

# Annual Report 2011

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## Supervision and Regulation

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The Federal Reserve has supervisory and regulatory authority over a variety of financial institutions and activities with the goal of promoting a safe, sound, and stable banking and financial system that supports the growth and stability of the U.S. economy. As described in this report, the Federal Reserve carries out its supervisory and regulatory responsibilities and supporting functions primarily by

- promoting the safety and soundness of individual financial institutions supervised by the Federal Reserve;
- developing supervisory policy (rulemakings, supervision and regulation letters (SR letters), policy statements, and guidance);
- identifying requirements and setting priorities for supervisory information technology initiatives;
- ensuring ongoing staff development to meet evolving supervisory responsibilities;
- regulating the U.S. banking and financial structure by acting on a variety of proposals; and
- enforcing other laws and regulations.

## 2011 Developments

During 2011, the U.S. banking system and financial markets improved further, continuing their recovery from the financial crisis that started in mid-2007.

**Performance of bank holding companies.** While a turnaround in bank holding companies' (BHCs) performance was evident during 2011, performance remains weak by historical standards, and the industry recovery could face challenges due to ongoing and elevated nonperforming asset levels. U.S. BHCs, in aggregate, reported earnings of \$108 billion for 2011, up from \$80 billion for the year ending December 31, 2010. Much of this improvement was due to lower loan loss provisioning and consequent reserve releases. The proportion of unprofitable BHCs, although down from 28 percent in 2010, remains high at 18 percent; unprofitable BHCs encompass roughly 15 percent of banking industry assets.<sup>\*</sup> Nonperforming assets present a significant challenge to industry recovery, with the nonperforming asset ratio remaining high at 4.1 percent of loans and foreclosed assets, the same percent as in 2010. Weaknesses were broad based, encompassing residential mortgages (first-lien), commercial real estate--especially non-owner nonfarm nonresidential and construction other than single-family--and commercial and industrial (C&I) loans. In 2011, an additional 172 BHCs that received funds from the U.S. Department of the Treasury's (Treasury) Troubled Asset Relief Program (TARP) repaid all funds received--120 of these companies repaid with funds received from the Small Business Lending Fund (SBLF). At year-end 2011, a total of 332 BHCs and banks that received funds from the TARP had repaid all funds received, and Treasury reports that approximately 89 percent of all distributed TARP funds have been repaid. Including income from dividends, interest and other sources, Treasury has received \$258.44 billion back from bank support programs, exceeding the \$245.10 billion in funds disbursed.

Although Treasury's SBLF Program's authorizing legislation provided up to \$30 billion for investing, interest in SBLF was lower than anticipated, with 935 financial institutions applying to the program for a combined funding request of \$11.7 billion. About one-third (320) of the total number of applicants were seeking to refinance TARP Capital Purchase Program (CPP) and Community Developer Capital Initiative (CDCI) funds. This group of institutions requested \$6.7 billion in funds, which was 57 percent of the total do nt requested. Ultimately, 332 institutions received \$4.03 billion in SBLF investments. Treasury approved 137 of the applicants s BACK TO 100 percent of all SBLF investments.<sup>1</sup> (Also see "Bank Holding Companies.")

**Performance of state member banks.** Similar to BHCs, the turnaround at state member banks in 2011 was muted. As a group, state

member banks reported a profit of \$11.5 billion for 2011, up from 6.1 billion for 2010. While earnings were up due largely to lower provisions (\$7.7 billion versus 17.7 billion in 2010), almost 11 percent of all state member banks continued to report losses. Mirroring trends at BHCs, the nonperforming assets ratio remained relatively high at 3.2 percent of loans and foreclosed assets, reflecting both contracting loan balances and ongoing weaknesses in asset quality. Growth in problem loans continued to slow during 2011, but weakness encompassed nonfarm nonresidential lending, residential mortgages, and C&I loans. The number of foreclosed properties continued to increase, particularly those associated with construction and land development and one- to four-family residential lending. The risk-based capital ratios for state member banks improved during 2011 in the aggregate, and the percent of state member banks deemed well capitalized under prompt corrective action standards remained high at 98 percent. In 2011, 12 state member banks with \$8.4 billion in assets failed, with losses of \$1.7 billion according to Federal Deposit Insurance Corporation (FDIC) estimates. (Also see "State Member Banks.")

**Implementation of enhanced prudential standards of the Dodd-Frank Act.** In December, the Board issued a notice of proposed rulemaking (NPR) to implement the enhanced prudential standards and early remediation requirements in sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The proposal generally applies to all U.S. BHCs with consolidated assets of \$50 billion or more and any nonbank financial company that may be designated by the Financial Stability Oversight Council (FSOC) as systemically important. A proposal implementing enhanced prudential standards for foreign banking organizations that have \$50 billion or more in consolidated assets and a U.S. banking presence will be issued separately. In general, savings and loan holding companies (SLHCs) would not be subject to the requirements of this proposal, except certain stress test requirements, although the Board plans to issue a separate proposal in the future to address the applicability of the enhanced standards to SLHCs. (See [box 1](#) for more details.)

**Capital adequacy standards.** In 2011, the Board issued several rulemakings and guidance documents related to capital adequacy standards, including joint proposed rulemakings with the other federal banking agencies that would implement certain revisions to the Basel capital framework and that address certain provisions of the Dodd-Frank Act. These rulemakings included two NPRs to revise the market-risk capital rules, a final rule that amends the advanced approaches capital adequacy framework to set minimum capital requirements consistent with section 171 of the Dodd-Frank Act, rules related to the treatment of subordinated debt for certain small banking organizations, and a final rule requiring U.S. BHCs with total consolidated assets of \$50 billion or more to submit annual capital plans to the Federal Reserve for review. (See "Supervisory Policy.")

**Supervision of savings and loan holding companies.** On July 21, 2011, responsibility for supervision and regulation of SLHCs transferred from the Office of Thrift Supervision (OTS) to the Federal Reserve, pursuant to the Dodd-Frank Act.<sup>2</sup> (See "Savings and Loan Holding Companies" for details.)

**Recovery and resolution planning.** The Federal Reserve is working with other regulatory agencies to reduce the probability of failure of the largest, most complex financial firms and to minimize the losses to the financial system and the economy if such a firm should fail. (See [box 2](#) for details.)

**Actions against mortgage servicers for faulty foreclosure proceedings.** In April 2011, the Federal Reserve announced formal enforcement actions against certain large mortgage servicers to ensure that those servicers addressed deficient practices in residential mortgage loan servicing and foreclosure processing. (See [box 3](#) for details.)

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## Box 1. Enhanced Prudential Standards and Early Remediation Requirements

In December, the Board issued an NPR to implement the enhanced prudential standards and early remediation requirements in sections 165 and 166 of the Dodd-Frank Act for large BHCs and systemically important nonbank financial companies.

The NPR would implement

**Risk-based capital and leverage requirements in two phases.** In the first phase, the covered companies would be subject to the Board's capital plan rule, which was issued in November 2011. In the second phase, the Board would issue a proposal to implement a risk-based capital surcharge based on the framework and methodology developed by the Basel Committee on Banking Supervision.

**Liquidity requirements in multiple phases.** First, covered companies would be subject to qualitative liquidity risk-management standards generally based on the interagency liquidity risk-management guidance issued in March 2010. These standards would require covered companies to conduct internal liquidity stress tests and set internal quantitative limits to manage liquidity risk. In later phases, the Board would issue one or more subsequent proposals to implement quantitative liquidity requirements based on the Basel III liquidity rules.

**Supervisory and company-run stress test requirements.** Supervisory stress tests similar to those conducted in recent years would be conducted annually by the Board. A summary of the results, including company-specific information, would be made public. In addition, the proposal requires companies to conduct one or more company-run stress tests each year and to make a summary of their results public.

**Single-counterparty credit limits.** The proposal would limit credit exposure of a covered company to a single counterparty as a percentage of covered company's regulatory capital. Credit exposure between the largest covered companies would be subject to a tighter limit.

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**Early remediation requirements.** The proposal would implement a framework to address financial weaknesses promptly. The Board is proposing a number of triggers for remediation—such as capital levels, stress test results, and risk-management weaknesses—calibrated to identify problems at an

early stage. Required actions would vary based on the severity of the situation, but could include restrictions on growth, capital distributions, and executive compensation, as well as capital raising or asset sales.

**Other requirements.** The proposal would also implement risk committee requirements and enhanced risk-management standards for covered companies and debt-to-equity requirements for companies that the FSOC determines pose a grave threat to financial stability and should be subject to a debt-to-equity limit.

A joint FDIC-Board final rule implementing the resolution plan requirements contained in section 165 of the Dodd-Frank Act was issued in October ([www.gpo.gov/fdsys/pkg/FR-2011-11-01/pdf/2011-27377.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-11-01/pdf/2011-27377.pdf)).

The comment period for the NPR ends on April 30, 2012. See press release and notice at [www.federalreserve.gov/newsevents/press/bcreg/20111220a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20111220a.htm).

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## Box 2. Recovery and Resolution Planning

Recovery and resolution planning are two separate, but related, efforts to ensure that the failure of a large global financial institution does not have serious adverse effects on the U.S. and the global financial system. The Federal Reserve, in conjunction with other U.S. supervisors, has continued to work with financial institutions to ensure a broad range of options for de-risking and de-leveraging in crisis. Large, globally active financial institutions are now developing the requisite governance and infrastructure to create and maintain recovery and resolution planning processes and to execute relevant strategies.

### Recovery Planning

The Federal Reserve has required that the largest and most globally active U.S. financial institutions develop recovery plans that describe a menu of options and actions, excluding any extraordinary official sector assistance, to be taken by management to maintain the financial institution as a going concern during situations of extreme stress. These plans were reviewed in several iterations during 2010 and 2011 by the Federal Reserve and other U.S. banking supervisors.

Consistent with principles developed by the Financial Stability Board, these same financial institutions participated in a series of crisis management meetings with the Federal Reserve, FDIC, Office of the Comptroller of the Currency, and international supervisors that were intended to consider the specific issues and impediments to coordinated international action that may arise in handling severe stress at specific financial institutions.

### Resolution Planning

The Dodd-Frank Act requires large, complex financial institutions to submit plans for their rapid and orderly resolution under the Bankruptcy Code in the event of material financial distress or failure. On November 1, 2011, the Federal Reserve and FDIC jointly issued rules implementing the resolution plan requirement for financial institutions that are subject to higher prudential standards ([www.gpo.gov/fdsys/pkg/FR-2011-11-01/html/2011-27377.htm](http://www.gpo.gov/fdsys/pkg/FR-2011-11-01/html/2011-27377.htm)).

In a phased approach based on nonbank asset size, the first group of financial institutions will submit their plans by July 1, 2012, with two additional groups submitting plans through December 31, 2013. The plans will identify/describe

- critical operations (those operations that are important to financial stability);
- core business lines—that is, business lines that support the firm's franchise value;
- material legal entities;
- interconnections and interdependencies;
- the company's corporate governance structure for resolution; and
- impediments to resolution and the actions the financial institution will take to improve its resolvability.

Plans must also provide explanations as to how and to what extent affiliated insured depository institutions are protected from risks associated with activities of any of the financial institutions' nonbank subsidiaries. The plans of foreign banking operations in the United States must focus on their U.S. operations along with explanations of how overall resolution planning for U.S. operations is integrated into their global contingency planning processes.

The Federal Reserve and the FDIC must review plans submitted by the financial institutions and may determine that a plan is not credible, or that it would not facilitate an orderly bankruptcy of the institution. Financial institutions submitting deficient plans will be required to resubmit plans with proposed changes in business operations and corporate structure to facilitate implementation of the plan. If a financial institution fails to adopt an acceptable plan, the FDIC and Federal Reserve may impose additional capital, leverage, or liquidity requirements on the financial institution. If suitable plans are not resubmitted within two years, the Federal Reserve and the FDIC may place restrictions on growth, activities, or operations and may require the financial institutions to divest assets. The Federal Reserve, in close cooperation with the FDIC, is working with the first group of financial institutions to develop their plans.

