banks that they supervise to establish and maintain procedures reasonably designed to assure and monitor an institution's compliance with the requirements of the Bank Secrecy Act (BSA), 31 U.S.C. §5311 *et seq.*, 12 U.S.C. §§§1829b, and §1951 – 1959, an AML and counter terrorist financing (CFT) statute. The agencies and the Department of the Treasury (Treasury), through the Financial Crimes Enforcement Network (FinCEN), have also issued regulations requiring financial institutions to establish and implement risk-based procedures for verifying the identity of each customer. *See* 12 CFR 21.21(b)(2) (OCC); 208.63(b)(2), 211.5(m)(2), 211.24(j)(2) (Federal Reserve); 326.8(b)(2) (FDIC); 31 CFR 1010.220 (FinCEN). Each of the agencies has issued regulations that set forth the requirements for banks under its supervision to establish and maintain procedures to ensure and monitor their compliance with the BSA (the "BSA/AML Compliance Program"). *See* 12 CFR 21.21, 163.177 (OCC); 208.63, 211.24(j)(1), 211.5(m)(1) (Federal Reserve); 326.8 (FDIC). The cornerstone of a strong BSA/AML Compliance Program is the adoption and implementation of comprehensive customer due diligence (know-your-customer) policies, procedures, and processes for all customers. Under statutory and regulatory authority, and using an interagency BSA/AML examination manual and an interagency statement on enforcement, the agencies examine banks and holding companies for BSA/AML compliance and take enforcement actions to address non-compliance. *See* 12 U.S.C. § 1818(s)(2); *Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act /Anti-Money Laundering Examination*

[225] 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.

Principle 29: Abuse of financial services

Manual; and "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements" (August 1, 2007). The agencies have traditionally supported the Basel Committee's efforts to provide guidance through the issuance of documents such as the *Prevention of criminal use of the banking system for the purpose of money-laundering*, December 1988; *Customer due diligence for banks*, October 2001; *Shell banks and booking offices*, January 2003; *Consolidated KYC risk management*, October 2004; *FATF 40 + IX*, 2003 and *FATF AML/CFT Methodology*, 2004, as updated; and *Due diligence and transparency regarding cover payment messages related to cross-border wire transfers*, May 2009.

The agencies and Treasury have also issued regulations requiring banks and holding companies to file suspicious activity reports (SARs) to report known or suspected criminal violations or suspicious transactions with the agencies, federal law enforcement authorities, and FinCEN. *See* 12 CFR 21.11, 163.180(d) (OCC); 208.62, 211.5(k), 211.24(f), 225.4(f) (Federal Reserve); 353 (FDIC); 31 CFR 1010.320 (FinCEN). BHCs (12 CFR 225.4(f)) and their nondepository subsidiaries are required to file SARs pursuant to Treasury regulations (e.g., insurance companies and broker/dealers, 31 CFR 1010.320). In addition, SLHCs and their non-bank subsidiaries, if not required, may decide to file SARs in appropriate circumstances. Effective customer due diligence policies, procedures, and processes provide the critical framework that enables banks and holding companies to comply with regulatory requirements and to report suspicious activity.

The agencies and Treasury may take enforcement actions against banks and holding companies to address significant failures to comply with suspicious activity reporting and other recordkeeping and reporting requirements, and in cases where noncompliance indicates possible criminal activity, matters may be referred to the U.S. Department of Justice (DOJ).

The agencies also supervise to ensure compliance with U.S. economic and trade sanctions, administered by the Treasury Department's Office of Foreign Assets Control (OFAC). *See* 31 CFR 500 *et seq*. OFAC has civil monetary penalty authority, and OFAC violations may result in criminal sanctions imposed by the DOJ.

Other agencies have enforcement authority with respect to certain conduct that results in abuse of financial services. For example, the Federal Trade Commission (FTC) and Consumer Financial Protection Bureau (CFPB) may take action against non-depository organizations involved in fraud that harms consumers. Consumer protection laws and regulations impose obligations on depository institutions that are designed to help ensure that they are not used as vehicles for abuse of consumers (e.g., the Electronic Fund Transfer Act and prohibitions against unfair, deceptive, or abusive practices). The Commerce Department administers and enforces certain export restrictions and violations of such restrictions may result in penalties. Finally, any conduct by a banking organization that rises to the level of a criminal offense (i.e., actual participation in fraud, money laundering, or other misconduct) can result in criminal prosecution of the banking organization and the individuals responsible for the criminal conduct.

Principle 29: Abuse of financial services

(Reference documents: FATF *Recommendations*, February 2012; *Consolidated KYC risk management*, October 2004; *Shell banks and booking offices*, January 2003; *Basel Committee on Banking Supervision Sound management of risks related to money laundering and financing of terrorism*, January 2014; and *Customer due diligence for banks*, October 2001.)

