Evaluation Report
2018-SR-B-010
June 20, 2018

Board of Governors of the Federal Reserve System

In Accordance With Applicable Guidance, Reserve Banks Rely on the Primary Federal Regulator of the Insured Depository Institution in the Consolidated Supervision of Regional Banking Organizations, but Document Sharing Can Be Improved

Office of Inspector General
Board of Governors of the Federal Reserve System
Bureau of Consumer Financial Protection

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Executive Summary, 2018-SR-B-010, June 20, 2018

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Findings

In accordance with applicable guidance related to consolidated supervision, we determined that the Federal Reserve Banks relied on the respective primary federal regulator (PFR) of regional banking organizations' (RBOs) insured depository institutions to supervise the RBOs we sampled. We also noted that the Reserve Banks appear to have increased their reliance on the PFRs.

We identified an opportunity for the Board of Governors of the Federal Reserve System (Board) to establish general guidelines for reliance on PFR documents and to ensure that all examiners have access to those documents. In addition, we found that the Board and the Reserve Banks could improve document-sharing processes. Finally, several RBO executives noted the potentially avoidable regulatory burden created because RBO employees sometimes upload the same documentation to multiple systems in response to Reserve Bank and PFR documentation requests.

Recommendations

Our report contains recommendations designed to improve document sharing among the Board, the Reserve Banks, and the PFRs. In its response to our draft report, the Board concurs with our recommendations and outlines actions to address each recommendation. We will follow up to ensure that the recommendations are fully addressed.

Purpose

We conducted this evaluation to assess the effectiveness of the consolidated supervision of RBOs. RBO bank holding companies (BHCs) have $10 billion to $50 billion in total consolidated assets. Specifically, we determined the extent to which the Reserve Banks rely on the PFR in executing consolidated supervision and the effectiveness of interagency coordination.

Background

The Board is the consolidated supervisor of BHCs—entities that own or control one or more banks. The Board delegates authority to each Reserve Bank to supervise the BHCs in the Reserve Bank's District. By law, the Reserve Banks must rely to the fullest extent possible on the work of the PFR of the BHCs' subsidiary depository institutions. Depending on the depository institution's charter and status as a member of the Federal Reserve System, the PFR is either the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, or the Board.

Office of Inspector General
Board of Governors of the Federal Reserve System
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Recommendations, 2018-SR-B-010, June 20, 2018

In Accordance With Applicable Guidance, Reserve Banks Rely on the Primary Federal Regulator of the Insured Depository Institution in the Consolidated Supervision of Regional Banking Organizations, but Document Sharing Can Be Improved

Finding 1: The Reserve Banks Relied on the PFRs to Supervise the RBOs in Our Sample and Appear to Be Increasing This Reliance

Number	Recommendation	Responsible office
	No recommendations.	

Finding 2: The Types of PFR Documentation That Reserve Bank Examiners Rely on and Have Access to Varies

Number	Recommendation	Responsible office
1	Define the types of documentation that Reserve Bank RBO examiners generally need to obtain to meet the Board's expectations for relying on work performed by the PFR, including the circumstances, if any, under which examiners should obtain supplemental documentation.	Division of Supervision and Regulation

Finding 3: The Board and the Reserve Banks Can Improve Their Document-Sharing Processes

Number	Recommendation	Responsible office
2	Evaluate potential solutions to improve document-sharing processes and develop a plan to ensure that Reserve Bank examiners have timely and complete access to FDIC and OCC supervisory documents.	Division of Supervision and Regulation

Finding 4: RBOs Upload the Same Documents to Multiple Regulators' Systems

Number	Recommendation	Responsible office
3	Evaluate potential solutions to minimize the burden of document requests on the RBOs and develop a plan to improve how the Reserve Banks obtain and share RBO documents.	Division of Supervision and Regulation

Office of Inspector General
Board of Governors of the Federal Reserve System
Bureau of Consumer Financial Protection

MEMORANDUM

DATE: June 20, 2018

TO: Michael S. Gibson
Director, Division of Supervision and Regulation
Board of Governors of the Federal Reserve System

FROM: Melissa Heist Melissa Heist
Associate Inspector General for Audits and Evaluations

SUBJECT: OIG Report 2018-SR-B-010, *In Accordance With Applicable Guidance, Reserve Banks Rely on the Primary Federal Regulator of the Insured Depository Institution in the Consolidated Supervision of Regional Banking Organizations, but Document Sharing Can Be Improved*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the effectiveness of the consolidated supervision of regional banking organizations.

Our report contains recommendations designed to improve document sharing among the Board, the Reserve Banks, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. We provided you with a draft of our report for review and comment. In your response, you concur with our recommendations and outline actions that will be taken to address our recommendations. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Division of Supervision and Regulation and the Reserve Banks in our sample. Please contact me if you would like to discuss this report or any related issues.

cc: Michael Johnson, Acting Deputy Director, Division of Supervision and Regulation
Kevin Bertsch, Associate Director, Division of Supervision and Regulation
Keith Coughlin, Assistant Director, Division of Supervision and Regulation
Robert Ashman, Advisor, Division of Supervision and Regulation
Anthony Cain, Manager, Division of Supervision and Regulation
Diana Nead, Manager, Division of Supervision and Regulation
Cynthia Goodwin, Vice President, Supervision, Regulation, and Credit, Federal Reserve Bank of Atlanta
Jim Nolan, Executive Vice President, Supervision, Regulation, and Credit, Federal Reserve Bank of Boston

Cathy Lemieux, Executive Vice President, Supervision and Regulation, Federal Reserve Bank of Chicago
Stephen H. Jenkins, Senior Vice President, Supervision, Credit Risk Management, and Statistics, Federal Reserve Bank of Cleveland
Robert Triplett, Senior Vice President, Banking Supervision, Federal Reserve Bank of Dallas
Kevin L. Moore, Senior Vice President, Supervision and Risk Management, Federal Reserve Bank of Kansas City
Christine M. Gaffney, Senior Vice President, Supervision, Regulation, and Credit, Federal Reserve Bank of Minneapolis
Kevin J. Stiroh, Executive Vice President, Supervision, Federal Reserve Bank of New York
William G. Spaniel, Senior Vice President and Lending Officer, Supervision, Regulation, and Credit, Federal Reserve Bank of Philadelphia
Lisa A. White, Executive Vice President, Supervision, Regulation, and Credit, Federal Reserve Bank of Richmond
Tracy Basinger, Executive Vice President and Director, Financial Institution Supervision and Credit, Federal Reserve Bank of San Francisco
Julie Stackhouse, Executive Vice President, Supervision, Credit, Community Development, and Learning Innovation, Federal Reserve Bank of St. Louis
Ricardo A. Aguilera, Chief Financial Officer and Director, Division of Financial Management
Tina White, Senior Manager, Compliance and Internal Control, Division of Financial Management

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Introduction

Objectives

We conducted an evaluation of the effectiveness of the consolidated supervision of regional banking organizations (RBOs). Our objectives were to evaluate (1) the reliance that the Federal Reserve Banks place on the primary federal regulator (PFR) in executing consolidated supervision and (2) the effectiveness of interagency coordination between the Board, the Reserve Banks, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC).[1]

Background

The Board of Governors of the Federal Reserve System (Board) is the consolidated supervisor of bank holding companies (BHCs). A BHC is a company that owns or controls one or more banks. The Board is responsible for supervising and regulating BHCs, even if a different regulatory agency supervises the BHC's subsidiary banks. Within the Federal Reserve System, which encompasses the Board and the Reserve Banks, the Board delegates to each Reserve Bank the authority to supervise the banks and BHCs located within the Reserve Bank's District. The Board's Division of Supervision and Regulation (S&R) oversees the Reserve Banks' execution of this delegated function and issues supervisory policy and guidance to assist the Reserve Banks in executing that authority.