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## Box 3. Actions against Mortgage Servicers for Faulty Foreclosure Proceedings

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In April 2011, the Federal Reserve issued consent cease-and-desist orders against certain large mortgage servicers requiring those servicers to implement significant improvements to their mortgage loan servicing and foreclosure processing practices. These actions were designed to correct practices that resulted in servicer errors and to prevent future abuses in the loan modification and foreclosure processes. Under the consent orders,

each servicer must, among other things, submit specific plans acceptable to the Federal Reserve that

- ensure there is adequate staff to carry out residential mortgage loan servicing, loss mitigation, and foreclosure activities;
- strengthen coordination of communications with borrowers throughout the loss mitigation and foreclosure processes by providing borrowers a primary point of contact who has access to current information about loss mitigation and foreclosure activities;
- ensure that foreclosures are not pursued once a loan modification has been approved, unless repayments under the modified loan are not made;
- establish robust controls and oversight over the activities of third parties that provide various residential mortgage loan servicing, loss mitigation, or foreclosure-related support, including local counsel in foreclosure or bankruptcy proceedings; and
- strengthen programs to ensure compliance with state and federal laws regarding servicing generally, and foreclosures in particular.

The orders also require the servicers to hire independent consultants to conduct reviews to identify borrowers who suffered financial injury as a result of wrongful foreclosure or other identified deficiencies. The orders require the servicer to provide remediation to such borrowers.

The Federal Reserve also issued consent cease-and-desist orders against six parent BHCs of national bank servicers to address deficient practices in the parent companies' oversight of residential mortgage loan servicing, loan modification, and foreclosure processes. The orders require the parent companies to implement policies, procedures, and practices designed to prevent future abuses.

Each institution under an order is required to submit quarterly reports to the Federal Reserve detailing the measures it has taken to comply with the enforcement action and the results of those measures.

See press release and notice at [www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm](http://www.federalreserve.gov/newsevents/press/enforcement/20110413a.htm).

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## Supervision

The Federal Reserve is the federal supervisor and regulator of all U.S. BHCs, including financial holding companies, and state-chartered commercial banks that are members of the Federal Reserve System. The Federal Reserve also has responsibility for supervising the operations of all Edge Act and agreement corporations, the international operations of state member banks and U.S. BHCs, and the U.S. operations of foreign banking organizations. Furthermore, through the Dodd-Frank Act, the Federal Reserve has been assigned responsibilities for nonbank financial firms and financial market utilities (FMUs) designated by the FSOC as systemically important. In addition, the act transferred authority for consolidated supervision of more than 400 SLHCs and their non-depository subsidiaries from the OTS to the Federal Reserve, effective July 21, 2011. In overseeing the institutions under the Federal Reserve's authority, the Federal Reserve seeks primarily to promote safety and soundness, including compliance with laws and regulations.

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### *Safety and Soundness*

To promote the safety and soundness of financial institutions, the Federal Reserve conducts on-site examinations and inspections, conducts off-site surveillance and monitoring, and takes enforcement and other supervisory actions as necessary. The Federal Reserve also provides training and technical assistance to foreign supervisors and minority-owned and de novo depository institutions.

#### **Examinations and Inspections**

The Federal Reserve conducts examinations of state member banks, FMUs, the U.S. branches and agencies of foreign banks, and Edge Act and agreement corporations. In a process distinct from examinations, it conducts inspections of holding companies and their nonbank subsidiaries. Whether an examination or an inspection is being conducted, the review of operations entails

1. an evaluation of the adequacy of governance provided by the board and senior management, including an assessment of internal policies, procedures, controls, and operations;
2. an assessment of the quality of the risk-management and internal control processes in place to identify, measure, monitor, and control risks;
3. an assessment of the key financial factors of capital, asset quality, earnings, and liquidity; and
4. a review for compliance with applicable laws and regulations.

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Table 1 provides information on examinations and inspections conducted by the Federal Reserve during the past five years.

**Table 1. State member banks and bank holding companies, 2007-2011**

Entity/item	2011	2010	2009	2008	2007
<b>State member banks</b>					
Total number	828	829	845	862	878
Total assets (billions of dollars)	1,891	1,697	1,690	1,854	1,519
Number of examinations	809	912	850	717	694
By Federal Reserve System	507	722	655	486	479
By state banking agency	302	190	195	231	215
<b>Top-tier bank holding companies</b>					
Large (assets of more than \$1 billion)					
Total number	491	482	488	485	459
Total assets (billions of dollars)	16,443	15,986	15,744	14,138	13,281
Number of inspections	672	677	658	519	492
By Federal Reserve System <sup>1</sup>	642	654	640	500	476
On site	461	491	501	445	438
Off site	181	163	139	55	38
By state banking agency	30	23	18	19	16
Small (assets of \$1 billion or less)					
Total number	4,251	4,362	4,486	4,545	4,611
Total assets (billions of dollars)	982	991	1,018	1,008	974
Number of inspections	3,306	3,340	3,264	3,192	3,186
By Federal Reserve System	3,160	3,199	3,109	3,048	3,007
On site	163	167	169	107	120
Off site	2,997	3,032	2,940	2,941	2,887
By state banking agency	146	141	155	144	179
<b>Financial holding companies</b>					
Domestic	417	430	479	557	597
Foreign	40	43	46	45	43

1. For large bank holding companies subject to continuous, risk-focused supervision, includes multiple targeted reviews. [Return to table](#)

The Federal Reserve uses a risk-focused approach to supervision, with activities directed toward identifying the areas of greatest risk to financial institutions and assessing the ability of institutions' management processes to identify, measure, monitor, and control those risks. Key aspects of the risk-focused approach to consolidated supervision of the largest institutions supervised by the Federal Reserve include

1. developing an understanding of each organization's legal and operating structure, and its primary strategies, business lines, and risk-management and internal control functions;
2. developing and executing a tailored supervisory plan that outlines the work required to maintain a comprehensive understanding and assessment of each institution, incorporating reliance to the fullest extent possible on assessments; information developed by other relevant domestic and foreign supervisors and functional regulators;
3. maintaining continual supervision of these organizations--including through meetings with the organization's management and analysis of internal and external information--so that the Federal Reserve's understanding and assessment of each organization's condition remains current;
4. assigning to each organization a supervisory team composed of Reserve Bank staff who have skills appropriate for the

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organization's risk profile; and

5. promoting Systemwide and interagency information-sharing through automated systems and other mechanisms.

To strengthen its supervision of the largest, most complex financial institutions, the Federal Reserve has created a centralized multidisciplinary body called the Large Institution Supervision Coordinating Committee (LISCC) to oversee the supervision of these companies. The committee uses horizontal evaluations to monitor interconnectedness and common practices among companies that could lead to greater systemic risk. The committee also uses additional and improved quantitative methods for evaluating the financial condition of companies and the risks they might pose to each other and to the broader financial system. The supervisory framework applicable to the LISCC portfolio, other BHCs with assets of \$50 billion or more, and nonbank financial firms designated by the FSOC for supervision by the Board will continue to evolve in coming years to reflect the recently issued rules for capital planning and resolution plans (see boxes 2 and 4). In addition, rules and guidance on enhanced prudential standards to increase regulatory requirements and expectations for each of these companies in line with their systemic footprints will be issued.

For other sized financial institutions, the risk-focused consolidated supervision program provides that examination and inspection procedures should be tailored to each organization's size, complexity, risk profile, and condition. The supervisory program for an institution, regardless of its asset size, entails both off-site and on-site work, including development of supervisory plans, pre-examination visits, detailed documentation, and preparation of examination reports tailored to the scope and findings of the examination.

### State Member Banks

At the end of 2011, 2,120 banks (excluding nondepository trust companies and private banks) were members of the Federal Reserve System, of which 828 were state chartered. Federal Reserve System member banks operated 58,211 branches, and accounted for 34 percent of all commercial banks in the United States and for 71 percent of all commercial banking offices. State-chartered commercial banks that are members of the Federal Reserve, commonly referred to as state member banks, represented approximately 13 percent of all insured U.S. commercial banks and held approximately 15 percent of all insured commercial bank assets in the United States.

Under section 10 of the Federal Deposit Insurance Act, as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994, the Federal Reserve must conduct a full-scope, on-site examination of state member banks at least once a year,<sup>3</sup> although certain well-capitalized, well-managed organizations having total assets of less than \$500 million may be examined once every 18 months.<sup>4</sup> The Federal Reserve conducted 507 exams of state member banks in 2011.

### Bank Holding Companies

At year-end 2011, a total of 5,341 U.S. BHCs were in operation, of which 4,742 were top-tier BHCs. These organizations controlled 5,247 insured commercial banks and held approximately 99 percent of all insured commercial bank assets in the United States.

Federal Reserve guidelines call for annual inspections of large BHCs and complex smaller companies. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of those banks, thereby minimizing duplication of effort and reducing the supervisory burden on banking organizations.

Inspections of BHCs, including financial holding companies, are built around a rating system introduced in 2005. The system reflects the shift in supervisory practices away from a historical analysis of financial condition toward a more dynamic, forward-looking assessment of risk-management practices and financial factors. Under the system, known as RFI but more fully termed RFI/C(D), holding companies are assigned a composite rating (C) that is based on assessments of three components: Risk Management (R), Financial Condition (F), and the potential Impact (I) of the parent company and its nondepository subsidiaries on the subsidiary depository institution. The fourth component, Depository Institution (D), is intended to mirror the primary supervisor's rating of the subsidiary depository institution.<sup>5</sup> Noncomplex BHCs with consolidated assets of \$1 billion or less are subject to a special supervisory program that permits a more flexible approach.<sup>6</sup> In 2011, the Federal Reserve conducted 642 inspections of large BHCs and 3,160 inspections of small, noncomplex BHCs.

### Financial Holding Companies

Under the Gramm-Leach-Bliley Act, BHCs that meet certain capital, managerial, and other requirements may elect to become financial holding companies and thereby engage in a wider range of financial activities, including full-scope securities underwriting, merchant banking, and insurance underwriting and sales. As of year-end 2011, 417 domestic BHCs and 40 foreign banking organizations had financial holding company status. Of the domestic financial holding companies, 36 had consolidated assets of \$15 billion or more; 108, between \$1 billion and \$15 billion; 59, between \$500 million and \$1 billion; and 214, less than \$500 million.

### Savings and Loan Holding Companies

On July 21, 2011, responsibility for supervision and regulation of SLHCs transferred from the OTS to the Federal Reserve, pursuant to the Dodd-Frank Act. As of the transfer date, 427 top tier SLHCs with estimated total consolidated assets of \$4.4 trillion transferred to the Federal Reserve. These SLHCs included more than 50 companies engaged primarily in nonbanking activities, such as insurance underwriting (approximately 26 SLHCs), commercial activities (approximately 20 SLHCs), and securities brokerage (10 SLHCs). The 25 largest SLHCs accounted for more than \$3.9 trillion of total consolidated assets; however, the savings association subsidiaries of these companies accounted for just \$384 billion of total consolidated assets. Only three institutions in the top 25 and approximately 86 percent

of the total SLHCs (370 firms) were engaged primarily in depository activities. These firms, however, held only 19 percent (\$839 billion) of the total consolidated assets of all SLHCs. The Office of the Comptroller of the Currency (OCC) is the primary regulator for most of the subsidiary savings associations of the firms engaged primarily in depository activities.

The transfer of SLHC supervision to the Federal Reserve precipitated legislative, supervisory, and policy changes. The Dodd-Frank Act requires the Board to issue specific rulemakings--such as rules to establish consolidated capital standards, evaluate the potential for creating intermediate holding companies to facilitate supervision of SLHCs that are primarily engaged in commercial activities, and assess supervisory fees for the largest companies. Other rulemakings are prompted by operational and practical considerations, such as rules regarding regulatory reports and guidance regarding the supervisory approach for SLHCs. Guidance and rulemakings issued include the following:

- SR letter 11-11, "Supervision of Savings and Loan Holding Companies" (July 21, 2011), describes the supervisory approach to be used for the first cycle of supervision of SLHCs ([www.federalreserve.gov/bankinforeg/srletters/sr1111.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1111.htm)).
- Two interim final rules: (1) "Savings and Loan Holding Companies," Regulation LL, sets forth the regulations governing SLHCs; and (2) "Mutual Holding Companies," Regulation MM, sets forth the regulations governing SLHCs organized in mutual form. See press release (August 12, 2011) at [www.federalreserve.gov/newsevents/press/bcreg/20110812a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110812a.htm).
- Final notice to require most SLHCs to file Federal Reserve regulatory reports with the Board, along with an exemption for some SLHCs from initially filing existing regulatory reports. See press release (December 23, 2011) at [www.federalreserve.gov/newsevents/press/bcreg/20111223a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20111223a.htm).

In addition to the regulatory and supervisory guidance issued on SLHCs, <sup>7</sup> Board staff continues to work on operational, technical, and practical transition issues while engaging the industry, Reserve Banks, and other financial regulatory agencies. Board staff has also issued internal policies and procedures, presented training sessions, conducted bi-weekly conference calls, and developed job aids to enhance the understanding of the SLHC population and to ensure consistent supervisory treatment of these institutions throughout the Federal Reserve System. A dedicated SLHC section has been staffed and is working to continue the supervisory and policy oversight of the SLHCs.