EC 1	**Principle 29: Abuse of financial services**
Criterion	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.
Legal Framework	Various statutes and regulations require the federal banking agencies to issue regulations and to conduct examinations to evaluate banks' compliance with laws and regulations pertaining to AML. The agencies must review each supervised bank's BSA/AML Compliance Program at each examination. *See* 12 U.S.C. § 1818(s)(2)(A). Supervisors must also determine that banks have adequate policies and procedures to prevent criminal activities, including fraud, money laundering and terrorist financing. The federal banking agencies have authority to enforce all banking rules and regulations, including compliance with the BSA, and certain enforcement obligations apply with respect to BSA/AML Compliance Program violations. *See* 12 U.S.C. § 1818(s)(3). State banking supervisors also have enforcement authority for state-chartered banking institutions. Other agencies have enforcement authority with respect to certain conduct, e.g., the FTC and CFPB, may take action against non-depository institutions involved in fraud that harms consumers. Any conduct that rises to the level of a criminal offense can result in criminal prosecution. The federal and state banking supervisors may require banks to undertake remedial actions and may assess civil money penalties and issue cease and desist orders. FinCEN and the DOJ have authority to assess civil and criminal penalties, respectively, for BSA violations.[226] *See* 31 U.S.C. §§ 5321-5322. The Consumer Financial Protection Bureau also supervises credit unions, and other financial companies, and enforces federal consumer financial laws; the agency may make referrals for the prosecution of criminal activities.
Practices and Procedures	The agencies 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 those requirements through civil enforcement actions. *See e.g.* 12 U.S.C. §§ 1818(s)(2) and (s)(3); 1818(i). These provisions are vigorously enforced by the federal banking agencies and, over the years, a number of banks and holding companies have been assessed significant penalties for BSA/AML compliance failures. In addition to the agencies, certain other federal and state government agencies play critical roles in safeguarding the U.S. financial sector from criminal activities as previously noted. The federal banking agencies issued a comprehensive BSA/AML Examination Manual ("FFIEC BSA/AML Examination Manual") that is frequently updated to ensure compliance with the rules and regulations. In addition, the federal banking agencies routinely issue risk management and other guidance to provide additional relevant

[226] Besides banks, other types of holding company subsidiaries may be "financial institutions," which are subject to BSA laws. *See* 31 U.S.C. § 5312(a)(2)). The agencies have implemented examination procedures for enterprise-wide compliance programs. *See Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act /Anti-Money Laundering Examination Manual*, at Compliance Program Structures – Overview.

EC 1	Principle 29: Abuse of financial services
	information on emerging and other risks. FinCEN also provides guidance on emerging fraud and other AML threats. The federal banking agencies also meet regularly through a number of various working groups to coordinate and share information. These working groups include, among others, the National Bank Fraud Working Group, the FFIEC BSA/AML Working Group, and the Bank Secrecy Act Advisory Group. The federal banking agencies also conduct regular outreach to financial institutions to reinforce their ongoing obligations to comply with BSA/AML regulations.

EC 2	Principle 29: Abuse of financial services
Criterion	The supervisor determines 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.
Legal Framework	The federal banking agencies 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. *See* 31 U.S.C. § 5318(h)(1) (statutory requirement); 12 CFR 21.21, 163.177 (OCC); 12 CFR 208.63, 211.5, 211.24 (Federal Reserve); and12 CFR 326.8 (FDIC). The agencies and Treasury have issued separate regulations requiring banks to establish a customer identification program (CIP). *See* 31 U.S.C. §5318(l) (statutory requirement); 12 CFR 208.63(b)(2) (Federal Reserve); 12 CFR 326.8(b)(2) (FDIC); 12 CFR 21.21(b)(2)(OCC); and 31 CFR 1020.220 (Treasury/FinCEN). The agencies and Treasury have issued regulations requiring banks and holding companies to file a suspicious activity report with FinCEN within 30 days of the initial detection of certain facts (within 60 days if attempting to identify a subject). *See* 31 CFR 1020.320(b) (Treasury/FinCEN); 12 CFR 21.11(d) (OCC); id. at 208.62(d) (Federal Reserve); id. at 353.3(b)(1) (FDIC); *see also* 31 U.S.C. § 5318(g) (statutory requirement). 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 Reserve); 12 CFR 326.8(b)(2) (FDIC); and 31 CFR 1010.220 (FinCEN). The federal banking agencies and Treasury have issued regulations requiring banks and holding companies to file a SAR with FinCEN within 30 days of the initial detection of certain facts (within 60 days if attempting to identify a subject). *See* 12 CFR 21.11, 163.180 (OCC); 12 CFR 208.62 (Federal Reserve); 12 CFR 353.3 (FDIC); 31 CFR 1010.320 (FinCEN); *see also* 31 U.S.C. §