S&R groups its oversight activities into multiple supervisory portfolios that are generally based on the total asset size of those institutions.

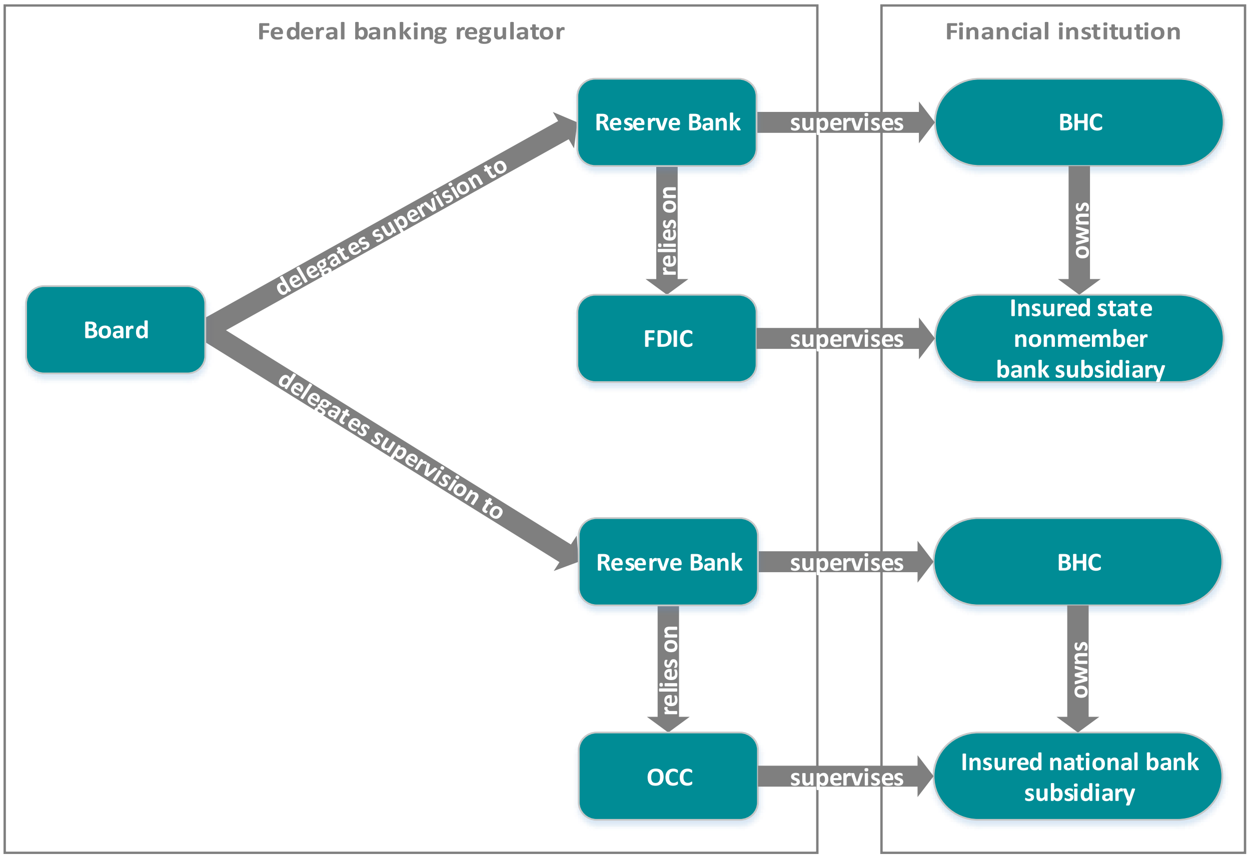
- The community banking organization (CBO) portfolio includes institutions with less than $10 billion in total consolidated assets.
- The RBO portfolio includes institutions with $10 billion to $50 billion in total consolidated assets.
- The large and foreign banking organization (LFBO) portfolio includes domestic institutions with more than $50 billion in total consolidated assets and foreign institutions with more than $50 billion in U.S. assets supervised by the Board that are not subject to Large Institution Supervision Coordinating Committee (LISCC) portfolio supervision.
- The LISCC portfolio includes the largest and most systemically important domestic and foreign financial institutions supervised by the Board.

The PFR for an insured depository subsidiary of a BHC depends on its charter and whether it is a member of the Federal Reserve System. For BHCs that own insured depository subsidiaries other than state member banks, the PFR for the insured depository is either the FDIC or the OCC (figure 1). The FDIC is the PFR for insured depository institutions with a state charter that are not members of the Federal Reserve

[1] For the purposes of this report, the term *primary federal regulator* and its abbreviation *PFR* refer to the OCC for national banks and the FDIC for state-chartered nonmember banks.

System, including state nonmember banks, and the OCC is the PFR for insured depository subsidiaries with a national bank charter.[2] For BHCs that own a state member bank—that is, an insured depository institution with a state charter that is also a member of the Federal Reserve System—the responsible Reserve Bank, under delegated authority from the Board, is the PFR.[3]

Figure 1. Supervision of State Nonmember Banks and National Banks Owned by a BHC



Source. OIG analysis of Board documents.

Note. As described in the text below, the Board has the authority to examine insured depository institution subsidiaries supervised by the FDIC and the OCC; the Board has explained it will exercise this authority in "rare and limited circumstances." This figure does not depict the Board's supervision of BHCs that own a state member bank, as the responsible Reserve Bank, under delegated authority from the Board, is the PFR for those institutions.

In executing consolidated supervision of BHCs, the Bank Holding Company Act of 1956, as amended, requires the Board to rely to the fullest extent possible on the oversight activities, such as target and full-

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[2] The scope of our evaluation did not include the Board's supervision of savings and loan holding companies, which are institutions that directly or indirectly control a federal or state savings association. For more information on our scope, see appendix A.

[3] For banks chartered by a state that are not members of the Federal Reserve System, in addition to relying on the work of the FDIC, the Board is required to rely to the fullest extent possible on the work of state regulatory agencies. Our evaluation focused solely on the Board's reliance on other federal banking regulators. For more information on our scope, see appendix A.

scope examinations, performed by the PFR.[4] The Reserve Banks incorporate the results of the PFR's work on the depository subsidiary into their continuous monitoring and annual full-scope examinations of the consolidated entity's financial condition and corporate functions conducted at the BHC level.

In 2016, the Board issued Supervision and Regulation Letter (SR Letter) 16-4, *Relying on the Work of the Regulators of the Subsidiary Insured Depository Institution(s) of Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of Less than $50 Billion*. SR Letter 16-4 explains the Board's expectations for its examiners' reliance on the work of the regulators for CBO and RBO insured depository institution subsidiaries in the examiners' supervision of BHCs.[5] According to SR Letter 16-4, when the Board is not the PFR for the insured depository subsidiary, the Reserve Banks will rely to the fullest extent possible on the PFR's assessment of the insured depository institution when assigning supervisory ratings to BHCs. When reliance on the PFR's target and full-scope examination reports does not sufficiently support the Board's expectations for supervising a BHC, SR Letter 16-4 states that the Reserve Bank will work with the PFR to resolve information gaps, and only in rare and limited circumstances will the Reserve Bank invoke its authority to examine the insured depository institution subsidiary.