Although significant milestones have been achieved, several complex policy issues still need to be addressed by the Board, including those related to consolidated capital requirements, intermediate holding companies, and the determination of the applicability of enhanced prudential standards to the SLHC population.

### Financial Market Utilities

FMUs manage or operate multilateral systems for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU. Under the Federal Reserve Act, the Board supervises FMUs that are chartered as member banks or Edge Act corporations and cooperates with other federal banking supervisors to supervise FMUs organized as bank service providers under the Bank Service Company Act. In its supervision of these FMUs, the Board is also guided by the risk-management standards and expectations contained in its "Policy on Payments System Risk."<sup>8</sup>

Under title VIII of the Dodd-Frank Act, the Board has an expanded set of responsibilities related to FMUs designated by the FSOC as systemically important, including promoting uniform risk-management standards, playing an enhanced role in the supervision of FMUs, reducing systemic risk, and supporting the stability of the broader financial system.

The Board's risk-based supervision program for FMUs is administered by the FMU Supervision Committee (FMU-SC). The FMU-SC is a multi-disciplinary committee of senior supervision, payment policy, and legal staff at the Board and Reserve Banks who are responsible for and knowledgeable about supervisory issues for FMUs. The FMU-SC's primary objective is to provide senior-level oversight, consistency, and direction to the Federal Reserve's supervisory process for FMUs. The FMU-SC coordinates with the LISCC on issues related to large financial institutions' roles in FMUs; FMUs' activities and implications for large financial institutions; and the payment, clearing, and settlement activities of large financial institutions more generally.

In an effort to promote greater financial market stability and mitigate systemic risk, the Board also is working with the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission, which also have supervisory authority for certain FMUs. The Federal Reserve's work with these agencies, including the planned sharing of appropriate information, aims to improve consistency in FMU supervision, promote robust FMU risk management, and improve the regulators' ability to monitor and mitigate systemic risk.

### International Activities

The Federal Reserve supervises the foreign branches and overseas investments of member banks, Edge Act and agreement corporations, and BHCs (including the investments by BHCs in export trading companies). In addition, it supervises the active foreign banking organizations conduct through entities in the United States, including branches, agencies, representative offices, and subsidiaries.

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**Foreign operations of U.S. banking organizations.** In supervising the international operations of state member banks, Edge Act and agreement corporations, and BHCs, the Federal Reserve generally conducts its examinations or inspections at the U.S. head offices of

these organizations, where the ultimate responsibility for the foreign offices lies. Examiners also visit the overseas offices of U.S. banks to obtain financial and operating information and, in some instances, to test their adherence to safe and sound banking practices and compliance with rules and regulations or to evaluate an organization's efforts to implement corrective measures. Examinations abroad are conducted with the cooperation of the supervisory authorities of the countries in which they take place; for national banks, the examinations are coordinated with the OCC. At the end of 2011, 46 member banks were operating 533 branches in foreign countries and overseas areas of the United States; 25 national banks were operating 475 of these branches; and 21 state member banks were operating the remaining 58. In addition, 17 nonmember banks were operating 25 branches in foreign countries and overseas areas of the United States.

**Edge Act and agreement corporations.** Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. Agreement corporations are similar organizations, state chartered or federally chartered, that enter into agreements with the Board to refrain from exercising any power that is not permissible for an Edge Act corporation. Sections 25 and 25A of the Federal Reserve Act grant Edge Act and agreement corporations permission to engage in international banking and foreign financial transactions. These corporations, most of which are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions and (2) make foreign investments that are broader than those permissible for member banks. At year-end 2011, 48 banking organizations, operating eight branches, were chartered as Edge Act or agreement corporations. These corporations are examined annually.

**U.S. activities of foreign banks.** The Federal Reserve has broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking and related activities in the United States through branches, agencies, representative offices, commercial lending companies, Edge Act corporations, commercial banks, BHCs, and certain nonbanking companies.

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 2011, 173 foreign banks from 51 countries operated 205 state-licensed branches and agencies, of which six were insured by the FDIC, and 47 OCC-licensed branches and agencies, of which four were insured by the FDIC. These foreign banks also owned nine Edge Act and agreement corporations and one commercial lending company. In addition, they held a controlling interest in 53 U.S. commercial banks. Altogether, the U.S. offices of these foreign banks at the end of 2011 controlled approximately 20 percent of U.S. commercial banking assets. These 173 foreign banks also operated 82 representative offices; an additional 44 foreign banks operated in the United States through a representative office only.

The Federal Reserve--in coordination with appropriate state regulatory authorities--examines state-licensed, non-FDIC insured branches and agencies of foreign banks on-site at least once every 18 months.<sup>9</sup> In most cases, on-site examinations are conducted at least once every 12 months, but the period may be extended to 18 months if the branch or agency meets certain criteria. As part of the supervisory process, a review of the financial and operational profile of each organization is conducted to assess the organization's ability to support its U.S. operations and to determine what risks, if any, the organization poses to the banking system through its U.S. operations. The Federal Reserve conducted or participated with state regulatory authorities in 379 examinations in 2011.

## Compliance with Regulatory Requirements

The Federal Reserve examines institutions for compliance with a broad range of legal requirements, including anti-money-laundering (AML) and consumer protection laws and regulations, and other laws pertaining to certain banking and financial activities. Most compliance supervision is conducted under the oversight of the Board's Division of Banking Supervision and Regulation, but consumer compliance supervision is conducted under the oversight of the Division of Consumer and Community Affairs. The two divisions coordinate their efforts with each other and also with the Board's Legal Division to ensure consistent and comprehensive Federal Reserve supervision for compliance with legal requirements.

## Anti-Money-Laundering Examinations

The Treasury regulations implementing the Bank Secrecy Act (BSA) generally require banks and other types of financial institutions to file certain reports and maintain certain records that are useful in criminal, tax, or regulatory proceedings. The BSA and separate Board regulations require banking organizations supervised by the Board to file reports on suspicious activity related to possible violations of federal law, including money laundering, terrorism financing, and other financial crimes. In addition, BSA and Board regulations require that banks develop written BSA compliance programs and that the programs be formally approved by bank boards of directors. The Federal Reserve is responsible for examining institutions for compliance with applicable AML laws and regulations and conducts such examinations in accordance with the Federal Financial Institutions Examination Council (FFIEC) *Bank Secrecy Act/Anti-Money Laundering Examination Manual*.<sup>10</sup>

## Specialized Examinations

The Federal Reserve conducts specialized examinations of supervised financial institutions in the areas of information technology, fiduciary activities, transfer agent activities, and government and municipal securities dealing and brokering. The Federal Reserve also conducts specialized examinations of certain nonbank entities that extend credit subject to the Board's margin regulations.

## Information Technology Activities

In recognition of the importance of information technology to safe and sound operations in the financial industry, the Federal Reserve reviews the information technology activities of supervised financial institutions, as well as certain independent data centers that provide information technology services to these organizations. All safety-and-soundness examinations include a risk-focused review of information technology risk-management activities. During 2011, the Federal Reserve continued as the lead supervisory agency for

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three of the 16 large, multiregional data processing servicers recognized on an interagency basis and assumed leadership of two more of the large servicers.

### **Fiduciary Activities**

The Federal Reserve has supervisory responsibility for state member banks and state member nondepository trust companies that reported \$53.9 trillion and \$39.5 trillion of assets, respectively, as of year-end 2011. These assets were held in various fiduciary and custodial capacities. On-site examinations of fiduciary and custodial activities are risk-focused and entail the review of an organization's compliance with laws, regulations, and general fiduciary principles, including effective management of conflicts of interest; management of legal, operational, and reputational risk exposures; and audit and control procedures. In 2011, Federal Reserve examiners conducted 140 on-site fiduciary examinations, excluding transfer agent examinations, of state member banks.

### **Transfer Agents**

As directed by the Securities Exchange Act of 1934, the Federal Reserve conducts specialized examinations of those state member banks and BHCs that are registered with the Board as transfer agents. Among other things, transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. On-site examinations focus on the effectiveness of an organization's operations and its compliance with relevant securities regulations. During 2011, the Federal Reserve conducted on-site transfer agent examinations at 11 of the 32 state member banks and BHCs that were registered as transfer agents.

### **Government and Municipal Securities Dealers and Brokers**

The Federal Reserve is responsible for examining state member banks and foreign banks for compliance with the Government Securities Act of 1986 and with the Treasury regulations governing dealing and brokering in government securities. Thirteen state member banks and six state branches of foreign banks have notified the Board that they are government securities dealers or brokers not exempt from the Treasury's regulations. During 2011, the Federal Reserve conducted three examinations of broker-dealer activities in government securities at these organizations. These examinations are generally conducted concurrently with the Federal Reserve's examination of the state member bank or branch.

The Federal Reserve is also responsible for ensuring that state member banks and BHCs that act as municipal securities dealers comply with the Securities Act Amendments of 1975. Municipal securities dealers are examined, pursuant to the Municipal Securities Rulemaking Board's rule G-16, at least once every two calendar years. Three of the 11 entities supervised by the Federal Reserve that dealt in municipal securities were examined during 2011.

### **Securities Credit Lenders**

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. As part of its general examination program, the Federal Reserve examines the banks under its jurisdiction for compliance with Board Regulation U (Credit by Banks and Persons other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock). In addition, the Federal Reserve maintains a registry of persons other than banks, brokers, and dealers who extend credit subject to Regulation U. The Federal Reserve may conduct specialized examinations of these lenders if they are not already subject to supervision by the Farm Credit Administration or the National Credit Union Administration (NCUA).

At the end of 2011, 533 lenders other than banks, brokers, or dealers were registered with the Federal Reserve. Other federal regulators supervised 171 of these lenders, and the remaining 362 were subject to limited Federal Reserve supervision. The Federal Reserve exempted 151 lenders from its on-site inspection program on the basis of their regulatory status and annual reports. Twenty-one inspections were conducted during the year.

### **Enforcement Actions**

The Federal Reserve has enforcement authority over the financial institutions it supervises and their affiliated parties. Enforcement actions may be taken to address unsafe and unsound practices or violations of any law or regulation. Formal enforcement actions include cease-and-desist orders, written agreements, prompt corrective action directives, removal and prohibition orders, and civil money penalties. In 2011, the Federal Reserve completed 143 formal enforcement actions. Civil money penalties totaling \$85,279,700 were assessed. As directed by statute, all civil money penalties are remitted to either the Treasury or the Federal Emergency Management Agency. Enforcement orders and prompt corrective action directives, which are issued by the Board, and written agreements, which are executed by the Reserve Banks, are made public and are posted on the Board's website ([www.federalreserve.gov/apps/enforcementactions/](http://www.federalreserve.gov/apps/enforcementactions/)).

In addition to taking these formal enforcement actions, the Reserve Banks completed 353 informal enforcement actions in 2011. Informal enforcement actions include memoranda of understanding (MOU) and board of directors resolutions. Information about these actions is not available to the public.

### **Surveillance and Off-Site Monitoring**

The Federal Reserve uses automated screening systems to monitor the financial condition and performance of state member banks and BHCs in the period between on-site examinations. Such monitoring and analysis helps direct examination resources to institutions that have higher-risk profiles. Screening systems also assist in the planning of examinations by identifying companies that are engaged in new or complex activities.

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The primary off-site monitoring tool used by the Federal Reserve is the Supervision and Regulation Statistical Assessment of Bank Risk

model (SR-SABR). Drawing mainly on the financial data that banks report on their Reports of Condition and Income (Call Reports), SR-SABR uses econometric techniques to identify banks that report financial characteristics weaker than those of other banks assigned similar supervisory ratings. To supplement the SR-SABR screening, the Federal Reserve also monitors various market data, including equity prices, debt spreads, agency ratings, and measures of expected default frequency, to gauge market perceptions of the risk in banking organizations. In addition, the Federal Reserve prepares quarterly Bank Holding Company Performance Reports (BHCPRs) for use in monitoring and inspecting supervised banking organizations. The BHCPRs, which are compiled from data provided by large BHCs in quarterly regulatory reports (FR Y-9C and FR Y-9LP), contain, for individual companies, financial statistics and comparisons with peer companies. BHCPRs are made available to the public on the National Information Center (NIC) website, which can be accessed at [www.ffiec.gov](http://www.ffiec.gov).