EC 2	Principle 29: Abuse of financial services
	5318(g). Specifically, a bank, a bank holding company, or a bank holding company's non-bank subsidiary, and an Edge or Agreement corporation must file a SAR whenever they detect or suspect any federal criminal violation against the bank or involving transactions conducted through the bank if (a) an insider was involved or (b) over US$5,000 was involved and the filer can identify a suspect, or (c) over US$25,000 was involved—or if the amount exceeds US$5,000 and the transactions may violate the BSA or AML rules. In cases involving violations requiring immediate attention, law enforcement authorities must be immediately informed, in addition to filing the SAR. Also, when a SAR is filed the board of directors or the relevant board committee must be promptly informed. Section 12 USC 1818(e) allows the federal banking agencies to remove or prohibit an institution affiliated party (IAP) for engaging in an act, omission or practice which constitutes a violation of law or written agreement with the supervisory, an unsafe or unsound practice, or breach of such party's fiduciary duty, provided additional factors are satisfied (i.e. loss to the bank, gain to the IAP, etc.). *See e.g.* 12 CFR part 21, subpart A (Minimum Security Devices and Procedures), 12 CFR part 168 (OCC); 12 CFR 208.61 (Federal Reserve); 12 CFR part 326 (FDIC). *See also* 12 CFR part 30, Appendix B, 12 CFR part 570170, Appendix B (OCC); 12 CFR part 364 Appendix B (FDIC); and 12 CFR part 208, Appendix D-2 (Federal Reserve) and 12 CFR part 225, Appendix F (Federal Reserve).
Practices and Procedures	Supervisors promote high ethical and professional standards in banks through various means, such as conducting outreach, providing training opportunities, or issuance guidance on appropriate compliance with BSA/AML regulations. The federal banking agencies have also brought enforcement actions against banks and individuals based upon failures to meet ethical and professional standards, including the fiduciary obligations of senior management and the board of directors. SARs involving bank insiders are properly reviewed and examinations of banks and holding companies are conducted by federal and state supervisors using a consistent, risk-based approach set forth in the *FFIEC BSA/AML Examination Manual* (Manual). The agencies released the Manual publicly to fully inform banks of examination criteria and disseminate uniform guidance on supervisory expectations. The agencies design, conduct, and facilitate training for the banking industry to introduce and reinforce regulations and procedures contained in the Manual. The agencies have issued a policy statement clarifying the practice for taking enforcement actions relating to BSA/AML compliance problems. This statement can be found in Appendix R of the Manual. The federal and state supervisors also assess more broadly whether the bank and holding company have adequate policies and processes in place to promote high ethical and professional standards to prevent the bank from being used, intentionally or unintentionally, for criminal activities. As part of the examination of the BSA/AML Compliance Program, U.S. federal banking agencies evaluate 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 Agencies also confirm that an institution's board meets the regulatory mandate of formally approving the written BSA/AML program. *See, e.g.*, 12 U.S.C. § 1818(s). As part of a bank's onsite examination by its supervisory regulator, the As part of a bank's onsite examination by its supervisory regulator, the agencies will examine the quality of a bank's suspicious activity monitoring and investigation processes as part of the internal control requirement of the bank's BSA/AML program. The agencies conduct their examinations of a bank based upon the procedures set forth in the FFIEC BSA/AML Examination Manual. *See* 12 CFR 21.21(b) (OCC); 12 CFR 326.8 (FDIC); and 12 CFR 208.63 (Federal Reserve).