For RBO BHCs with a national bank or state nonmember bank subsidiary, the Reserve Bank issues a rating for the BHC based largely on the PFR's supervision of the subsidiary. During the annual full-scope BHC examination, the Reserve Bank assigns each BHC a composite (C) rating based on an evaluation and rating of the institution's overall risk management, financial condition, and future potential risk to any subsidiary depository institutions. In addition to the composite rating, the Reserve Bank also assigns component ratings based on the BHC's risk management (R), financial condition (F), and the potential impact (I) of the parent company and any nondepository subsidiaries on any subsidiary depository institutions. The Reserve Bank will also assign a depository institution (D) rating that will generally reflect the PFR's assessment of any subsidiary depository institutions. This rating system is abbreviated as RFI/C (D).

According to SR Letter 16-4, the Board tailors its supervision of BHCs based on the size of the organization; its complexity; and the degree of systemic risk that the organization poses to the U.S. financial system and the economy, including the Deposit Insurance Fund. For RBO BHCs that are not complex,[6] SR Letter 16-4 provides that the RFI/C (D) rating "should heavily rely on" the PFR's assessment of banking subsidiaries that meet all the following criteria:

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[4] Section 5(c) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. § 1844(c)). The Bank Holding Company Act of 1956, as amended, also requires the Board to rely to the fullest extent possible on the work of state regulatory agencies of BHC subsidiaries. The Board's reliance on state regulatory agencies was not within the scope of this evaluation. For more information on our scope, see appendix A.

[5] SR Letters address policy and procedural matters that are of continuing relevance to S&R's supervisory efforts or that the Board has otherwise decided to make public. The Board addresses SR Letters to supervised institutions as well as to the Reserve Banks and posts them on its public website.

[6] In determining whether a BHC is complex, the Board considers a number of factors, including the size and structure of the BHC; the extent of intercompany transactions between the BHC and the subsidiary or subsidiaries; and the risk, scale, and complexity of the activities of any nondepository subsidiaries.

- a CAMELS composite rating of 1 or 2, indicating the institution is viewed as sound[7]
- a low or moderate risk profile
- satisfactory management practices with an associated satisfactory management component rating
- stable financial and risk conditions
- recently issued insured depository institution examination reports

When these criteria are present, SR Letter 16-4 states that Board and Reserve Bank employees will likely need to perform only limited analysis beyond the required annual holding company inspection supplemented by continuous monitoring. For RBO BHCs that are complex or that do not meet the criteria described above, the Reserve Bank may tailor its supervisory approach to conduct more detailed monitoring of the BHC's internal management information systems, internal audit function, and loan review reports to ensure that the PFR's conclusions are a valid basis for assigning ratings to the BHC.

The Reserve Banks assign an examiner to be the central point of contact (CPC) for each RBO in their District. Board internal guidance directs CPCs to coordinate their supervisory planning process with the PFR to review high-risk areas, avoid duplicative efforts, and fill knowledge gaps.[8] Under SR Letter 16-4, CPCs should obtain results from all PFR target and full-scope examinations that address significant safety and soundness risks. Also, CPCs should communicate with their PFR counterparts on at least a quarterly basis to understand the scope, scheduling, and status of examination work and exit meetings, as well as the status of draft and final reports.

[7] Bank examiners use the Uniform Financial Institution Rating System, commonly referred to as the CAMELS rating system, to describe a bank's soundness. Examiners rank the bank in six categories on a scale from 1 (highest) to 5 (lowest): capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk.

[8] During its annual full-scope assessment of a BHC, the Reserve Bank determines the institution's RFI/C (D) rating. In general, the Board refers to assessments of BHCs as *inspections* and assessments of insured depositories as *examinations*. For the purposes of this report, we refer to assessments of both BHCs and insured depositories as *examinations*.

Finding 1: The Reserve Banks Relied on the PFRs to Supervise the RBOs in Our Sample and Appear to Be Increasing This Reliance

Based on our interviews of Board and Reserve Bank supervisory employees, our analysis of the supervision of the 12 RBOs in our sample, and our interviews with executives from those RBOs, we determined that, in accordance with applicable guidance, the Reserve Banks rely on the PFR in supervising RBOs.[9] Although some CPCs have experienced challenges obtaining certain information from the PFR, as described in findings 2 and 3, the CPCs for the institutions in our sample ultimately obtained sufficient information from the PFR to rely on its work. In addition, for the RBO BHCs in our sample, the hours that Reserve Banks allocated to examinations and continuous monitoring generally decreased between 2013 and 2017.

The Bank Holding Company Act of 1956, as amended, requires the Board to rely to the fullest extent possible on the reports and supervisory information of other regulatory agencies. The Board provides its expectations for how the Reserve Banks should rely on the PFR's work and coordinate with the PFR in various SR Letters and Board internal guidance. This guidance includes the following:

- SR Letter 16-4, which states that the Board will rely to the fullest extent possible on the assessment of the PFR, as reflected in the examination work performed by the PFR, when assigning Board supervisory ratings to BHCs.
- SR Letter 14-3 job aid, *Supervisory Guidance on Dodd-Frank Act Company-Run Stress Testing for Banking Organizations with Total Consolidated Assets of More Than $10 Billion but Less Than $50 Billion*, which divides Dodd-Frank Act Stress Test (DFAST) high-level questions between the Reserve Banks and the PFR.
- Board internal guidance, which states that CPCs should coordinate their supervisory planning process and examination program with the appropriate PFR to ensure that high-risk areas are appropriately reviewed, duplicative efforts are avoided, and knowledge gaps are filled.

Reserve Banks Rely on the PFRs

To assess the Reserve Banks' approach to relying on the PFR, we reviewed the Reserve Banks' supervisory plans for the 12 institutions in our sample. Board internal guidance indicates that Reserve Banks are expected to perform a full-scope examination and at least one targeted review during the supervisory cycle for each RBO. The guidance also provides that participation on a PFR-led targeted review of a control function, such as internal audit, internal loan review, compliance, or risk management, meets the requirement for achieving the one targeted review. Based on our analysis of Reserve Bank documents,

[9] To conduct our evaluation, we selected a nonstatistical sample of RBOs supervised by 4 of the 12 Reserve Banks. Among the institutions that those 4 Reserve Banks supervise, we selected a nonstatistical sample of 12 RBO BHCs that own either a national bank or a state nonmember bank insured depository subsidiary. For more information on our sampling methodology, see appendix A.

the planned approach for the 12 RBOs in our sample complies with the requirements set forth by Board internal guidance. For our sample institutions, the Reserve Banks' planned examination activities for 2017 consisted primarily of one annual full-scope examination and one target examination conducted either independently or in coordination with the PFR.

SR Letter 16-4 describes the Board's expectations for Reserve Bank reliance on the work of the PFR. Specifically, SR Letter 16-4 states that for noncomplex RBOs with satisfactory supervisory ratings, the Reserve Banks will likely need to perform only limited analysis beyond the required annual full-scope examination if the RBO's insured depository institution subsidiaries exhibit certain characteristics.[10] Each Reserve Bank planned to conduct an annual full-scope examination of the BHCs in our sample, among other limited supervisory activities. During the annual full-scope BHC examination, the Reserve Bank assigned each BHC an RFI/C (D) rating based largely on the PFR's supervision of the subsidiary.

Additionally, the Board has developed work programs for the components of the annual BHC full-scope examination that promote reliance on the PFR. In completing those work programs, examiners should use information and assessments of the subsidiary provided by the PFR. If the PFR's documentation includes adequate responses to questions in the work programs, the Board expects examiners to leverage this information to the fullest extent possible.

The PFRs Planned to Conduct Significantly More Examinations Than the Reserve Banks

Based on our analysis of Reserve Bank documents for the institutions in our sample, we found that the PFRs had planned significantly more examinations as compared with the Reserve Banks. The PFRs planned to conduct 6 to 20 examinations per institution during calendar year 2017. By contrast, the Reserve Banks typically conduct 1 annual full-scope examination at each institution and 1 target examination, with the PFR often participating in the review.