Federal Reserve analysts use Performance Report Information and Surveillance Monitoring (PRISM), a querying tool, to access and display financial, surveillance, and examination data. In the analytical module, users can customize the presentation of institutional financial information drawn from Call Reports, Uniform Bank Performance Reports, FR Y-9 statements, BHCPRs, and other regulatory reports. In the surveillance module, users can generate reports summarizing the results of surveillance screening for banks and BHCs. During 2011, four major upgrades to the web-based PRISM application were completed.

The Federal Reserve works through the FFIEC Task Force on Surveillance Systems to coordinate surveillance activities with the other federal banking agencies.

### **Training and Technical Assistance**

The Federal Reserve provides training and technical assistance to foreign supervisors and minority-owned and de novo depository institutions.

### **International Training and Technical Assistance**

In 2011, the Federal Reserve continued to provide technical assistance on bank supervisory matters to foreign central banks and supervisory authorities. Technical assistance involves visits by Federal Reserve staff members to foreign authorities as well as consultations with foreign supervisors who visit the Board or the Reserve Banks. The Federal Reserve, along with the OCC, the FDIC, and the Treasury, was an active participant in the Middle East and North Africa Financial Regulators' Training Initiative, which is part of the U.S. government's Middle East Partnership Initiative. The Federal Reserve also contributes to the regional training provision under the Asia Pacific Economic Cooperation Financial Regulators' Training Initiative.

In 2011, the Federal Reserve offered a number of training courses exclusively for foreign supervisory authorities, both in the United States and in a number of foreign jurisdictions. Federal Reserve staff also took part in technical assistance and training missions led by the International Monetary Fund, the World Bank, the Asian Development Bank, the Basel Committee on Banking Supervision, and the Financial Stability Institute.

The Federal Reserve is also an associate member of the Association of Supervisors of Banks of the Americas (ASBA), an umbrella group of bank supervisors from countries in the Western Hemisphere. The group, headquartered in Mexico,

- promotes communication and cooperation among bank supervisors in the region;
- coordinates training programs throughout the region with the help of national banking supervisors and international agencies; and
- aims to help members develop banking laws, regulations, and supervisory practices that conform to international best practices.

The Federal Reserve contributes significantly to ASBA's organizational management and to its training and technical assistance activities.

### **Initiatives for Minority-Owned and De Novo Depository Institutions**

The Partnership for Progress program is a Federal Reserve System program created to preserve and promote minority-owned, woman-owned, and de novo depository institutions (MDIs). Launched in 2008, the program seeks to help these institutions compete effectively in today's marketplace by offering MDIs a combination of one-on-one assistance and targeted workshops on topics of particular relevance in terms of starting and growing a bank in a safe and sound manner. In addition, training and information on resources are provided through an extensive public website ([www.fedpartnership.gov](http://www.fedpartnership.gov)).

Designated Partnership for Progress coordinators serve as local program contacts in each of the 12 Reserve Bank Districts and the Board of Governors to answer questions and coordinate assistance for institutions requesting guidance.

During 2011, the banking industry continued to face significant challenges. MDIs faced increasing marketplace challenges, operated in some of the hardest-hit regions and were adversely impacted by the recession and sluggish economic recovery. The economic crisis has significantly impacted a large number of MDIs primarily due to high unemployment, weak credit demand, capital deficiencies, and increasing regulatory costs.

In an effort to strengthen the Partnership for Progress program and address the provisions of section 367 of the Dodd-Frank Act,

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enhancements to the program were made, including

- initiation of an interagency task force to focus on challenges raised by minority bankers;
- a review of the effectiveness of the methods currently used to promote and preserve minority banks;
- informational sessions for district coordinators to discuss the conditions of minority banks, on topics such as capital investment, asset quality, troubled asset management, and the impact of bank failures;
- transition of the program management function to a senior supervision staff member; and
- development of website enhancements that will operate as an electronic resource center for MDIs. This site is expected to be launched in 2012.

Throughout the year, the Federal Reserve Banks hosted conference calls and meetings with key minority bankers, community leaders, academia leaders, the National Bankers Association (NBA), the National Urban League in Philadelphia, the Small Business Administration in Philadelphia, and other national partners in order to help coordinate methods and strategies for preserving and promoting MDIs and the communities they serve.

In 2011, the Federal Reserve Banks hosted/participated in a variety of workshops and seminars, including

- a conference on Small Business and Entrepreneurs and the Impact of the Economic Crisis;
- a presentation on MDI conditions at the NBA Convention in Dallas;
- an outreach effort with investment firms interested in providing capital to MDIs;
- a Supplier Diversity Forum and a reception for small businesses and entrepreneurs-- in partnership with the National Urban League--focusing on Doing Business with Large Businesses; and
- the FDIC MDI Roundtable in Los Angeles, held in collaboration with the National Association of Chinese American Bankers, on the topic of "Risk Management."

The results of these efforts collectively are expected to further our initiative to comply with section 367 of the Dodd-Frank Act in a very challenging environment for the banking industry in general and MDIs in particular.

### **Business Continuity**

In 2011, the Federal Reserve continued its efforts to strengthen the resilience of the U.S. financial system in the event of unexpected disruptions, including focused supervisory efforts to evaluate the resiliency of the banking institutions under its jurisdiction. The Federal Reserve, together with other federal and state financial regulators, is a member of the Financial Banking Information Infrastructure Committee (FBIIC), which was formed to improve coordination and communication among financial regulators, enhance the resiliency of the financial sector, and promote the public/private partnership. The FBIIC has established emergency communication protocols to maintain effective communication among members in the event of an emergency. The members of the FBIIC will convene by conference call no later than 90 minutes following the first public report of an event to share situational and operational status reports. As a member of FBIIC, the Federal Reserve is then responsible for establishing and maintaining communication with the institutions for which it has primary supervisory authority and for ensuring coordination between public affairs and media relations staff.

### *Supervisory Policy*

The Federal Reserve's supervisory policy function, carried out by the Board, is responsible for developing regulations and guidance for financial institutions under the Federal Reserve's supervision, as well as guidance for examiners. The Board, often working together with the other federal banking agencies, issues rulemakings, public SR letters, and other policy statements and guidance in order to carry out its supervisory policy function. Federal Reserve staff also take part in supervisory and regulatory forums, provide support for the work of the FFIEC, and participate in international policymaking forums, including the Basel Committee on Banking Supervision, the Financial Stability Board, and the Joint Forum.

### **Capital Adequacy Standards**

In 2011, the Board issued several rulemakings and guidance documents related to capital adequacy standards, including joint proposed rulemakings with the other federal banking agencies that would implement certain revisions to the Basel capital framework and that address certain provisions of the Dodd-Frank Act.

- In January, the federal banking agencies issued for comment an NPR to revise their market-risk capital rules. These proposed revisions would implement a number of changes to the Basel Accord intended to (1) better capture positions for which the market-risk capital rules are appropriate, (2) reduce procyclicality in market-risk capital requirements, (3) enhance the rules' sensitivity to risks that are not adequately captured by the current regulatory measurement methodologies, and (4) increase market discipline through enhanced disclosures. The NPR is available at [www.gpo.gov/fdsys/pkg/FR-2011-01-11/pdf/2010-32189.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-01-11/pdf/2010-32189.pdf).
- The federal banking agencies issued a subsequent NPR in December that amended the January market-risk NPR by proposing

to replace methodologies for calculating specific risk-capital requirements that relied on credit ratings with alternative methods for evaluating creditworthiness, as required by section 939A of the Dodd-Frank Act. The NPR is available at [www.gpo.gov/fdsys/pkg/FR-2011-12-21/pdf/2011-32073.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-12-21/pdf/2011-32073.pdf).

- The federal banking agencies published a final rule in June that amends the advanced approaches capital adequacy framework, consistent with section 171 of the Dodd-Frank Act. The rule requires a banking organization operating under the advanced approaches framework to meet, on an ongoing basis, the higher of the minimum risk-based requirements under the general risk-based capital rules and the minimum requirements under the advanced approaches risk-based capital rules. The rule is available at [www.gpo.gov/fdsys/pkg/FR-2011-06-28/pdf/2011-15669.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-06-28/pdf/2011-15669.pdf).
- In June, the Board sought comment on and adopted an interim final rule that allows small BHCs that are S-Corps or that are organized in mutual form to exclude subordinated debt issued to Treasury under the SBLF from treatment as "debt" for purposes of the debt-to-equity standard under the Board's "Small Bank Holding Company Policy Statement." The interim final rule is available at [www.gpo.gov/fdsys/pkg/FR-2011-06-21/pdf/2011-14983.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-06-21/pdf/2011-14983.pdf).
- The Board also adopted a final rule in June that allows BHCs that are S-Corps or that are organized in mutual form to include in tier 1 capital all subordinated debt issued to Treasury under the TARP, subject to certain limits. The rule also allows small BHCs that are S-Corps or that are organized in mutual form to exclude subordinated debt issued to Treasury under TARP from treatment as "debt" for purposes of the debt-to-equity standard under the Board's "Small Bank Holding Company Policy Statement." This rule makes final an interim final rule that the Board adopted in June 2009 and is available at [www.gpo.gov/fdsys/pkg/FR-2011-06-21/pdf/2011-14983.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-06-21/pdf/2011-14983.pdf).
- In December, the Board issued a final rule requiring top-tier U.S. BHCs with total consolidated assets of \$50 billion or more to submit annual capital plans for review. The aim of the annual capital plans is to ensure that institutions have robust, forward-looking capital planning processes that account for their unique risks, and to help ensure that institutions have sufficient capital to continue operations throughout times of economic and financial stress. Under the rule, the Federal Reserve annually will evaluate institutions' capital adequacy; internal capital adequacy assessment processes; and plans to make capital distributions, such as dividend payments or stock repurchases. The capital plan rule is available at [www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf). (Also see [box 4](#).)
- In addition, the Board, under a separate rulemaking, proposed to use the capital planning requirements to meet the Board's obligations to impose enhanced capital standards on large financial firms under section 165(b)(1)(A)(i) of the Dodd-Frank Act. The NPR on enhanced prudential standards and early remediation requirement for covered companies is available at [www.federalreserve.gov/newsevents/press/bcreg/20111220a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20111220a.htm). (Also see [box 1](#).)

In 2011, Board and Reserve Bank staff conducted in-depth supervisory analyses of a number of complex capital issuances, private capital investments, and other transactions to evaluate their qualification for inclusion in regulatory capital and consistency with safety and soundness. For certain transactions, banking organizations were required to make changes necessary for instruments to satisfy regulatory capital criteria while other transactions were disallowed from inclusion in a banking organization's regulatory capital. With respect to certain sales and structured finance transactions, banking organizations were required to maintain additional capital for their exposures that were more commensurate with the risk of the arrangements and the organization's support for the transactions.

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## Box 4. Capital Planning and Stress Testing

Since the onset of the financial crisis, the Board has led a series of initiatives to strengthen the capital positions of large, complex banking organizations, including working with the firms to bolster their internal processes for assessing capital needs and enhancing the Board's supervisory practices for assessing capital adequacy. These efforts culminated in a supervisory review of capital plans of 19 banking organizations in the first quarter of 2011, including any plans they had for increasing dividends or buying back stock, a process officially known as the Comprehensive Capital Analysis and Review (CCAR). The CCAR process is a formal part of the Board's annual assessment of all banking organizations with assets of \$50 billion or more, and the requirement to submit annual capital plans to the Board has been codified by the issuance of the capital plan rule, as discussed further below.

A key objective of the annual CCAR exercise is to ensure that firms' capital planning processes are sufficiently comprehensive and forward-looking. Part of this process is the use of internal stress testing to assess whether firms would have sufficient capital to withstand a significant decline in revenues and potentially large losses so that they would be able to continue functioning as sources of credit and providers of other financial services, even in the event of a worse-than-anticipated weakening of the economy. Supervisory evaluations of individual firms' capital plans and the analysis supporting them are conducted simultaneously across all participating firms, allowing the process to be informed by a comparative analysis across the firms and to capture a large share of domestic U.S. banking system assets and activities.

This supervisory review of capital planning processes was formalized in November 2011, as the Board issued a final rule requiring top-tier U.S. BHCs with total consolidated assets of \$50 billion or more to submit annual capital plans for review (the capital plans rule). Under this rule, the Federal Reserve will annually evaluate institutions' capital adequacy, internal capital adequacy processes, and plans to make capital distributions, such as dividend payments or stock repurchases. In addition, the Board's assessment of these practices and of the firms' capital adequacy is supported by supervisory stress testing carried out by the Board in association with the CCAR.