EC 3	Principle 29: Abuse of financial services
Criterion	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.[227]
Legal Framework	The federal banking agencies and, pursuant to 31 USC 5318(g), the Secretary of the Treasury, require required banks to report suspicious transactions. The Secretary of the Treasury issued regulations pursuant to this statute at 31 CFR Part 1010 that require banks to report suspicious transactions to FinCEN. Each agency has also issued its own regulations requiring banks and holding companies to file a SAR with FinCEN within 30 days of the initial detection of suspicious activity certain facts (within 60 days if attempting to identify a subject). *See* 31 CFR 1020.320(b) (Treasury/FinCEN); 12 CFR 21.11(d) (OCC); id. at 208.62(d) (Federal Reserve); id. at 353.3(b)(1) (FDIC); *see also* 31 U.S.C. § 5318(g) (statutory requirement). Specifically, a bank, bank holding company, and bank holding company's non-bank subsidiary are under an obligation to file a SAR whenever it detects any known or suspected federal criminal violation, or pattern of criminal violations, committed or attempted against the bank or involving a transaction or transactions conducted through the bank, where the filer believes that it was either an actual or potential victim of a criminal violation, or series of criminal violations, or that the filer was used to facilitate a criminal transaction, and (1) an insider was involved; or (2) over $5,000 was involved, and the filer can identify a suspect; or (3) over $25,000 was involved, but the bank cannot identify a suspect; or alternatively, that the transaction involves $5,000 or more and involves potential money laundering or violations of the BSA. *See* 12 CFR 21.11(c) (OCC); id. at 208.62(c) (Federal Reserve); and id. at 353.3(a) (FDIC). In cases involving violations requiring immediate attention, such as when a reportable transaction is ongoing, the filing institution, whether a bank or holding company, must immediately notify law enforcement and the agency in addition to filing a SAR. *See* 12 CFR 21.11(d) (OCC); id.at 208.62(d) (Federal Reserve); id.at 353.3(b)(2) (FDIC). Also, whenever a bank files a SAR it must promptly notify the board of directors or board committee. *See* 12 CFR 21.11(h) (OCC); id. at 208.62(h) (Federal Reserve); and id. at 353.3(f) (FDIC). Banks and holding companies are required at all times to conduct their business and exercise their powers with due regard to safety and soundness. *See* 12 CFR 30.21 (OCC); 12 CFR 208.3(d)(1) (addressing conditions of membership in the Federal Reserve); 12 CFR 30 (safety and soundness standards for national banks) and 12 CFR 364 for FDIC. As part of this obligation, the federal banking agencies expect banks to report directly to them any suspicious activities and incidents of fraud which might be material to the safety, soundness, or reputation of the institution.
Practices and Procedures	In instances where a bank knows, suspects, or has reason to suspect that a customer may be linked to terrorist activity against U.S., the bank is instructed, according to the FFIEC BSA/AML Examination Manual, to immediately call. Similarly, if any other suspected violation requires immediate attention, the bank is instructed to notify the procedures and controls used by their reporting financial institutions to identify, monitor, and report violations and suspicious activities. *See* FFIEC BSA/AML Examination Manual – Suspicious Activity Reporting Overview. As stated on page 78 of the FFIEC BSA/AML Examination Manual, "For situations requiring immediate attention, in addition to filing a timely SAR, a bank must immediately notify, by telephone, an 'appropriate law enforcement authority' and, as necessary, the bank's primary regulator." In general, material issues affecting the safety, soundness,

[227] 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 serving as an FIU.

EC 3	Principle 29: Abuse of financial services
	or reputation of a supervised institution, whether or not reflected on a SAR, are monitored by the FBAs. SARs, CTRs, and CTR exemptions can be downloaded from or obtained directly online from a controlled BSA-reporting database (FinCEN Portal) maintained by FinCEN. Each agency has staff authorized to obtain this data from the BSA-reporting database that supervisors can use to help scope and plan their examination activities. The FBAs also provide guidance, notices, and alerts to the banking industry on criminal activity and terrorist finance trends. *See*, e.g., OCC Alerts, FDIC's Financial Institution Letters and Special Alerts and FinCEN's Secure Information Sharing System. FinCEN also publishes the "SAR Activity Review, Trends, Tips and Issues" to provide information and guidance to SAR filers, and also issues the "SAR Activity Review, By the Numbers" to provide numerical data and information concerning the number and types of SAR filings. As a part of its examination scoping responsibilities, 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. This scoping process includes determining the examination staffing needs and technical expertise, and selecting examination procedures to be completed. *See* Manual p. 15. Additionally, the agencies review SARs that report known or suspected criminal activities by current and former officers, directors, employees, and other institution-affiliated parties (IAPs) to ensure that appropriate enforcement actions are brought against IAPs. *See*, Federal Reserve *SR letter 03-20*, **"**Suspicious Activity Reports and Enforcement Actions against Individuals*."* In addition, the OCC's Fast Track Enforcement Program is designed to ensure that bank insiders who have engaged in criminal acts in banks, but who are not being criminally prosecuted, are prohibited from working in the banking industry. SAR data is reviewed to identify IAPs that have engaged in suspicious or illegal conduct. *See* OCC PPM 5310-8 (Rev). The FDIC describes among other SAR review processes, its internal review procedure of IAP SARs in the Winter 2007 Supervisory Insights Journal.

EC 4	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	The agencies are authorized to inform relevant authorities, including Treasury and FinCEN, of suspicious transactions. *See e.g.* 12 CFR Part 21.11 (OCC); 12 CFR Part 261 (Federal Reserve); 12 CFR 309.6 (FDIC). 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.
Practices and Procedures	The supervisor is authorized to independently inform the financial intelligence unit of additional suspicious transactions, and to share such information with other relevant authorities, as appropriate. The federal banking agencies and FinCEN have specific regulations that address the disclosure of SARs to other government agencies. *See e.g.*, 12 CFR 21.11, 12 CFR 309.6 and 31 CFR 1010.