For our sample of RBO BHCs and their subsidiaries, the Reserve Banks' 2017 supervisory plans outlined 194 total examinations to be performed by the PFR; the Reserve Bank; or both, either jointly or concurrently. Of those 194 planned examinations, the PFR intended to lead 162 subsidiary examinations, the Reserve Bank intended to lead 15 BHC examinations, and the Reserve Banks and the PFRs anticipated conducting 17 concurrent or joint examinations involving both BHCs and subsidiaries (figure 2).[11] Of the 15 planned Reserve Bank–led examinations in our sample, 12 were annual full-scope examinations and 3 were target examinations. Only one institution in our sample was designated *complex* and assigned a CAMELS composite rating of 3; for that RBO, the Reserve Bank planned to conduct its annual full-scope examination and two target examinations in accordance with SR Letter 16-4, which allows for closer

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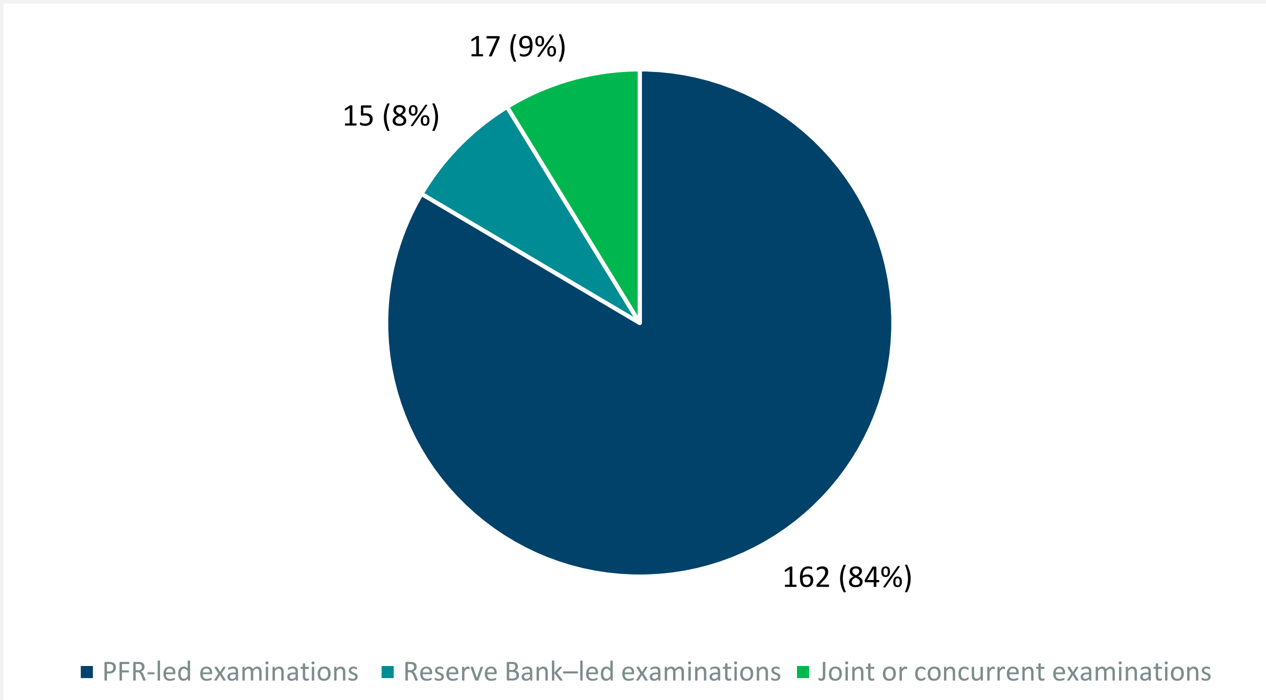
[10] These RBO insured depository institution characteristics include that the institution has a CAMELS composite rating of 1 or 2, is viewed as sound, has a low or moderate risk profile, is in stable financial condition, has satisfactory management practices and an associated satisfactory management component rating, and has a recently issued insured depository institution examination report.

[11] During the fieldwork for this evaluation, we analyzed the Reserve Banks' calendar year 2017 supervisory plans for each of the institutions in our sample. The plans reflected the PFRs' supervisory plans that they provided to the respective Reserve Bank and the Reserve Bank–led examinations that the Reserve Banks planned to conduct. Based on the information available to us as of January 24, 2018, we noted that the Reserve Banks had not conducted four of the planned examinations, including two in which the institution left the RBO portfolio during calendar year 2017.

Reserve Bank supervision of such institutions, to ensure that the conclusions reached by the PFR remain a valid basis for assigning the supervisory ratings at the BHC level. All other RBOs in our sample were designated *noncomplex* and assigned a CAMELS composite rating of 2, and therefore fell under the Board's noncomplex RBO expectations, as described above.

Figure 2. Planned Examinations of the RBOs in Our Sample for Calendar Year 2017



Source. OIG analysis of Board and Reserve Bank documents and data.

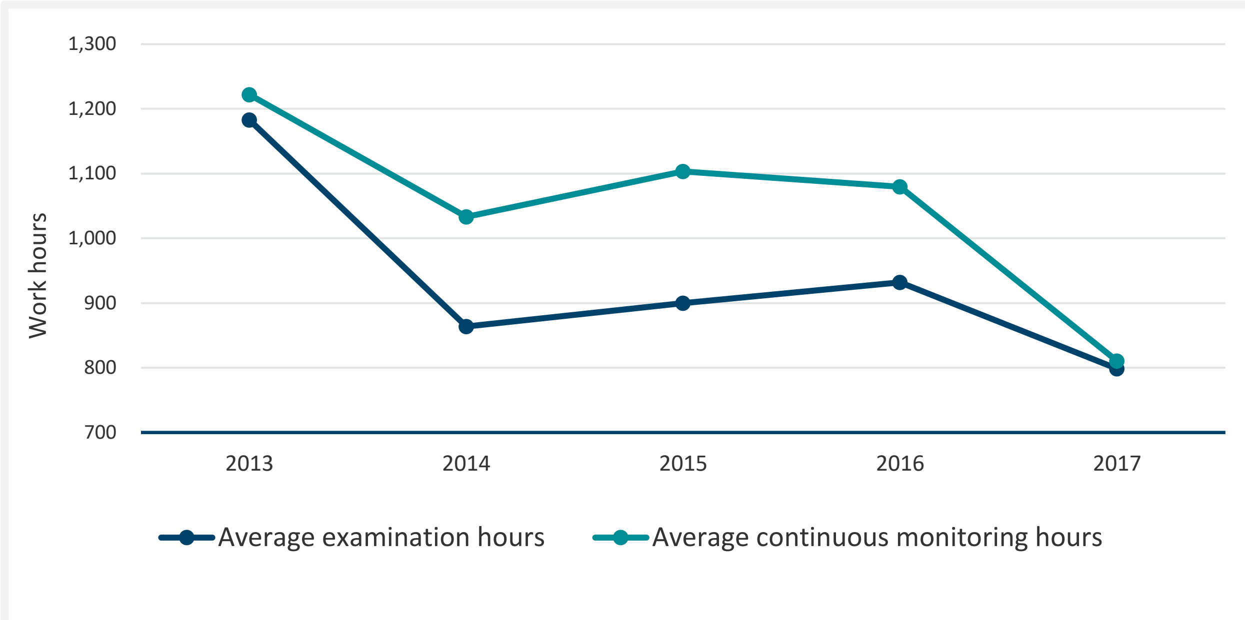
Note. Percentages do not total 100 due to rounding.