The organizations covered by the capital plan rule are required to make their projections using scenarios provided by the Board and at least a scenario developed by the firm itself, appropriate to its business model and portfolios. The rule also requires a firm to support its analysis of sources and uses of capital over the planning period. In the annual CCAR review, the Board assesses a firm's ability to effectively identify, measure, and assess its risks; its methodologies for estimating firm-wide losses and revenues under stress scenarios; and its analysis for determining the impact of a stressed operating environment on capital adequacy. And, consistent with CCAR, the rule requires firms to develop comprehensive capital policies to govern their capital planning, capital issuance, usage, and distribution.

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The capital plan rule relates to certain requirements for large organizations in the Dodd-Frank Act, particularly the stress testing standards. As the Board implements these stress testing requirements, it is expected that firms subject to the capital plan rule would use their Dodd-Frank Act-required stress test results to help meet the stress testing requirements of the capital plans rule. Thus, results of firms' stress testing requirements in the Dodd-Frank Act will be an integral component of firms' capital plans as they evaluate possible capital needs and resources under stress scenarios. Additionally, the Dodd-Frank Act requires supervisors to conduct independent supervisory stress tests. As part of CCAR, the Board has further developed its ability to make independent supervisory estimates of firms' potential future losses and revenues, which is a key tool in the evaluation of stress testing performed by firms as part of their capital plans and a key component of our supervisory assessments of capital adequacy. It is expected that the supervisory tests required under Dodd-Frank will be an integral part of supervisory stress testing for CCAR. (Also see "Capital Adequacy Standards.")

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## International Guidance on Supervisory Policies








As a member of the Basel Committee on Banking Supervision, the Federal Reserve actively participates in efforts to advance sound supervisory policies for internationally active banking organizations and enhance the strength and stability of the international banking system.

### Basel Capital Framework



During 2011, the Federal Reserve participated in ongoing international initiatives to enhance the Basel capital framework through the publication of the revised version of *Basel III: A global regulatory framework for more resilient banks and banking systems* in June 2011 and a series of "Frequently Asked Questions" on various Basel III-related topics, including the definition of "regulatory capital" and "counterparty credit (CCR) risk."

The Federal Reserve contributed to supervisory policy recommendations, reports, and papers issued for consultative purposes or finalized by the Basel Committee that were designed to improve the supervision of banking organizations' practices and to address specific issues that emerged during the financial crisis. The listing below includes key final and consultative papers from 2011.

Final papers:

- *Revisions to the Basel II market risk framework - updated as of 31 December 2010* (issued in February and available at [www.bis.org/publ/bcbs193.htm](http://www.bis.org/publ/bcbs193.htm) ).
- *Range of methodologies for risk and performance alignment of remuneration* (issued in May and available at [www.bis.org/publ/bcbs194.htm](http://www.bis.org/publ/bcbs194.htm) .
- *Basel III: A global regulatory framework for more resilient banks and banking systems - revised version June 2011* (issued in June and available at [www.bis.org/publ/bcbs189.htm](http://www.bis.org/publ/bcbs189.htm) ). The revised version includes capital treatment for bilateral CCR risk finalized by the Basel Committee in June 2011.
- *Principles for the Sound Management of Operational Risk* (issued in June and available at [www.bis.org/publ/bcbs195.htm](http://www.bis.org/publ/bcbs195.htm) .
- *Operational Risk - Supervisory Guidelines for the Advanced Measurement Approaches* (issued in June and available at [www.bis.org/publ/bcbs196.htm](http://www.bis.org/publ/bcbs196.htm) .
- *Treatment of trade finance under the Basel capital framework* (issued in October and available at [www.bis.org/publ/bcbs205.htm](http://www.bis.org/publ/bcbs205.htm) .
- *High cost credit protection* (issued in December and available at [www.bis.org/publ/bcbs\\_nl16.htm](http://www.bis.org/publ/bcbs_nl16.htm) .

Consultative papers:


- *Capitalisation of bank exposures to central counterparties - second consultative document* (issued in November and available at [www.bis.org/publ/bcbs206.htm](http://www.bis.org/publ/bcbs206.htm) .
- *Core principles for effective banking supervision* (published in December and available at [www.bis.org/publ/bcbs213.htm](http://www.bis.org/publ/bcbs213.htm) .

### Joint Forum

In 2011, the Federal Reserve continued its participation in the Joint Forum--an international group of supervisors of the banking, securities, and insurance industries established to address various cross-sector issues, including the regulation of financial conglomerates. The Joint Forum operates under the aegis of the Basel Committee, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors.

The Joint Forum, through its founding organizations, issued a *Report on asset securitisation incentives* in July 2011 that provided an update on the conditions in the global securitization market, as well as an assessment of regulatory reforms implemented following the financial crisis analyses. The report is available at [www.bis.org/publ/joint26.htm](http://www.bis.org/publ/joint26.htm) . Back to the TOP

In addition, the Joint Forum issued, in December 2011, a consultative document, *Principles for the supervision of financial*

*conglomerates*. The document is available at [www.bis.org/publ/joint27.htm](http://www.bis.org/publ/joint27.htm) .

## Accounting Policy

The Federal Reserve strongly endorses sound corporate governance and effective accounting and auditing practices for all regulated financial institutions. Accordingly, the Federal Reserve's supervisory policy function is responsible for monitoring major domestic and international proposals, standards, and other developments affecting the banking industry in the areas of accounting, auditing, internal controls over financial reporting, financial disclosure, and supervisory financial reporting.

During 2011, Federal Reserve staff addressed numerous issues related to financial sector accounting and reporting, including fair value accounting, financial instrument accounting and reporting, balance sheet offsetting, loan accounting, business combinations, lease accounting, securitizations, securities financing transactions, consolidation of structured entities, external and internal audit processes, and international financial reporting standards.

To address these and other issues, Federal Reserve staff consulted with key constituents in the accounting and auditing professions, including standard-setters, accounting firms, accounting and financial sector trade groups, and other financial sector regulators. The Federal Reserve also participated in meetings of the Basel Committee's Accounting Task Force, which represents the Basel Committee at international meetings on accounting, auditing, and disclosure issues affecting global banking organizations. These efforts helped inform our understanding of domestic and international practices--as well as proposed accounting, auditing, and regulatory standards--and helped in our formulation of policy positions using insight obtained through these forums.

During 2011, the Federal Reserve shared its views with accounting and auditing standard-setters through informal discussions and public comment letters. Comment letters on the following proposals were issued during the past year:

- Public Company Accounting Oversight Board's proposal related to changes in the auditor's reporting model.
- Financial Accounting Standards Board's proposals related to netting of balance sheet amounts, hedge accounting, impairment of financial assets, and effective dates and transition methods.

Working with international bank supervisors, Federal Reserve staff contributed to the development of numerous other comment letters related to accounting and auditing matters that were submitted to the International Accounting Standards Board and the International Auditing and Assurance Standards Board through the Basel Committee.

Federal Reserve staff also participated in other supervisory activities to assess interactions between accounting standards and regulatory reform efforts. These activities included supporting Dodd-Frank Act initiatives related to stress testing of banks and credit-risk retention requirements for securitizations, as well as various Basel III activities.

The Federal Reserve issued supervisory guidance to financial institutions and supervisory staff on accounting matters, as appropriate, and participated in a number of supervisory-related activities. For example, Federal Reserve staff

- issued guidance to address supervisory considerations related to the disposal of nonperforming assets and foreclosed real estate through exchanges brokered by marketing agents;
- developed and participated in a number of domestic and international training programs to educate supervisors about new and emerging accounting and reporting topics affecting financial institutions; and
- supported the efforts of the Reserve Banks in financial institution supervisory activities related to financial accounting, auditing, reporting, and disclosure.

## Credit-Risk Management

The Federal Reserve works with the other federal banking agencies to develop guidance on the management of credit risk; to coordinate the assessment of regulated institutions' credit risk; and to ensure that institutions properly identify, measure, and manage credit risk.

### Supervisory Expectations for Risk Management of Agricultural Credit Risk

In October, the Federal Reserve issued supervisory guidance to serve as a reminder to banking organizations and supervisory staff of the key risk factors in agricultural lending and supervisory expectations for a banking organization's risk-management practices. The guidance was issued largely in response to recent market developments. The potential for volatile market conditions and risk factors raises the importance of ensuring that agricultural banks have in place appropriate risk-management programs and prudent lending standards. A key component of a sound risk-management program is the linkage between an analysis of market conditions and an agricultural bank's risk-management and capital planning practices. The range and extent of market analysis may vary depending on the composition of the bank's portfolio and overall risk exposure.

### Shared National Credit Program

In August, the Federal Reserve and the other banking agencies released summary results of the 2011 annual review of the Shared National Credit (SNC) Program. The agencies established the program in 1977 to promote an efficient and consistent review and

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classification of SNCs. A SNC is any loan or formal loan commitment--and any asset, such as other real estate, stocks, notes, bonds, and debentures taken as debts previously contracted--extended to borrowers by a supervised institution, its subsidiaries, and affiliates that aggregates to \$20 million or more and either (1) is shared by three or more unaffiliated supervised institutions under a formal lending agreement or (2) a portion of which is sold to two or more unaffiliated supervised institutions, with the purchasing institutions assuming their pro rata share of the credit risk.

The 2011 SNC review was based on analyses of credit data as of December 31, 2010, provided by federally supervised institutions. The 2011 SNC portfolio totaled \$2.5 trillion, with 8,030 credit facilities to approximately 5,400 borrowers. From the previous period, the dollar volume of the portfolio commitment amount rose by \$6 billion or 0.2 percent, and the number of credits declined by 259, or 3.1 percent.

Although credit quality improved significantly over the past two years, the percentage of criticized and classified assets remains elevated at 12.7 and 8.5 percent, respectively.<sup>11</sup> Criticized assets declined by \$126 billion to \$321 billion, a 28.2 percent decrease from the 2010 results. Criticized assets represented 12.7 percent of the portfolio, compared with 17.8 percent in the 2010 review. Classified credits declined by \$90 billion, a 29.5 percent decrease. Classified credits represented 8.5 percent of the portfolio, compared with 12.1 percent in the 2010 review. Credits rated special mention declined by \$36 billion to \$106 billion, a 25.4 percent decline. Special mention credits represented 4.2 percent of the portfolio, compared with 5.7 percent in 2010. As in 2010, the reduction in the level of criticized assets is attributed to improved borrower operating performance, debt restructurings, bankruptcy resolutions, and greater borrower access to bond and equity markets.

The number of credits originated in 2010 rose dramatically compared to 2009 and 2008, and equaled approximately 75 percent of the large volume of credits originated in 2007. While the overall quality of underwriting in 2010 was significantly better than in 2007, some easing of standards was noted, specifically in leveraged finance credits, compared to the relatively tighter standards present in 2009 and the latter half of 2008. Underwriting standards were generally satisfactory overall though the observed softening may be due to increasing competition and market liquidity.

The performance of the SNC portfolio remained heavily influenced by significant exposure to 2006- and 2007-vintage credits with weak underwriting standards. These loans comprised 40.1 percent of SNC commitments, but accounted for 58.4 percent of criticized commitments. Refinancing risk remains elevated as nearly \$2 trillion, or 78 percent, of the SNC portfolio will mature by the end of 2014. Of this amount, \$204 billion is criticized.

### **Compliance Risk Management**

The Federal Reserve works with international and domestic supervisors to develop guidance that promotes compliance with BSA/AML and counter terrorism laws.

### **Bank Secrecy Act and Anti-Money-Laundering Compliance**

In 2011, the Federal Reserve continued to actively promote the development and maintenance of effective BSA/AML compliance risk-management programs. For example, the Federal Reserve issued guidance in March 2011, SR letter 11-6, "Guidance on Accepting Accounts from Foreign Embassies, Consulates and Missions (foreign missions)." <sup>12</sup> The interagency advisory (attached to SR letter 11-6) supplements prior guidance and provides information to financial institutions regarding the provision of account services to foreign missions in a manner that fulfills the needs of those foreign governments while complying with the provisions of the BSA. Also, Federal Reserve supervisory staff participated in interagency projects designed to clarify regulatory expectations, including guidance for financial institutions on the reorganization of the Financial Crimes Enforcement Network's (FinCEN) BSA regulations.

The Federal Reserve is a member of the Treasury-led BSA Advisory Group, which includes representatives of regulatory agencies, law enforcement, and the financial services industry and covers all aspects of the BSA. The Federal Reserve also participates in the FFIEC BSA/AML working group, which is a monthly forum for the discussion of pending BSA policy and regulatory matters. In addition to the FFIEC agencies, the BSA/AML working group includes FinCEN and, on a quarterly basis, the SEC, the Commodity Futures Trading Commission, the Internal Revenue Service, and the Office of Foreign Assets Control (OFAC) in order to share and discuss information on policy issues and general trends more broadly.