EC 5	Principle 29: Abuse of financial services
Criterion	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 programme, on a group-wide basis, has as its essential elements: (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 (as necessary), 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 recognise unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (eg escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (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 (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.
Legal Framework	Pursuant to 31 U.S.C. § 5318(l), the agencies 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 to the extent reasonable and practicable, and maintain records of the information used to verify the person's identity, including name, address, and other identifying information. 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; this provision is implemented by regulation 31 CFR 1020.220. In addition, for certain non-U.S. accounts and transactions, banks must identify beneficial owners. *See* section 312 of the USA Patriot Act, 31 U.S.C. 5318(i), and 31 CFR 1010.620. The BSA regulations generally require that the banks properly safeguard and maintain copies of records and reports for a period of five years following the completion of the transaction. *See* 31 CFR Chapter X. 12 USC § 5318(i) and 31 CFR Part 1010 requires due diligence for U.S. private banking and correspondent bank accounts involving foreign persons. This statute requires minimum standards for private banking accounts including reasonable steps to ascertain the identity of nominal and beneficial owners of, and the source of funds deposited into, such account as needed to guard against money laundering and to conduct enhanced scrutiny of any such account requested or maintained by, or on behalf of, a senior foreign political figure, or any immediate family member or close associate of a senior foreign political figure that is reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption. However, in practice, banks are expected to, and do, apply these standards to all other accounts and transactions. Section 312 of the USA PATRIOT Act also specifically requires banks to perform due diligence and, in some cases, enhanced due diligence, with regard to correspondent accounts established or maintained for foreign financial institutions, and private banking accounts established or maintained for non-U.S. persons (31 USC § 5318(i)).

EC 5	Principle 29: Abuse of financial services
	Banks must have an adequate BSA/AML compliance program in place that includes ongoing monitoring to detect criminal and suspicious activities. Specifically, the BSA/AML compliance program must have sufficient internal controls for monitoring suspicious activity, a qualified BSA compliance officer to oversee the program, independent testing to identify any vulnerabilities in the program, and regular BSA/AML compliance training for all relevant personnel (31 USC § 5318(h)). Each federal banking agency has its own regulation on BSA compliance programs. *See*, e.g., 12 CFR 21.21. 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.
Practices and Procedures	All banks are required to have a BSA compliance program (31 U.S.C. § 5318(h)) and maintain certain bank records relating to AML programs (31 U.S.C. § 5318(k); 18 U.S.C. §1829b; 31 CFR 1020 subpart D). The cornerstone of a strong BSA/AML program is the adoption of comprehensive CDD policies, procedures, and processes for all customers, and enhanced due diligence (EDD) procedures for those customers that present a higher risk for money laundering and terrorist financing. Effective CDD policies and procedures provide the critical framework that enables banks to comply with regulatory requirements and to report suspicious activity. *See* Manual, p. 52. Supervisors determine whether the internal controls in a bank's BSA/AML Compliance Program include prudent account opening procedures and ongoing monitoring systems, including a customer acceptance policy identifying business relationships the bank will not accept, if any. Examination procedures with respect to internal controls, CDD, USA PATRIOT Act Section 312, PEPs and CIP are set forth in the FFIEC BSA/AML Examination Manual. The U.S. federal banking agencies evaluate whether the bank's CIP enables the bank to form a reasonable belief of the customer's true identity at account opening and whether the bank has measures in place to ensure account profiles are current in order to promote risk-based monitoring of accounts. Where appropriate, supervisors also review accounts to determine whether a bank has identified certain individuals that are politically exposed persons (PEPs) under U.S. law and whether management is involved in decisions to accept PEP accounts or maintain existing accounts whose holders are determined to be PEPs, and to ensure the bank conducts ongoing risk-based monitoring of PEP accounts. *See* FFIEC BSA/AML Examination Manual, p. 300. *See also*, 31 U.S.C. § 5318(i)(3)(b) and 31 CFR part 1010.620(c). The U.S. federal banking agencies and FinCEN have issued detailed "frequently asked questions" (FAQs) relating to CIP requirements that can be found on FinCEN's website. *See* "Interagency Interpretive Guidance on Customer Identification Program Requirements" under section 326 of the USA Patriot Act (April 28, 2005). In addition, the Department of the Treasury and the Federal Banking Agencies issued guidance requiring enhanced due diligence for PEP accounts. See, Guidance on Enhanced Scrutiny for Transactions that may Involve the Proceeds for Foreign Official Corruption dated January 2001. The agencies have enforced supervisory guidance that directs banks to establish CDD policies, procedures and processes, which are integrated into the bank's overall risk management strategy. The agencies have identified failures of such during examinations evidenced by recent public enforcement actions. Details of the enforcement actions may be found on each agency's website. Below are some examples: In the Matter of Wachovia Bank, National Association, Charlotte, North Carolina AA-EC-10-17 #2010-037 (OCC - 2010) In the Matter of HSBC Bank USA, N.A., Mclean, Virginia AA-EC-10-98 #2010-199 (OCC – 2010) In the Matter of Citibank, N.A., Sioux Falls, South Dakota AA-EC-12-18 #2012-052 (OCC – 2012)