Reserve Bank Hours Spent on Examinations and Continuous Monitoring Have Decreased Over Time

The average and total annual work hours Reserve Bank staff spent on examinations and continuous monitoring of the RBOs in our sample decreased significantly between 2013 and 2017 (figures 3 and 4).[12] According to a Board official, within the RBO portfolio, S&R has deliberately dedicated fewer Reserve Bank resources to noncomplex RBO BHCs that own subsidiaries supervised by the FDIC or the OCC and do not have material activities at the holding company level. The Board has increasingly allocated more Reserve Bank resources to RBO BHCs that own a state member bank.

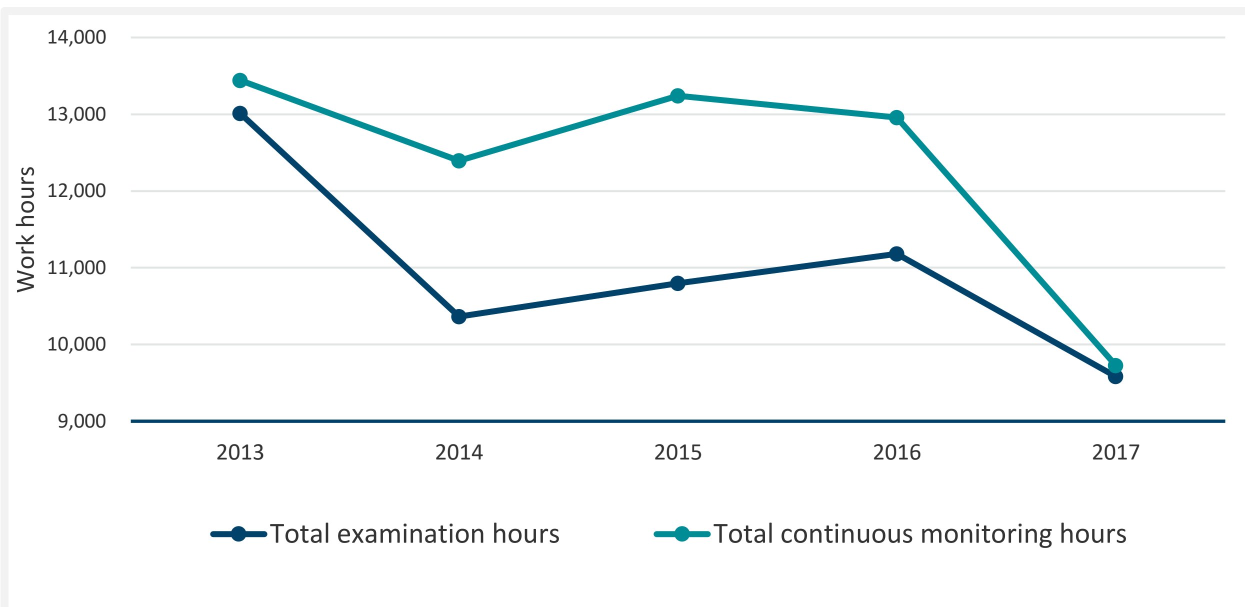
[12] The average and total annual work hours for examinations and continuous monitoring do not include work hours attributable to horizontal reviews conducted across all institutions in the RBO portfolio. Among the institutions in our sample, one joined the RBO portfolio in 2014 and one left the RBO portfolio in 2017.

Figure 3. Average Reserve Bank Work Hours for Examinations and Continuous Monitoring per Year for the 12 RBOs in Our Sample



Source. OIG analysis of Board data. The Board provided data for calendar years 2015 through 2017 from its current timekeeping system and data for calendar years 2013 and 2014 from legacy timekeeping systems. According to a Board analyst, examiners record their own work hours in the timekeeping system.

Figure 4. Total Reserve Bank Work Hours for Examinations and Continuous Monitoring per Year for the 12 RBOs in Our Sample



Source. OIG analysis of Board data. The Board provided data for calendar years 2015 through 2017 from its current timekeeping system and data for calendar years 2013 and 2014 from legacy timekeeping systems. According to a Board analyst, examiners record their own work hours in the timekeeping system.

RBO Executives Indicated That the Reserve Banks Rely on the PFRs

Interviews with executives from the 12 RBOs in our sample supported the conclusions we drew about Reserve Bank reliance on the PFR from our review of documents and the distribution of examiner hours. Eleven of the 12 executives indicated that the Reserve Banks rely on the PFR to the fullest extent possible in supervising their institution.[13]

- One RBO executive stated that the Reserve Bank overseeing that RBO is increasingly relying on the PFR, evidenced by a decline in the number of Reserve Bank examiners onsite at the institution.
- Another executive explained that the institution does not receive separate examination reports or letters from the PFR and the Reserve Bank and noted that the Reserve Bank is leaning on the work of the PFR.
- A third executive confirmed that the Reserve Bank is relying on the PFR to the fullest extent possible and stated that in the past few years, the Reserve Bank has conducted fewer examinations.

[13] One executive declined to answer the question, citing uncertainty concerning how to interpret the phrase "to the fullest extent possible."

Finding 2: The Types of PFR Documentation That Reserve Bank Examiners Rely on and Have Access to Varies

The types of PFR-generated documentation that RBO examiners at the Reserve Banks rely on to conduct their work varies. In some instances, examiners only rely on final PFR reports; in other instances, examiners also rely on documents that supplement those reports, such as scope and conclusion memorandums, which may provide more-detailed explanations of the PFR's assessment of the institution. We also found that examiners' access to PFR documentation and information is inconsistent. In SR Letter 16-4, which applies to institutions with less than $50 billion in total consolidated assets, the Board requires examiners to "[u]nderstand the . . . regulators' examination work, including the scope, basis for, and support of conclusions reached, and the goal of any supervisory action." In addition to the ongoing dialog between the Reserve Bank examiners and the PFRs, an information-sharing agreement between the Board and one of the PFRs states that the agencies will share relevant supervisory products, such as reports of examination, supervisory letters, conclusion memorandums, and continuous monitoring reports, to facilitate continual familiarity at both the BHC level and the subsidiary level.

Multiple contributing causes help to explain these documentation inconsistencies. First, our interviews revealed varying expectations on the part of Reserve Bank examiners and officials about the need to obtain and review underlying workpapers and other supporting documents to support reliance on the PFR's work. Second, different interpretations of the information-sharing agreement between the Board and one of the PFRs have resulted in the inconsistent availability of certain information to some examiners. Third, in some instances, relationships between Reserve Bank examiners and their PFR counterparts have determined how quickly examiners can obtain PFR documentation. These contributing causes may lead to inconsistent approaches by the Reserve Banks to supervising similarly situated institutions.

The PFR Documentation That Reserve Bank Examiners Request and Obtain Varies

SR Letter 16-4 requires Reserve Bank examiners to understand the scope and basis for any conclusions drawn by the PFR. In practice, the documentation that examiners obtain to help meet this requirement varies. Some examiners told us they request and obtain supplementary documentation, such as the PFR's examination conclusion memorandums, which generally include a detailed explanation of the PFR's supervisory conclusions. However, other examiners told us they rely solely on the PFR's final supervisory letter or report, which typically includes less detail than the supplementary documentation.

The Board and one of the PFRs have agreed-upon principles for information sharing, but Reserve Bank officials and examiners stated that they have not implemented those principles in a consistent manner. The information-sharing agreement between the two agencies states that the supervisory products that the Board and the PFR will share include reports of examination, supervisory letters, conclusion memorandums, and continuous monitoring reports. In addition, the FDIC, the OCC, and the Board have issued an interagency statement for the sharing of information during examination coordination.[14] Nonetheless, the CPCs we interviewed indicated that access to such supervisory products has been inconsistent.