The FFIEC BSA/AML working group also is responsible for updating the FFIEC *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (Manual). The FFIEC developed the Manual as part of its ongoing commitment to provide current and consistent interagency guidance on risk-based policies, procedures, and processes for financial institutions to comply with the BSA and safeguard their operations from money laundering and terrorist financing.

In 2011, the Federal Reserve, together with the FDIC and the OCC, issued a Spanish-language translation of the Manual. This initiative was largely in response to requests from industry and trade groups and furthers the collective goal of making regulatory expectations regarding BSA/AML compliance programs as accessible and useful as possible.

The Federal Reserve and other federal banking agencies continued during 2011 to regularly share examination findings and enforcement proceedings with FinCEN under the interagency MOU that was finalized in 2004.

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In 2011, the Federal Reserve coordinated extensively with OFAC on their efforts under the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010. This law builds upon the U.S. government's role in protecting its domestic financial system from exposure to Iran's illicit and deceptive financial practices by strengthening existing U.S. sanctions. The Federal Reserve continued

during 2011 to regularly share examination findings and enforcement proceedings with OFAC under the 2006 interagency MOU.

### International Coordination on Sanctions, Anti-Money-Laundering, and Counter-Terrorism Financing

The Federal Reserve participates in a number of international coordination initiatives related to sanctions, money laundering, and terrorism financing. For example, the Federal Reserve has a long-standing role in the U.S. delegation to the intergovernmental Financial Action Task Force (FATF) and its working groups, contributing a banking supervisory perspective to formulation of international standards on these matters. In 2011, the Federal Reserve actively contributed to the development of a FATF typologies report that addressed laundering the proceeds of corruption. In addition, the Federal Reserve has provided input and review of ongoing work to revise the FATF Recommendations in order to ensure that they continue to provide a comprehensive and current framework for combating money laundering and terrorist financing. Also, the Federal Reserve continues to participate in a subcommittee of the Basel Committee that focuses on AML/counter-terrorism financing issues.

### Other Policymaking Initiatives

In 2011, the Board issued or proposed guidance in a number of areas including the following:

- In January, the Board issued guidance on the potential impact of high-cost credit protection transactions on the assessment of a banking organization's overall capital adequacy. The guidance states that while credit-risk mitigation techniques can significantly reduce a banking organization's level of risk, in some cases the high premiums or fees paid for certain credit protection, combined with other terms and conditions, call into question the degree of risk transfer of the transaction. The guidance provides a set of criteria for evaluating the degree of risk transfer of a transaction and describes actions that the Board may take in order to account for high-cost credit protection transactions when assessing a banking organization's overall capital adequacy. The guidance is available at [www.federalreserve.gov/bankinforeg/srletters/sr1101.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1101.htm).
- The Board and the OCC jointly issued guidance in April that expands on previous guidance on the use of models and sets forth the agencies' expectations regarding a robust approach to the assessment and management of model risk. The guidance summarizes the principles of a model risk-management framework, including robust model development, implementation, and use; effective validation; and sound governance, policies, and controls. The guidance is available at [www.federalreserve.gov/bankinforeg/srletters/sr1107.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1107.htm).
- In April, the federal banking agencies, Federal Housing and Finance Agency, Housing and Urban Development, and the SEC jointly sought comment on an NPR that would implement the requirements of section 941(b) of the Dodd-Frank Act. More specifically, the NPR would (1) 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 (2) prohibit a securitizer from directly or indirectly hedging or transferring the credit risk the securitizer is required to retain. The NPR would exempt from risk retention any asset-backed security collateralized solely by qualified residential mortgages as defined in the proposed rule. The NPR is available at <http://edocket.access.gpo.gov/2011/pdf/2011-8364.pdf>.
- In June, the federal banking agencies jointly requested comment on proposed stress testing guidance that outlines high-level principles for stress testing practices, which are applicable to all banking organizations with more than \$10 billion in total consolidated assets (see [box 4](#)). The proposed guidance highlights the importance of stress testing as an ongoing risk-management practice that supports a banking organization's forward-looking assessment of its risks. The proposed guidance is available at [www.federalreserve.gov/newsevents/press/bcreg/20110609a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110609a.htm).
- The federal banking agencies issued guidance in July on their expectations for sound CCR risk-management practices. This guidance reinforces sound governance of CCR risk-management practices through prudent board and senior management oversight, management reporting, and risk-management functions. In addition, the guidance also summarizes the sound practices necessary for an effective CCR management framework and the characteristics of an appropriate systems infrastructure. The guidance is available at [www.federalreserve.gov/newsevents/press/bcreg/20110705a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110705a.htm).
- The Federal Reserve, along with the other FFIEC agencies, issued the "Supplement to Authentication in an Internet Banking Environment" (supplement), which supplements the similarly titled guidance issued in 2005. The supplement is intended to enhance supervised organizations' Internet banking control environments. Accordingly, the supplement clarifies and increases supervisory expectations in the areas of risk assessments, customer authentication, layered security controls, and awareness and education programs. The guidance is available at [www.federalreserve.gov/bankinforeg/srletters/sr1109.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1109.htm).
- In March, the federal banking agencies requested comment on a joint proposed rule to ensure that regulated financial institutions design their incentive compensation arrangements to take account of risk. The proposed rule, which is being issued pursuant to the Dodd-Frank Act, would apply to certain financial institutions with more than \$1 billion in assets. It also contains heightened standards for the largest of these institutions. The proposed rule is available at [www.federalreserve.gov/newsevents/press/bcreg/20110330a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110330a.htm). (Also see [box 5](#).)

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## Box 5. Incentive Compensation

Flawed incentive compensation practices in the financial industry--providing executives and other employees with incentives to take imprudent actions inconsistent with the long-term health of their financial organizations--were among the many factors contributing to the financial crisis. To help address these problems, the Federal Reserve issued draft supervisory guidance on incentive compensation practices for public comment in October 2009. After modest revisions, it was adopted by the federal banking agencies (Federal Reserve, OCC, FDIC, OTS) in June 2010 ([www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm)).

In 2009, the Federal Reserve undertook a supervisory initiative--a "horizontal review" of incentive compensation practices at the 25 largest banking



organizations. The horizontal review was designed to assess

- the potential for incentive compensation arrangements to encourage imprudent risk-taking;
- the actions that the large complex banking organizations have taken to correct deficiencies in incentive compensation design; and
- the adequacy of the organizations' compensation-related risk management, controls, and corporate governance.

These organizations have made significant changes to their practices and are approaching substantial conformance with the guidance. A recent Financial Stability Board report shows that U.S. banks are at or near the leading edge of practice internationally. More details about the horizontal review are presented in an October 2011 white paper ([www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf](http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf)).

The Dodd-Frank Act requires the reporting to regulators of incentive compensation arrangements and prohibits incentive compensation arrangements that provide excessive compensation or that could expose the firm to inappropriate risks. Banking organizations, broker-dealers, investment advisers, and certain other firms are covered under the act if they have \$1 billion or more in total assets. To implement the act, seven financial regulatory agencies (Federal Reserve, OCC, FDIC, OTS, NCUA, SEC, and the Federal Housing and Finance Agency) issued a joint proposed rule in April 2011 ([www.gpo.gov/fdsys/pkg/FR-2011-04-14/pdf/2011-7937.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-04-14/pdf/2011-7937.pdf)). The banking agencies' existing reviews have been done using their safety-and-soundness authority; the proposed rule would add to that authority and provide regulatory authority to some other agencies, such as the SEC. The core principles of the proposed rule are similar to those in the banking agencies' guidance. A very large number of comments were received from the public, and these comments are being carefully considered in the drafting of the final rule. The final rule is forthcoming in 2012.

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## Regulatory Reports

The Federal Reserve's supervisory policy function is also responsible for developing, coordinating, and implementing regulatory reporting requirements for various financial reporting forms filed by domestic and foreign financial institutions subject to Federal Reserve supervision. Federal Reserve staff members interact with other federal agencies and relevant state supervisors, including foreign bank supervisors as needed, to recommend and implement appropriate and timely revisions to the reporting forms and the attendant instructions.

### Bank Holding Company Regulatory Reports

The Federal Reserve requires that U.S. BHCs periodically submit reports that provide information about their financial condition and structure. This information is essential to formulating and conducting bank regulation and supervision. It is also used in responding to requests by Congress and the public for information about BHCs and their nonbank subsidiaries. Foreign banking organizations also are required to periodically submit reports to the Federal Reserve.

- FR Y-9 series reports--the FR Y-9C, FR Y-9LP, and FR Y-9SP--provide standardized financial statements for BHCs on both a consolidated and a parent-only basis. The reports are used to detect emerging financial problems, to review performance and conduct pre-inspection analysis, to monitor and evaluate risk profiles and capital adequacy, to evaluate proposals for BHC mergers and acquisitions, and to analyze a holding company's overall financial condition.
- Nonbank subsidiary reports--the FR Y-11, FR 2314, FR Y-7N, and FR 2886b--help the Federal Reserve determine the condition of BHCs that are engaged in nonbank activities and also aid in monitoring the number, nature, and condition of the companies' nonbank subsidiaries.
- The FR Y-8 report provides information on transactions between an insured depository institution and its affiliates that are subject to section 23A of the Federal Reserve Act; it is used to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act.
- The FR Y-10 report provides data on changes in organization structure at domestic and foreign banking organizations.
- The FR Y-6 and FR Y-7 reports gather additional information on organization structure and shareholders from domestic banking organizations and foreign banking organizations, respectively; the information is used to monitor structure so as to determine compliance with provisions of the Bank Holding Company Act (BHC Act) and Regulation Y and to assess the ability of a foreign banking organization to continue as a source of strength to its U.S. operations.

During 2011, the Federal Reserve implemented a number of changes to the FR Y-9C reporting requirements to better understand BHCs' risk exposures, primarily with respect to lending and securitizations; to better support macroeconomic analysis and monetary policy purposes; and to collect certain information prescribed by changes in accounting standards. These revisions included (1) break out by loan category of other loans and leases that are troubled debt restructurings for those that (a) are past due 30 days or more or in nonaccrual status or (b) are in compliance with their modified terms and clarify reporting of restructured troubled debt consumer loans; (2) break out of other consumer loans into automobile loans and all other consumer loans in several schedules; (3) break out of commercial mortgage-backed securities issued or guaranteed by U.S. government agencies and sponsored agencies; (4) create a new Schedule HC-V, Variable Interest Entities (VIEs), for reporting major categories of assets and liabilities of consolidated entities; (5) break out of loans and other real estate owned (OREO) information covered by FDIC loss-sharing agreements by loan and OREO category; (6) break out of life insurance assets into data items for general account and separate account life insurance assets; (7) addition of new data items for the total assets of captive insurance and reinsurance subsidiaries; (8) addition of new income statement items for credit valuation adjustments and debit valuation adjustments included in trading revenues (for BHCs with total assets of \$100

billion or more); (9) revision of the reporting instructions in the areas of construction lending, one- to four-family residential mortgage banking activities, and maturity and repricing data; and (10) collection of expanded information on the quarterly-averages schedule.

In 2011, the Federal Reserve proposed the following revisions to the FR Y-9C for implementation in 2012 to better understand BHCs' risk exposures, to better support macroeconomic analysis and monetary policy purposes, and to collect certain information prescribed by changes in accounting standards: (1) add a section to Schedule HC-C, Loans and Lease Financing Receivables, to collect information on the allowance for loan and lease losses by loan category; (2) add two data items to Schedule HC-P, 1-4 Family Residential Mortgage Banking Activities, to collect the amount of representation and warranty reserves for one- to four-family residential mortgage loans sold; (3) add a data item to Schedule HC-N, Past Due and Nonaccrual Loans, Leases, and Other Assets, to collect the outstanding balance of purchased credit impaired loans by past due and nonaccrual status; (4) add a new Schedule HC-U, Loan Origination Activity in Domestic Offices, to collect information on loan originations; and (5) modify the reporting instructions to clarify the reporting and accounting treatment of specific valuation allowances.