EC 5	Principle 29: Abuse of financial services
	In the Matter of JPMorgan Chase Bank, N.A., Columbus, OH AA-EC-13-04 #2013-002 (OCC – 2013). Federal Reserve Written Agreement, M & T Bank Company (2013), http://www.federalreserve.gov/newsevents/press/enforcement/enf20130617a1.pdf. FDIC Cease and Desist Order, Community First Bank, Somerset, New Jersey FDCI-13-194b (2013). http://www.fdic.gov/news/news/press/2013/pr13094a.html

EC 6	Principle 29: Abuse of financial services
Criterion	The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include: (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.
Legal Framework	*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. 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) and its implementing regulation at 31 CFR 1010.630 prohibit U.S. banks from providing correspondent accounts to foreign shell banks. FinCEN has issued specific regulations at 31 CFR 13.176 that require U.S. banks to take reasonable steps to ensure that correspondent accounts provided to foreign banks are not being used to indirectly provide financial services to foreign shell banks. U.S. banks are required to obtain certification to that effect from their foreign bank customers and to periodically obtain re-certification. FinCEN has issued regulations specific to correspondent banking. *See* 31 CFR part 1010, Subpart F.13.176
Practices and Procedures	The FFIEC BSA/AML Examination Manual has a chapter specifically addressing correspondent banking relationships (see pages 125-129). The agencies supervise banks to ensure compliance with foreign correspondent banking requirements, in accordance with the procedures and expectations set forth in the Manual. The agencies confirm that banks are meeting their legal obligation to include procedures for a periodic review of each correspondent account to determine consistency with the information obtained about the type, purpose, and anticipated activity of the account as required under 31 U.S.C. § 5318(i). 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. The agencies enforce requirements that banks establish due diligence and enhanced due

EC 6	Principle 29: Abuse of financial services
	diligence policies and processes regarding correspondent banking. The agencies have cited failures of such rules as a cause of concern during examinations as evidenced by recent public AML enforcement cases that have involved correspondent banking breakdowns. *See In the Matter of HSBC*. Examples of other enforcement actions taken involving correspondent banking breakdowns are found on each agency's website, some of which are described below: In the Matter of Wachovia Bank, National Association, Charlotte, North Carolina AA-EC-10-17 #2010-037 (OCC - 2010)In the Matter of HSBC Bank USA, N.*A*., Mclean, Virginia AA-EC-10-98 #2010-199 (OCC – 2010) In the Matter of Citibank, N.A., Sioux Falls, South Dakota AA-EC-12-18 #2012-052 (OCC – 2012) In the Matter of JPMorgan Chase Bank, N.A., Columbus, OH AA-EC-13-04 #2013-002 (OCC – 2013). Federal Reserve Cease and Desist Order, Commerzbank AG (2013), http://www.federalreserve.gov/newsevents/press/enforcement/enf20131017a1.pdf. FDIC Consent Order, Banesco USA, Coral Gables, FL FDIC13-166b (2103) http://www.fdic.gov/news/news/press/2014/pr14006a.html U.S. federal and state banking agencies generally view BSA/AML risks in domestic correspondent banking as low compared to other types of financial services. Nevertheless, U.S. federal and state banking supervisors evaluate the policies and procedures for U.S. banks that offer correspondent banking services to domestic respondent banks, as well as the processes in place for managing the risks involved in these correspondent relationships and for detecting and reporting suspicious activity. *See* pp. 125-129, Manual.

EC 7	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	Treasury regulations, 31 C.F.R. 5381(h)), require financial institutions to have adequate AML compliance programs that include sufficient internal controls for monitoring suspicious activity, a qualified BSA compliance officer to oversee the program, independent testing to identify any vulnerabilities to the program, and regular BSA/AML compliance training for all relevant personnel. Under 12 U.S.C. § 1818(s), each examination by various federal banking agency is required to include an examination of the institution's BSA Compliance Program. Under statutes (e.g., 12 U.S.C. §§ 248 (Federal Reserve); 481, 1464(d) (OCC); and 1820 (FDIC),)) federal banking agency supervisors have complete access to a supervised bank's books and records during an examination. *See* PPM 5310-10 for examiner guidance (OCC). In some circumstances, supervisors may also review the books and records of bank affiliates and subsidiaries. In addition, supervisors have access to the books and records of bank service companies, and to the books and records of independent service providers that are subject to the Bank Service Company Act, 12 U.S.C. § 1867.

EC 7	Principle 29: Abuse of financial services
	The federal and state banking agencies' supervision process includes both on-site examinations and off-site surveillance and monitoring. In general, on-site examinations must occur once every 12 to 18 months. *See*, 12 CFR 4.6 and 4.7 (OCC); 12 CFR 208.64 (Federal Reserve); 12 CFR 337.12 (FDIC). However, those financial institutions that the agencies believe possess significant compliance risks may be examined more frequently. The federal banking agencies are responsible for examining banks and holding companies within their respective jurisdictions for safety and soundness and compliance with applicable laws. In addition, 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).
Practices and Procedures	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 to be 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.