- The Reserve Bank examiners we interviewed explained that when examiners participate on a PFR-led examination, the examiners have unfettered access to PFR information, including conclusion memorandums and workpapers. However, examiners participate on only a small percentage of PFR-led examinations.[15]

- One CPC explained that examiners typically obtain documents from the PFR for DFAST or internal audit examinations—two areas in which examiners often work jointly with the PFR.

- Some examiners we interviewed reported a reluctance or a refusal on the part of one PFR to share documentation other than final reports of examination when the Reserve Bank examiners do not participate on a PFR-led examination.

Multiple Causes Contribute to Inconsistent Access to Documentation

We found multiple contributing causes to the varying levels of access that Reserve Bank examiners have to PFR documentation and information.

Examiners Receive Inconsistent Messages About the Documentation Needed to Rely on the PFR

Reserve Bank examiners said they receive inconsistent messages about the documentation required to execute consolidated supervision of the BHC.

- Some Reserve Bank and Board officials indicated that examiners do not need to obtain additional documentation to supplement the PFRs' final supervisory documents.

- One Board official noted that given the limited risk presented by noncomplex holding companies with satisfactory supervisory ratings and no material negative risk trends, the Board is more able to fully rely on the conclusions of the PFR for those institutions without reviewing the supplemental documentation that helps to explain the basis for conclusions.

- By contrast, other Reserve Bank officials indicated that examiners should obtain supplemental documentation to support their reliance on the PFRs' final supervisory documents. One Reserve

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[14] The *Interagency Policy Statement on Examination Coordination and Implementation* states that agencies should consider sharing examination workpapers and the resulting findings and conclusions.

[15] Of the 162 PFR-led target examinations planned for the 12 RBOs in our sample, Reserve Bank examiners planned to participate on 4.

Bank official stated that conclusion memorandums often provide details that allow examiners to more fully rely on the PFRs' work.

The examiners we interviewed communicated differing perceptions of the expectations for the documentation required to rely on the PFR, which may reflect the inconsistent messaging from Reserve Bank and Board officials. Of the nine examiners we interviewed who discussed their views on the subject,

- four stated that supplemental documentation is not needed to rely on the work of a PFR
- three stated that it is only needed in certain circumstances
- two stated that it is needed on a routine basis

Differences in the Board's and a PFR's Portfolio Designation May Affect the Implementation of Their Information-Sharing Agreement

Multiple Reserve Bank officials and examiners we interviewed indicated that accessing documentation from one of the PFRs can depend on whether that PFR has classified the institution as a mid-size or community bank. According to these officials and examiners, challenges have sometimes arisen when obtaining PFR documentation pertaining to RBO institutions classified by that PFR as community banks. Although the information-sharing agreement with that PFR expressly covers institutions in the Board's RBO portfolio, officials and examiners told us that when that PFR classifies the subsidiary as a community bank, the agency interprets the agreement as not covering those institutions. However, an official with this PFR told us that the agency expects its examiners to share documents if the institution is in the Board's RBO portfolio. Differences between the PFR's expectations for sharing documents and the challenges described by some Reserve Bank examiners underscore the importance of Reserve Bank and Board officials coordinating with senior PFR officials to ensure that examiners have timely access to documentation.

Relationships Can Drive Access to PFR Documentation

Board officials stated that CPCs are expected to establish an effective relationship with their PFR counterparts. According to several Reserve Bank officials, the timeliness with which CPCs obtain PFR documents can depend on the CPC's relationship with his or her counterpart at the FDIC or the OCC.

- One Reserve Bank official stated that relationships with the PFRs can contribute to obtaining timely access to the documents necessary to rely on the PFR. The official noted that although current relationships with the PFRs are positive, those relationships may change over time.

- Another Reserve Bank official stated that a strong relationship between the CPC and the PFR can lead to obtaining information more quickly through direct contact with the PFR. This Reserve Bank official stated that in the past, some relationships with PFR counterparts were not strong, making working with the PFR more challenging.

Some CPCs we interviewed noted that the PFRs should provide requested information as a matter of practice rather than based on the strength of examiner relationships.

Recommendation

We recommend that the Director of S&R

1. Define the types of documentation that Reserve Bank RBO examiners generally need to obtain to meet the Board's expectations for relying on work performed by the PFR, including the circumstances, if any, under which examiners should obtain supplemental documentation.

Management Response

In its response to our draft report, the Board concurs with our recommendation. The agency notes that S&R will develop and issue examiner guidance to clarify the Board's expectations for the types of documentation that Reserve Bank examiners need to obtain to rely on the work of the PFR.

OIG Comment

The actions described by the Board appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

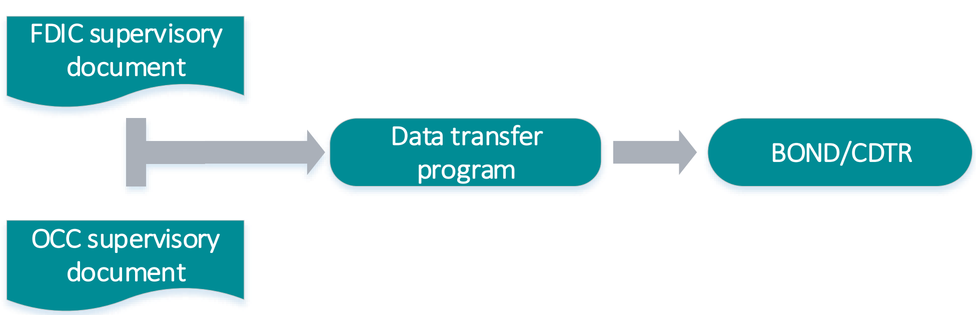
Finding 3: The Board and the Reserve Banks Can Improve Their Document-Sharing Processes

We found that the Banking Organization National Desktop (BOND) does not always provide Reserve Bank examiners with timely and complete access to PFR final supervisory information and documents. SR Letter 16-4 states that the PFRs and the Reserve Banks need to share information through ongoing dialog between the Reserve Bank and the PFR and exchange documentation to ensure Reserve Banks have a timely understanding of the PFR's supervisory analysis and conclusions. Moreover, timely information sharing is necessary so that Reserve Bank examiners have an adequate basis for relying on the PFR's work. Examiners sometimes lack timely and complete access to final PFR supervisory documents because certain document-sharing processes cause delays. As a result, examiners may not have up-to-date or complete documentation of the PFR's assessment of RBO BHC depository subsidiaries. As a workaround, examiners may make duplicative requests for documents from the PFR or request the documents directly from the supervised institution.

BOND Does Not Always Provide Examiners With Timely Access to PFR Documents

Although the Board has established guidance in SR Letter 16-4 to foster the timely sharing of information, we have determined that many examiners do not receive timely access to work completed by the PFRs. The Board implemented BOND in 2002 to facilitate the collaboration necessary to supervise BHCs and other banking organizations. The Board created BOND and the Central Document and Text Repository (CDTR) for the posting of documents pertaining to large institutions and expanded their use in 2003 to include all CBO and RBO examination reports and transmittal letters.[16] The FDIC and the OCC share final copies of supervisory documents, in accordance with information-sharing agreements, with the Board and the Reserve Banks through an official electronic channel that feeds into BOND and CDTR (figure 5).

Figure 5. Official Channel for Receiving PFR Documents



Source. OIG analysis of Board documents and interviews with Board and Reserve Bank officials and employees.

[16] These supervisory documents are stored in CDTR, which BOND accesses when users search for information in BOND.