### **Savings and Loan Holding Company Regulatory Reports**

On July 21, 2011, the responsibility for supervision and regulation of SLHCs transferred from the OTS to the Board, pursuant to section 312 of the Dodd-Frank Act. In preparation of this event, the Federal Reserve, on February 8, 2011, published in the *Federal Register* a notice of intent (76 *Fed. Reg.* 7091) to require SLHCs to submit the same reports as BHCs (FR Y-6, FR Y-7, FR Y-9 reports, FR Y-11/11S, FR 2314/2314S, FR Y-8, FR Y-12/12A, FR Y-7Q, or FR Y-7N/NS ) beginning with the March 31, 2012, reporting period.<sup>13</sup> The notice of intent stated that the Board would issue a formal proposed notice on information collection activities for SLHCs after the transfer date. On August 25, 2011, the Board issued a proposal to exempt a limited number of SLHCs from initially submitting Federal Reserve regulatory reports and allow a two-year phased-in reporting for most SLHCs beginning with the March 31, 2012, reporting period (76 *Fed. Reg.* 53129).<sup>14</sup>

After consideration of the comments received on the proposal, the Board issued a press release, on December 23, 2011, announcing that the proposed collections of information from SLHCs had been finalized with modifications. The final notice was published in the *Federal Register* on December 29, 2011, (76 *Fed. Reg.* 81933) in which the Board retained the two-year phase-in approach for most SLHCs and modified the exemption criteria for commercial SLHCs and certain insurance SLHCs.<sup>15</sup> The exemption for commercial SLHCs will be reviewed periodically and may be rescinded if the Board determines that FR Y-9 financial information and other regulatory reports are needed to effectively and consistently assess compliance with capital and other regulatory requirements. Insurance SLHCs will be exempt only until consolidated regulatory capital rules are finalized for SLHCs, at which time they may be required to file consolidated financial statements--to demonstrate their compliance with the capital rules--and other Federal Reserve reports.

### **Commercial Bank Regulatory Reports**

As the federal supervisor of state member banks, the Federal Reserve, along with the other banking agencies (through the FFIEC), requires banks to submit quarterly Call Reports. Call Reports are the primary source of data for the supervision and regulation of banks and the ongoing assessment of the overall soundness of the nation's banking system. Call Report data provide the most current statistical data available for evaluating institutions' corporate applications, for identifying areas of focus for both on-site and off-site examinations, and for considering monetary and other public policy issues. Call Report data, which also serve as benchmarks for the financial information required by many other Federal Reserve regulatory financial reports, are widely used by state and local governments, state banking supervisors, the banking industry, securities analysts, and the academic community.

During 2011, the FFIEC implemented revisions to the Call Report to better understand banks' risk exposures, primarily with respect to lending and securitizations, to better support macroeconomic analysis and monetary policy purposes, and to collect certain information prescribed by changes in accounting standards. The revisions included (1) break out by loan category of other loans and leases that are troubled debt restructurings for those that (a) are past due 30 days or more or in nonaccrual status or (b) are in compliance with their modified terms and clarify reporting of restructured troubled debt consumer loans; (2) break out other consumer loans into automobile loans and all other consumer loans in several schedules; (3) break out of commercial mortgage-backed securities issued or guaranteed by U.S. government agencies and sponsored agencies; (4) addition of a new memorandum item for the estimated amount of nonbrokered deposits obtained through the use of deposit-listing service companies; (5) break out of existing items for deposits of individuals, partnerships, and corporations into deposits of individuals and deposits of partnerships and corporations; (6) creation of a new Schedule RC-V, VIEs, for reporting major categories of assets and liabilities of consolidated VIEs; (7) break out of loans and OREO information covered by FDIC loss-sharing agreements by loan and OREO category; (8) break out of life insurance assets into data items for general account and separate account life insurance assets; (9) addition of new data items for the total assets of captive insurance and reinsurance subsidiaries; (10) addition of new income statement items for credit valuation adjustments and debit valuation adjustments included in trading revenues (for banks with total assets of \$100 billion or more); (11) change of the reporting frequency from annually to quarterly for the data reported in Schedule RC-T, Fiduciary and Related Services, on collective investment funds and common trust funds; and (12) revision of the reporting instructions in the areas of construction lending, one- to four-family residential mortgage banking activities, and maturity and repricing data.

In addition, during 2011, the FFIEC implemented several revisions to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) to (1) collect additional detail on trading assets, (2) revise the reporting instructions in Schedule reporting of time deposits of \$100,000 or more, and (3) expand the data collected on Schedule Q, Financial Assets and Liabilities Measured at Fair Value.

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In 2011, the FFIEC proposed the following revisions to the Call Report for implementation in 2012 to better understand banks' risk exposures, to better support macroeconomic analysis and monetary policy purposes, and to collect certain information prescribed by

changes in accounting standards: (1) add a section to Schedule RC-C, Loans and Lease Financing Receivables, to collect information on the allowance for loan and lease losses by loan category; (2) add two data items to Schedule RC-P, 1-4 Family Residential Mortgage Banking Activities, to collect the amount of representation and warranty reserves for one- to four-family residential mortgage loans sold; (3) add a data item to Schedule RC-N, Past Due and Nonaccrual Loans, Leases, and Other Assets, to collect the outstanding balance of purchased credit impaired loans by past due and nonaccrual status; (4) add a new Schedule RC-U, Loan Origination Activity in Domestic Offices, to collect information on loan originations; (5) add new items in Schedule RC-M, Memoranda, in which savings associations and certain state savings and cooperative banks would report on the test they use to determine compliance with the Qualified Thrift Lender requirement and whether they have remained in compliance with this requirement; (6) revise two existing items in Schedule RC-R, Regulatory Capital, used to calculate the leverage ratio denominator to accommodate certain differences between the regulatory capital standards that apply to the leverage capital ratios of banks versus savings associations; and (7) modify the reporting instructions to clarify the reporting and accounting treatment of specific valuation allowances.

### *Supervisory Information Technology*

The Federal Reserve's supervisory information technology function, carried out by the Board's Division of Banking Supervision and Regulation and the Reserve Banks under the guidance of the Subcommittee on Supervisory Administration and Technology, works to identify and set priorities for information technology initiatives within the supervision and regulation business line.

In 2011, the supervisory information technology function focused on

- **Large Bank Supervision.** Improved the supervision of large and regional financial institutions with new processes and linked workflows to enable continuous updates of information provided through examinations and ongoing monitoring activities.
- **Community Bank Supervision.** Worked with community bank examiners and other regulators to implement enhanced tools to support community bank examinations.
- **Data Management.** (1) Improved the data management infrastructure and inventorying of supervisory information and (2) enhanced data analytics to support core business needs. These improvements were the result of stress testing, capital assessments, and additional risk monitoring that created additional demands for investment in data collections.
- **Collaboration.** (1) Enhanced information sharing among staff at the Board and Reserve Banks through tools to support communities of practice, (2) developed and piloted an electronic solution to support exam teams' ability to share documents, and (3) created an Interagency Steering Group to improve methods for sharing work among state and federal regulators.
- **Modernization.** Initiated significant projects to modernize software products and business capabilities in the areas of document management, resource prioritization, and scheduling.

### **National Information Center**

The NIC is the Federal Reserve's comprehensive repository for supervisory, financial, and banking-structure data. It is also the main repository for many supervisory documents. NIC includes (1) data on banking structure throughout the United States as well as foreign banking concerns; (2) the National Examination Desktop, which enables supervisory personnel as well as federal and state banking authorities to access NIC data; (3) the Banking Organization National Desktop, an application that facilitates secure, real-time electronic information sharing and collaboration among federal and state banking regulators for the supervision of banking organizations; and (4) the Central Document and Text Repository, which contains documents supporting the supervisory processes.

Within the NIC, the supporting systems have been modified over time to extend their usefulness and improve business workflow efficiency. During 2011, work was completed on upgrading the entire NIC infrastructure to provide easier access to information, a consistent Federal Reserve-enterprise information data repository, a comprehensive metadata repository, and uniform security across the Federal Reserve System. The transition began in May 2010 and effectively was substantially complete by year-end 2011 with only a limited number of applications requiring transition in early 2012. Business changes were implemented to the systems of record for both examination and inspection mandates, and improvements were made to the collection and reporting of key examination and inspection findings to track consistently on a national level across the Federal Reserve System.

The structure and supervisory databases in the NIC were modified to support Dodd-Frank changes and to facilitate the supervision of SLHCs. A significant amount of progress occurred during 2011 to successfully capture and integrate the former OTS data and documents into the NIC database constructs. Data comparisons and validation analyses were performed to determine which SLHCs and non-depository institution subsidiaries of SLHCs were missing or incomplete on NIC. New data elements were added to the repositories. Integration of data related to SLHC organizations will continue in 2012 as regulatory reports are modified to collect structure, financial, and supervisory information directly from these entities.

The NIC also supports the Shared National Credit Modernization project (SNC Mod), a multiyear, interagency, information technology development effort to improve the efficiency and effectiveness of the systems that support the SNC Program. SNC Mod focuses on a complete rewrite of the current legacy systems to take advantage of modern technology to enhance and extend the system's capabilities. During 2011, the SNCnet application was implemented in three phases in support of the 2011 SNC examination process. The creation of this automated tool is an interagency initiative led by the Federal Reserve System. Timely delivery of the SNCnet tool enabled significant process efficiencies for the examination teams and ultimately resulted in the ability to publish the summary of findings approximately six to eight weeks ahead of the previous schedule. During 2012, additional enhancements are expected for both the

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collection repository and to the exam tool application that will provide further benefits to the examination teams.

During 2011, in support of the Comprehensive Capital Analysis and Review initiative and in planning for the Dodd-Frank Act stress testing program, NIC staff were engaged with the teams responsible for planning the new data collections (FR Y-14). The Supervision Risk program is also undergoing significant changes with substantial increases in the data requirements as well as modeling tools to use with those data. NIC staff are responsible for providing project management for those initiatives to best serve the business sponsors.

Finally, the Federal Reserve participated in a number of technology-related initiatives supporting the supervision function as part of FFIEC task forces and interagency committees. These efforts support standardized data collections and cross-agency information sharing. Work in this area will continue to be important as the agencies work through the implementation of the Dodd-Frank Act.

### *Staff Development*

The Federal Reserve's staff development program is responsible for the ongoing development of nearly 3,109 professional supervisory staff to ensure that they have the skills necessary to meet their evolving supervisory responsibilities. The Federal Reserve also provides course offerings to staff at state banking agencies. Training activities in 2011 are summarized in [table 2](#).

### **Examiner Commissioning Program**

The Examiner Commissioning Program (ECP) involves approximately 22 weeks of instruction. Individuals move through a combination of classroom offerings, self-paced assignments, and on-the-job training over a period of two to five years. Achievement is measured by two professionally validated proficiency examinations: the first proficiency exam is required of all ECP participants, and the second proficiency exam is offered in two specialty areas--(1) safety and soundness and (2) consumer compliance. A third specialty, in information technology, requires that individuals earn the Certified Information Systems Auditor certification offered by the Information Systems Audit Control Association. In 2011, 252 examiners passed the first proficiency exam and 69 passed the second proficiency exam (55 in safety and soundness and 14 in consumer compliance).

**Table 2. Training for banking supervision and regulation, 2011**

Course sponsor or type	Number of enrollments		Instructional time (approximate training days) <sup>1</sup>	Number of course offerings
	Federal Reserve personnel	State and federal banking agency personnel		
Federal Reserve System	2,273	495	910	182
FFIEC	394	217	360	90
The Options Institute <sup>2</sup>	4	7	3	1
Rapid Response™	11,406	1,045	10	78

1. Training days are approximate. System courses were calculated using five days as an average, with FFIEC courses calculated using four days as an average. [Return to table](#)

2. The Options Institute, an educational arm of the Chicago Board Options Exchange, provides a three-day seminar on the use of options in risk management. [Return to table](#)

### **Continuing Professional Development**

Other formal and informal learning opportunities are available to examiners, including other schools and programs offered within the System and FFIEC-sponsored schools. System programs are also available to state and federal banking agency personnel. The Rapid Response® program, introduced in 2008, offers System and state personnel 60-90 minute teleconference presentations on emerging issues or urgent training needs associated with implementation or issuance of new laws, regulations, or guidance.

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## Regulation

The Federal Reserve exercises important regulatory influence over entry into the U.S. banking system, and the structure of the system, through its administration of several federal statutes. The Federal Reserve is also responsible for imposing margin requirements on securities transactions. In carrying out its responsibilities, the Federal Reserve coordinates supervisory activities with the other federal banking agencies, state agencies, functional regulators (that is, regulators for insurance, securities, and commodities firms), and foreign bank regulatory

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## *Regulation of the U.S. Banking Structure*

The Federal Reserve administers five federal statutes that apply to BHCs, financial holding companies, member banks, and foreign banking organizations--the BHC Act, the Bank Merger Act, the Change in Bank Control Act, the Federal Reserve Act, and the International Banking Act. On July 21, 2011, as a result of the Dodd-Frank Act, the Federal Reserve also became responsible for administering section 10 of the Home Owners' Loan Act that applies to SLHCs. The Federal Reserve is now also responsible for administering the Change in Bank Control Act with respect to SLHCs.