EC 8	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	In appropriate circumstances, 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. The federal banking agencies 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.statutes must undergo a hearing to have its deposit insurance revoked, and for convictions of civil statutes a hearing may be conducted. The most serious sanction that the federal

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	banking agencies 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). Any bank convicted of violating the criminal money laundering statutes must undergo a hearing to consider if its deposit insurance or charter should be revoked, and for convictions of civil statutes a hearing may be conducted. *See* 12 U.S.C. § 1818(w) (revocation of insurance for state charted banks); 12 U.S.C. §93(d) (revocation of charter for nationally chartered banks); 12 U.S.C. §1821(c)(5)(M) (FDIC); and 12 U.S.C. §§3105(i) (FRB).
Practices and Procedures	The federal banking agencies refer cases involving potential criminal violations of BSA/AML regulations to DOJ, and work cooperatively with DOJ in its investigations of such cases. In general, BSA/AML deficiencies that give rise to supervisory enforcement actions relate to compliance with the four-part BSA/AML Compliance Program rule, CIP rule, and with SAR and CTR filing requirements. In the event that BSA/AML deficiencies are significant, repeated, remain unresolved by the bank's management, or are otherwise of serious concern, the appropriate agency may exercise its enforcement authority by taking a formal action against a bank subject to its supervision. 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. The provisions of each enforcement action are tailored to address the particular characteristics of the violations identified by the supervisors. In order to promote a consistent approach for enforcement of BSA/AML Compliance Program requirements and to make those standards more transparent to the industry, the agencies issued an interagency statement in August 2007 to clarify the circumstances in which an agency will issue a cease and desist order to address noncompliance with certain BSA/AML requirements. This statement can be found in Appendix R of the FFIEC BSA/AML Examination Manual.

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Criterion	The supervisor determines that banks have: (a) requirements for internal audit and/or external experts[228] 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 appointed 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 programmes for their staff, including CDD and methods to monitor and detect criminal and suspicious activities.
Legal Framework	Treasury regulations, 31 CFR 5318(h)), require banks to have a BSA/AML compliance program, and each federal banking agency has its own regulation on BSA compliance programs (see, e.g., 12 CFR 21.21). The FFIEC BSA/AML Examination Manual

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

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	specifically addresses the regulatory expectations pertaining to internal controls, including CDD requirements, which are an essential component of a bank's internal controls. *See* § 1818(s). Banks must have an adequate BSA/AML Compliance Program in place that includes independent testing of the bank's compliance program; the designation of an individual responsible for coordinating and monitoring day-to-day compliance; and ongoing training programs. *See* 12 U.S.C. § 1818(s). The agencies have issued "Interagency Guidelines Establishing Standards for Safeguarding Customer Information" that advises banks to perform background checks for employees with responsibilities for, or access to, customer information. *See* 12 CFR part 208, Appendix D-2 and 12 CFR part 225, Appendix F (Federal Reserve); 12 CFR part 364, Appendix B (FDIC); 12 CFR part 30, and Appendix B, (§ III-C-1- e) (OCC). 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)).
Practices and Procedures	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 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. If one or more of the components of the BSA/AML Compliance Program are considered inadequate, the agencies may take informal or formal supervisory actions to require the bank to correct the deficiencies to strengthen the bank's compliance program. *See* the response to Principle 29, EC1 and EC8. 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 (OCC Bulletin 2013-29) and payment processors (OCC Bulletin 2008-12). *See* FinCEN Guidance No. FIN-2012-A010. 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. *See FFIEC Information Technology Examination Handbook*, Operations, Personnel Controls. The agencies have also issued guidance to the industry concerning best practices in this area. *See e.g.*, Comptroller's Handbook for *Asset Management* – Conflicts of Interest; FFIEC, The Detection, Investigation and Prevention of Insider Loan Fraud: A White Paper, May, 2003; OCC *The Directors Book* – The Role of a National Bank Director, March 1997.

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	The agencies have also issued risk management guidance for third party relationships (OCC Bulletin 2013-29) and payment processors (OCC Bulletin 2008-12). *See also* FinCEN Guidance No. FIN-2012-A010 and FDIC Guidance No. FIL-3-2012.

EC 10	Principle 29: Abuse of financial services
Criterion	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 utilise adequate management information systems to provide the banks' Boards, management, and the dedicated officers with timely and appropriate information on such activities.
Legal Framework	As discussed previously, 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 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). 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).
Practices and Procedures	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 (*See* Manual).