Many interviewees indicated that BOND does not provide timely access to PFR documents, such as supervisory target letters and reports. Multiple Reserve Bank examiners and officials explained that there is a lag between the time the PFR submits the document to the RBO and the time that the document becomes accessible in BOND. A PFR official also stated that BOND impedes the timely sharing of final supervisory products.

We searched BOND for the PFR documents pertaining to each of our sample RBOs and determined that several PFR documents were not available in BOND. For example, as of April 3, 2018, the most recent PFR examination report for an RBO depository subsidiary in our sample was completed in March 2016. In addition to missing documents, a Reserve Bank official stated that often just the cover page of a PFR document may be viewable in BOND, and a Reserve Bank examiner stated that in some instances, only a few pages of an examination report are viewable in BOND. Upon hearing those observations, we asked a Reserve Bank examiner whether a PFR examination report posted to BOND was viewable; the examiner indicated that several pages of the examination report were blank.

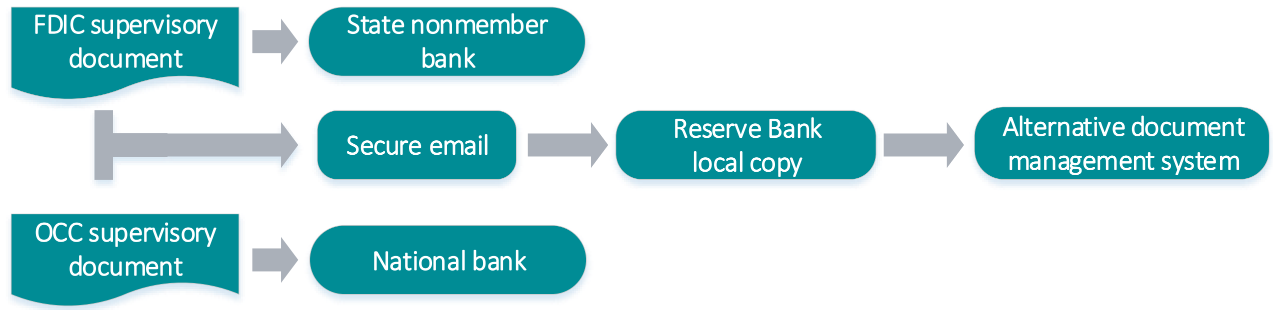
Data Processing Challenges and Miscommunication Resulted in Some Documents Being Inaccessible to Examiners

In addition to delays in information being available to examiners in BOND, data processing challenges and miscommunications between the agencies have led to instances of examiners not being able to access necessary documents in BOND. As an example, a Board analyst stated that one PFR changed its classification scheme for certain supervisory events without informing the Board of the changes; as a result, certain documentation did not upload to BOND properly because of the classification mismatch.

Other challenges continue to affect BOND. One Board analyst noted that BOND is not displaying a substantial amount of supervisory information provided by one PFR due to data processing challenges. In December 2017, the Board began to reprocess thousands of that PFR's supervisory documents so that those materials would display properly in BOND. The Board analyst noted that the Board plans to continue to reprocess these types of PFR documents in BOND on a monthly basis. In June 2017, the Board established a project team to assess the current state and use of BOND and CDTR and to deliver recommendations for next steps to the Board's committee on document management.

Through interviews, we heard about an alternative channel through which examiners can access PFR documents (figure 6). Reserve Banks use this alternative channel to receive, store, and manage documents, including documents from other regulators. A Board analyst explained that the PFRs send information to the Reserve Banks via secure email, and Reserve Bank employees sometimes post that information to an alternative document management system. However, a Board official stated that Reserve Bank employees post documents to the alternative system on an ad hoc and inconsistent basis. A Board employee acknowledged that it is "hit-or-miss" with regard to whether PFR documents are available to examiners in the alternative document management system.

Figure 6. Alternative Channel for Receiving PFR Documents



Source. OIG analysis of the results of interviews with Board and Reserve Bank officials and employees.

According to a Reserve Bank official, the Reserve Banks created this alternative means of receiving PFR documentation out of necessity during the 2007–2009 financial crisis. The same official also noted that if BOND worked consistently, the Reserve Banks would not have to rely on this channel for timely access to information. Similarly, an official from one PFR expressed a preference for BOND to work as intended so that the PFR can eliminate this redundant means of transferring documents to the Reserve Banks.

Lack of Timely and Complete Access to Documents May Result in an Incomplete Understanding of the PFR’s Conclusions and in Duplicative Requests

Incomplete and untimely receipt of the PFR’s supervisory documentation may result in examiners not having a complete or up-to-date understanding of the PFR’s assessment of RBO BHC depository subsidiaries. In addition, examiners sometimes seek to work around these interagency information-sharing issues by submitting duplicative requests directly to the PFR or the RBO. A Reserve Bank official explained that examiners sometimes request a copy directly from the PFR because there is a lag between when a report is uploaded to BOND and when it is available. Another Reserve Bank official similarly stated that examiners work around delays in accessing documentation by making direct, and potentially duplicative, requests to the supervised institution.

A Board analyst stated that Reserve Bank examiners assigned to LISCC institutions and LFBOs can access the PFRs’ systems directly to obtain supervisory documents. Another Board analyst stated that the RBO examiners should have the same ability to access the PFRs’ systems as the LISCC and LFBO examination teams.

Recommendation

We recommend that the Director of S&R

2. Evaluate potential solutions to improve document-sharing processes and develop a plan to ensure that Reserve Bank examiners have timely and complete access to FDIC and OCC supervisory documents.

Management Response

In its response to our draft report, the Board concurs with our recommendation. The agency notes that S&R will evaluate potential solutions to improve document-sharing practices with the FDIC and the OCC and will develop a plan to ensure that Reserve Bank examiners have timely and complete access to the final supervisory documents issued by the FDIC and the OCC.

OIG Comment

The actions described by the Board appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Finding 4: RBOs Upload the Same Documents to Multiple Regulators' Systems

Several executives representing the RBOs in our sample explained that to be responsive to Reserve Bank and PFR documentation requests, their employees upload the same documentation to multiple systems maintained by the Board, the Reserve Banks, and the PFRs. The Bank Holding Company Act of 1956, as amended, requires the Board, to the fullest extent possible, to avoid duplication of examination activities, reporting requirements, and requests for information. RBO employees sometimes upload the same documentation to multiple regulator systems due to the Board's preferred information-sharing practices. These duplicative efforts reflect a potentially avoidable burden on RBO employees at supervised institutions.

Reserve Bank and PFR Documentation Requests Sometimes Result in Duplicative Efforts by RBOs

According to an RBO executive, a PFR official, and Reserve Bank officials, RBO employees sometimes upload the same documentation to Reserve Bank systems and to PFR systems.[17] Some RBOs have established a secure system and provided Reserve Bank and PFR employees with credentials to access the system so they can download documents directly from the RBO's system. In those instances, the RBO only has to load documentation to one system to address requests from multiple regulators. In other instances, RBOs that have a national bank or a state nonmember bank insured depository subsidiary upload documentation to a file-sharing application established by the Board, and they load many of the same documents onto the FDIC's or the OCC's system, as applicable.

The Board Encourages Reserve Bank Employees to Use the Board's Document-Sharing Application

A Board official and a Reserve Bank official stated that the Board prefers that Reserve Bank examiners use the Board's file-sharing application to obtain RBO documentation rather than access systems maintained by the RBOs, although the Board does not prohibit the practice of Reserve Banks accessing documents on the RBOs' systems. One Board official indicated that the Board's application is the preferred location for RBOs to upload documentation in response to Reserve Bank requests because the Board has certified it as a secure channel, although another Reserve Bank official acknowledged that the application has file size limitations.