In administering these statutes, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of the U.S. banking system at the local, regional, and national levels; the international operations of domestic banking organizations; or the U.S. banking operations of foreign banks. The proposals concern BHC and SLHC formations and acquisitions, bank mergers, and other transactions involving banks and savings associations or nonbank firms. In 2011, the Federal Reserve acted on 414 proposals representing 1,035 individual applications filed under the six statutes. Many of these proposals involved banking organizations in less than satisfactory financial condition.

### **Bank Holding Company Act Proposals**

Under the BHC Act, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming a BHC through the acquisition of one or more banks in the United States. Once formed, a BHC must receive Federal Reserve approval before acquiring or establishing additional banks. Also, BHCs generally may engage in only those nonbanking activities that the Board has previously determined to be closely related to banking under section 4(c)(8) of the BHC Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement.<sup>16</sup>

When reviewing a BHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the proposal, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law. In the case of a foreign banking organization seeking to acquire control of a U.S. bank, the Federal Reserve also considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. In 2011, the Federal Reserve acted on 307 applications and notices filed by BHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities, including proposals involving private equity firms.

A BHC may repurchase its own shares from its shareholders. When the company borrows money to buy the shares, the transaction increases the company's debt and decreases its equity. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital adequacy guidelines. In 2011, the Federal Reserve acted on seven stock repurchase proposals by a BHC.

The Federal Reserve also reviews elections submitted by BHCs seeking financial holding company status under the authority granted by the Gramm-Leach-Bliley Act. BHCs seeking financial holding company status must file a written declaration with the Federal Reserve. In 2011, 14 domestic financial holding company declarations were approved.

### **Bank Merger Act Proposals**

The Bank Merger Act requires that all proposals involving the merger of insured depository institutions be acted on by the relevant federal banking agency. The Federal Reserve has primary jurisdiction if the institution surviving the merger is a state member bank. Before acting on a merger proposal, the Federal Reserve considers the financial and managerial resources of the applicant, the future prospects of the existing and combined organizations, the convenience and needs of the community(ies) to be served, and the competitive effects of the proposed merger. The Federal Reserve also 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. In 2011, the Federal Reserve approved 67 merger applications under the act.

### **Change in Bank Control Act Proposals**

The Change in Bank Control Act requires individuals and certain other parties that seek control of a U.S. bank, BHC, or SLHC to obtain approval from the relevant federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks, BHCs, and SLHCs. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank, BHC, or SLHC being acquired; the future prospects of the institution to be acquired; the effect of the proposed change on competition in any relevant market; the completeness of the information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the Deposit Insurance Fund. A proposed transaction should not jeopardize the stability of the institution or the interests of depositors. During its review of a proposed transaction, the Federal Reserve may contact other regulatory or law enforcement agencies for information about relevant individuals. In 2011, the Federal Reserve approved 115 change in control proposals related to state member banks, BHCs, and SLHCs, including proposals involving private equity firms.

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### **Federal Reserve Act Proposals**

Under the Federal Reserve Act, a bank must seek Federal Reserve approval to become a member bank. A member bank may be

required to seek Federal Reserve approval before expanding its operations domestically or internationally. State member banks must obtain Federal Reserve approval to establish domestic branches, and all member banks (including national banks) must obtain Federal Reserve approval to establish foreign branches. When reviewing proposals for membership, the Federal Reserve considers, among other things, the bank's financial condition and its record of compliance with banking laws and regulations. When reviewing proposals to establish domestic branches, the Federal Reserve considers, among other things, the scope and nature of the banking activities to be conducted. When reviewing proposals for foreign branches, the Federal Reserve considers, among other things, the condition of the bank and the bank's experience in international banking. In 2011, the Federal Reserve acted on membership proposals for 44 banks, and new and merger-related branch proposals for 427 domestic branches and eight foreign branches.

State member banks must also obtain Federal Reserve approval to establish financial subsidiaries. These subsidiaries may engage in activities that are financial in nature or incidental to financial activities, including securities-related and insurance agency-related activities. In 2011, no financial subsidiary applications were submitted.

### **Overseas Investment Proposals by U.S. Banking Organizations**

U.S. banking organizations may engage in a broad range of activities overseas. Many of the activities are conducted indirectly through Edge Act and agreement corporation subsidiaries. Although most foreign investments are made under general consent procedures that involve only after-the-fact notification to the Federal Reserve, large and other significant investments require prior approval. In 2011, the Federal Reserve approved 20 applications and notices for overseas investments by U.S. banking organizations, many of which represented investments through an Edge Act or agreement corporation.

### **International Banking Act Proposals**

The International Banking Act, as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires foreign banks to obtain Federal Reserve approval before establishing branches, agencies, commercial lending company subsidiaries, or representative offices in the United States.

In reviewing proposals, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. It also considers whether the home-country supervisor has consented to the establishment of the U.S. office; the financial condition and resources of the foreign bank and its existing U.S. operations; the managerial resources of the foreign bank; whether the home-country supervisor shares information regarding the operations of the foreign bank with other supervisory authorities; whether the foreign bank has provided adequate assurances that information concerning its operations and activities will be made available to the Federal Reserve, if deemed necessary to determine and enforce compliance with applicable law; whether the foreign bank has adopted and implemented procedures to combat money laundering and whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering; and the record of the foreign bank with respect to compliance with U.S. law. In 2011, the Federal Reserve approved seven applications by foreign banks to establish branches, agencies, or representative offices in the United States.

### **Home Owners' Loan Act Proposals**

Under the Home Owners' Loan Act, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming an SLHC through the acquisition of one or more savings associations in the United States. Once formed, an SLHC must receive Federal Reserve approval before acquiring or establishing additional savings associations. Also, SLHCs generally may engage in only those nonbanking activities that are specifically enumerated in the Home Owners' Loan Act or which the Board has previously determined to be closely related to banking under section 4(c)(8) of the BHC Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement. In 2011, the Federal Reserve acted on five applications and notices filed by SLHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities.

Under the Home Owners' Loan Act, a savings association reorganizing to a mutual holding company (MHC) structure must receive Federal Reserve approval prior to its reorganization. In addition, an MHC must receive Federal Reserve approval before converting to stock form, and MHCs must receive Federal Reserve approval before waiving dividends declared by the MHC's subsidiary. In 2011, the Federal Reserve received no applications for MHC reorganizations. In 2011, the Federal Reserve acted on no applications filed by MHCs to convert to stock form and 14 applications to waive dividends.

When reviewing an SLHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the proposal, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law.

The Federal Reserve also reviews elections submitted by SLHCs seeking treatment as financial holding companies under the authority granted by the Dodd-Frank Act. SLHCs seeking financial holding company treatment must file a written declaration with the Federal Reserve. In 2011, no SLHC financial holding company declarations were approved.

### **Public Notice of Federal Reserve Decisions**

Certain decisions by the Federal Reserve that involve an acquisition by a BHC, a bank merger, a change in control, or the establishment of a new U.S. banking presence by a foreign bank are made known to the public by an order or an announcement. Orders state the decision, the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are made public immediately; they are subsequently reported in the Board's weekly H.2 statistical release. The H.2 release also contains announcements of applications and notices received by the Federal Reserve upon which action has not yet been

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taken. For each pending application and notice, the related H.2A release gives the deadline for comments. The Board's website ([www.federalreserve.gov](http://www.federalreserve.gov)) provides information on orders and announcements as well as a guide for U.S. and foreign banking organizations that wish to submit applications.

### *Enforcement of Other Laws and Regulations*

The Federal Reserve's enforcement responsibilities also extend to the disclosure of financial information by state member banks and the use of credit to purchase and carry securities.

#### **Financial Disclosures by State Member Banks**

State member banks that issue securities registered under the Securities Exchange Act of 1934 must disclose certain information of interest to investors, including annual and quarterly financial reports and proxy statements. By statute, the Board's financial disclosure rules must be substantially similar to those of the SEC. At the end of 2011, 12 state member banks were registered with the Board under the Securities Exchange Act.

#### **Securities Credit**

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. The Board's Regulation T limits the amount of credit that may be provided by securities brokers and dealers when the credit is used to purchase debt and equity securities. The Board's Regulation U limits the amount of credit that may be provided by lenders other than brokers and dealers when the credit is used to purchase or carry publicly held equity securities if the loan is secured by those or other publicly held equity securities. The Board's Regulation X applies these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce the Board's securities credit regulations. The SEC, the Financial Industry Regulatory Authority, and the Chicago Board Options Exchange examine brokers and dealers for compliance with Regulation T. With respect to compliance with Regulation U, the federal banking agencies examine banks under their respective jurisdictions; the Farm Credit Administration and the NCUA examine lenders under their respective jurisdictions; and the Federal Reserve examines other Regulation U lenders.

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## References

1. The TARP statistics only include those BHCs that did not participate in the Supervisory Capital Assessment Program in 2009. [Return to text](#)
2. Pursuant to the Home Owners' Loan Act, 12 U.S.C. Section 1461 *et. seq.*, an SLHC is defined as any company that directly or indirectly controls either a savings association or any other company that is an SLHC. [Return to text](#)
3. The Office of the Comptroller of the Currency examines nationally chartered banks, and the FDIC examines state-chartered banks that are not members of the Federal Reserve. [Return to text](#)
4. The Financial Services Regulatory Relief Act of 2006, which became effective in October 2006, authorized the federal banking agencies to raise the threshold from \$250 million to \$500 million, and final rules incorporating the change into existing regulations were issued on September 21, 2007. [Return to text](#)
5. Each of the first two components has four subcomponents: *Risk Management*-- (1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. *Financial Condition*-- (1) Capital, (2) Asset Quality, (3) Earnings, and (4) Liquidity. [Return to text](#)
6. The special supervisory program was implemented in 1997 and modified in 2002. See SR letter 02-01 for a discussion of the factors considered in determining whether a BHC is complex or noncomplex ([www.federalreserve.gov/boarddocs/srletters/2002/sr0201.htm](http://www.federalreserve.gov/boarddocs/srletters/2002/sr0201.htm)). [Return to text](#)
7. See also SR-11-13 (7-25-11) "Guidance Regarding Prior Notices with respect to Dividend Declarations by Savings Association Subsidiaries of Savings and Loan Holding Companies" ([www.federalreserve.gov/bankinforeg/srletters/sr1113.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1113.htm)) and SR 11-12 (7-21-11) "Deregistration Procedures for Certain Savings and Loan Holding Companies" ([www.federalreserve.gov/bankinforeg/srletters/sr1112.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1112.htm)). [Return to text](#)
8. [www.federalreserve.gov/paymentsystems/psr\\_about.htm](http://www.federalreserve.gov/paymentsystems/psr_about.htm). [Return to text](#)
9. The OCC examines federally licensed branches and agencies, and the FDIC examines state-licensed FDIC-insured branches in coordination with the appropriate state regulatory authority. [Return to text](#)
10. The FFIEC is an interagency body of financial regulatory agencies established to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the OCC, the Consumer Financial Protection Bureau, and the chair of the State Liaison Committee. [Return to text](#)
11. Criticized assets are composed of special mention and classified assets. Special mention assets are loans and securities that exhibit potential but are not classified. Classified assets are loans and securities that exhibit well-defined weaknesses or a distinct possibility of loss. [Return to text](#)
12. [www.federalreserve.gov/bankinforeg/srletters/sr1106.htm](http://www.federalreserve.gov/bankinforeg/srletters/sr1106.htm). [Return to text](#)
13. See notice of intent at [www.gpo.gov/fdsys/pkg/FR-2011-02-08/html/2011-2782.htm](http://www.gpo.gov/fdsys/pkg/FR-2011-02-08/html/2011-2782.htm). [Return to text](#)
14. See proposal at [www.gpo.gov/fdsys/pkg/FR-2011-08-25/html/2011-21736.htm](http://www.gpo.gov/fdsys/pkg/FR-2011-08-25/html/2011-21736.htm). [Return to text](#)

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15. See press release and notice at [www.federalreserve.gov/newsevents/press/bcreg/20111223a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20111223a.htm). [Return to text](#)

16. Since 1996, the act has provided an expedited prior notice procedure for certain permissible nonbank activities and for acquisitions of small banks and nonbank entities. Since that time, the act has also permitted well-run BHCs that satisfy certain criteria to commence certain other nonbank activities on a de novo basis without first obtaining Federal Reserve approval. [Return to text](#)

\*This sentence was printed incorrectly and has been revised. (5/24/12) [Return to text](#)

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