EC 11	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	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 FinCEN have issued interagency guidance on the scope of this "safe harbor," as judicially interpreted, on May 24, 2004. *See* SR letter 04-8; OCC Bulletin 2004-24; and FDIC FIL-67-2004. Federal law provides protection from civil liability for all reports of suspicious transactions made to appropriate authorities, including supporting documentation, regardless of whether such reports are filed pursuant to the SAR instructions. *See* 31 U.S.C. § 5318(g)(3). Specifically, the law provides that a bank and 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 or political subdivision of any state, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure." *See* p. 68, the Manual. Section 351 of the USA Patriot Act amended 31 U.S.C. § 5318(g)(3) to expand the immunity under safe harbor protections to include directors, officers, employees, and agents of the bank or holding company who participate in preparing and reporting SARs. This safe harbor applies to SARs filed within the required reporting thresholds as well as to SARs filed voluntarily on any activity below the threshold. Each agency has applicable regulations that specifically include a safe harbor provision for the filing of SARs. *See* 12 CFR 21.11(l), 12 CFR 163.180(d) (OCC); 12 CFR 208.62(k) (Federal Reserve); and 12 CFR 353.3(h) (FDIC). Finally, section 355 of the USA Patriot Act specifically authorizes banks and holding companies to include suspicions of illegal activity in written employment references. *See* 12 U.S.C. § 1828(w).
Practices and Procedures	The agencies review the procedures and practices of a bank's or holding company's suspicious activity reporting process to ensure that appropriate procedures are being conducted. The FFIEC BSA/AML Examination Manual – Suspicious Activity Reporting Overview reiterates the "safe harbor" provision by noting that it applies to any bank, its directors, officers, employees, and agents who make a disclosure to the appropriate authorities of any potential violation of law or regulation (*See* p. 68, the Manual). Specifically, such individuals "shall not be liable to any person under any law or regulation of the United States, any constitution, law, or regulation of any State or political subdivision of any State, or under any contract or other legally enforceable agreement (including arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure or any other person identified in the disclosure".

EC 12	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	The federal banking agencies are authorized, directly or indirectly, to cooperate with the relevant domestic and foreign financial sector supervisory authorities or share with them information related to suspected or actual criminal activities where this information

EC 12	Principle 29: Abuse of financial services
	is for supervisory purposes. *See* Section 8(v) of the Federal Deposit Insurance Act (12 U.S.C. § 1818(v))regarding disclosure of supervisory information to foreign banking authorities, if the foreign authority is conducting an investigation to determine whether there is a violation of law or regulation dealing with banking matters or currency transactions that are administered or enforced by the foreign authority. Section 15 of the International Banking Act (12 U.S.C. § 3109) also authorizes sharing information with foreign bank regulatory or supervisory authorities, if such disclosure does not prejudice the interests of the United States, and the foreign authority agrees to maintain the confidentiality of the information to the extent possible under applicable law. 12 CFR 4.37 permits them to share non-public OCC information with certain other agencies of foreign governments (not just foreign bank regulators or supervisors), subject to appropriate confidentiality safeguards. 12 CFR part 309 gives the FDIC discretion in the sharing of confidential information, subject to appropriate confidentiality safeguards. 12 CFR 261.20 and 261.21 permit the Federal Reserve to share confidential supervisory information with other agencies under certain circumstances, subject to confidentiality safeguards.
Practices and Procedures	The federal banking agencies 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 federal banking agencies will coordinate directly with domestic banking supervisors. The agencies may also share information with the relevant supervisory and enforcement agencies, subject to confidentiality restrictions. 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 foreign 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. The agencies are party (either separately or jointly) to over twenty supervisory information sharing arrangements with foreign bank supervisors.

EC 13	Principle 29: Abuse of financial services
Criterion	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.
Legal Framework	Section 314(a) of the USA PATRIOT Act establishes a secure communication process between FinCEN and the financial institutions.
Practices and Procedures	The agencies employ highly skilled personnel for a number of specialties, including BSA/AML compliance and terrorist financing offences. These specialists are highly skilled, receive ongoing training, are deployed in the largest, most complex and high-risk institutions, and are well prepared to identify unusual or potentially criminal activity in their areas of expertise. In addition to these subject matter experts, the agencies have fraud experts on staff to handle fraud cases and liaise with law enforcement agencies, such as the DOJ and FBI. The agencies also alert the industry of fraud schemes through issuing guidance and conducting presentations at

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	industry conferences. In addition, FinCEN routinely issues alerts and notices to banks via the 314(a) communication network and through guidance documents. The FDIC's Office of Inspector General-Office of Investigations carries out a comprehensive nationwide program for the prevention, detection, and investigation of criminal or otherwise prohibited activity affecting the FDIC and its programs. The Office of Investigations coordinates with DOJ, FBI, U.S. Secret Service, IRS, Office of Inspector General, and state and local law enforcement authorities regarding the prosecution of federal criminal offenses, including money laundering and terrorist financing offences.

Assessment of Principle 29	Compliant
Comments	