[17] For example, in conducting continuous monitoring, Reserve Banks request documents such as board of director packages, committee meeting minutes, and other management information system reports. Often, the PFR requests the same documents.

Uploading Documents to Multiple Regulator Systems Is Burdensome for RBO Employees

Employees for some RBOs routinely load the same documentation to multiple systems maintained by each of its federal prudential regulators.

- One RBO executive stated that the agencies should jointly work on an approach to gather and store information in the same repository so the bank does not receive multiple requests from different agencies for the same information.

- Another RBO executive stated that the institution established a regulatory folder where it uploads documents for both the Reserve Bank and the PFR, but the examiners were later told that they could no longer access an individual bank's secured website. According to this RBO executive, the institution now uploads documentation to separate systems for its Reserve Bank and its PFR.

- Yet another RBO executive stated that when the Reserve Bank and the FDIC conduct a joint examination, the institution has to upload materials to each regulator's system, which is inefficient. This executive also stated that although the administrative burden of loading materials to two different sites may seem small, the volume of material magnifies the effect of the burden.

Recommendation

We recommend that the Director of S&R

3. Evaluate potential solutions to minimize the burden of document requests on the RBOs and develop a plan to improve how the Reserve Banks obtain and share RBO documents.

Management Response

In its response to our draft report, the Board concurs with our recommendation. The agency notes that S&R will evaluate potential solutions to minimize the burden on RBOs resulting from multiple regulators' requests for the same documents; S&R also will develop a plan to improve how the Reserve Banks obtain and share RBO documents.

OIG Comment

The actions described by the Board appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Appendix A: Scope and Methodology

The scope of our evaluation includes the Board's and the Reserve Banks' oversight of BHCs that own at least one national bank or one state nonmember bank insured depository subsidiary. We also assessed the Board's and the Reserve Banks' coordination activities with the FDIC and the OCC. Our scope did not include the Board's oversight of savings and loan holding companies or RBOs in which the insured depository institution subsidiary is a state member bank, nor did our scope include analysis of coordination with other federal functional regulatory agencies or state regulatory agencies.

We selected a nonstatistical sample of 4 out of 12 Reserve Banks—the Federal Reserve Banks of Atlanta, Chicago, New York, and San Francisco. We sought to select Reserve Banks that are geographically dispersed and that supervise the most RBOs with national bank or state nonmember bank subsidiaries.

For each of our four sample Reserve Banks, we selected 3 RBOs, for a total of 12 RBOs in our sample. In selecting these RBOs, we considered the following characteristics:

- the consolidated assets of the institution
- the most recent CAMELS and RFI/C (D) composite, component, and subcomponent ratings
- whether the institution has been highlighted in recent Board risk reports
- the number of insured depository subsidiaries owned by the institution
- the institution's tenure in the RBO portfolio

As of May 2017, when we selected our RBO sample, there were 59 institutions in the Board's RBO portfolio and 41 BHCs in the RBO portfolio that had either a national bank or a state nonmember bank insured depository subsidiary. In selecting among those 41 institutions, we chose a sample of 12 RBOs that reflected a diverse range within each of the characteristics listed above. For example, we selected institutions toward the upper, middle, and lower ranges of the $10 billion to $50 billion consolidated assets spectrum. In addition, we selected institutions that had varying CAMELS and RFI/C (D) composite, component, and subcomponent ratings. Our samples are nonstatistical, so the results of our analysis cannot be extrapolated to the entire populations of Reserve Banks or RBOs.

To accomplish our objectives, we reviewed a variety of supervisory documents for each sample RBO, such as the *Institutional Overview, Risk Assessment, and Supervisory Plan*; the DFAST scope memorandum; the full-scope examination's scope memorandum; the annual full-scope examination report; and the DFAST letter. We also reviewed in detail the Board's guidance applicable to consolidated supervision and the RBO portfolio. We compared the number of 2017 PFR examination reports that are viewable to users in BOND for each sample RBO to the number of 2017 PFR-led examinations planned for each sample RBO, as described in the Reserve Banks' supervisory plans.

In addition, we conducted more than 50 interviews. We interviewed Board officials who oversee the RBO portfolio; Board Division of Information Technology officials who provided details on the systems used to share documentation during the RBO BHC supervision process; officials from the Federal Reserve Banks of Atlanta, Chicago, New York, and San Francisco who manage their Reserve Bank's RBO portfolio; CPCs assigned to each of the 12 RBOs in our sample; executives from each of the 12 RBOs in our sample; and FDIC and OCC officials.

In April 2018, we shared our discussion draft report with the FDIC and the OCC for comment.

We conducted our fieldwork from June 2017 through April 2018. We performed our evaluation in accordance with the *Quality Standards for Inspection and Evaluation*, issued in January 2012 by the Council of the Inspectors General on Integrity and Efficiency.

Appendix B: Management's Response

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF
SUPERVISION AND REGULATION

June 8, 2018

Melissa Heist,
Associate Inspector General
for Audits and Evaluations
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC, 20551

Dear Ms. Heist:

Thank you for the opportunity to comment on your draft report, *In Accordance With Applicable Guidance, Reserve Banks Rely on the Primary Federal Regulator of the Insured Depository Institution in the Consolidated Supervision of Regional Banking Organizations, but Document Sharing Can Be Improved.* We appreciate the effort that the Office of Inspector General ("OIG") has put into this report and the recommendations it has provided for improving our supervisory processes.

The report found that, in accordance with applicable guidance related to consolidated supervision, Reserve Banks relied on the respective primary federal regulators ("PFRs") of the insured depository institutions to supervise RBOs and the Federal Reserve appears to be increasing this reliance. The report states that the types of PFR documents that Reserve Bank examiners rely on and have access to vary. The report also found that the Board and the Reserve Banks could improve document-sharing processes and that potentially avoidable regulatory burden resulted from RBO employees sometimes uploading the same documentation to multiple regulators' systems in response to Reserve Bank and PFR documentation requests. As such, the OIG makes the following three recommendations to address these issues.

1. The Division of Supervision and Regulation should define the types of documentation that Reserve Bank RBO examiners generally need to meet the Board's expectations for relying on work performed by the PFR, including any

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circumstances, if any, under which examiners should obtain additional supplemental documentation.

2. The Division of Supervision and Regulation should evaluate potential solutions to improve document-sharing processes and develop a plan to ensure that Reserve Bank examiners have timely and complete access to FDIC and OCC supervisory documents.
3. The Division of Supervision and Regulation should evaluate potential solutions to minimize the burden of document requests on the RBOs and develop a plan to improve how the Reserve Banks obtain and share RBO documents.

The Division of Supervision and Regulation acknowledges the conclusions in the OIG report and agrees with the report recommendations. The Division of Supervision and Regulation recognizes the importance of providing clarity on Board expectations that define the types of documentation that RBO examination staff will obtain to rely on the work of the PFR. In response to this recommendation, the division will develop and issue examiner guidance to clarify the Board's expectations.

For the second recommendation, the Division of Supervision and Regulation acknowledges that Reserve Bank examiners need timely and complete access to FDIC and OCC supervisory documents to rely on the work of the PFR. In response to this recommendation, the division will evaluate potential solutions to improve document-sharing processes with these agencies and will develop a plan to ensure that Reserve Bank examiners have the necessary timely and complete access to the final supervisory documents issued by the FDIC and OCC.

For the last recommendation, the Division of Supervision and Regulation acknowledges that requests from Reserve Banks and the PFR may result in potentially avoidable regulatory burden when RBOs sometimes are asked to upload the same documents to multiple regulators' systems. The division will evaluate potential solutions to minimize the burden on RBOs from multiple regulators' requests for the same documents and will develop a plan to improve how the Reserve Banks obtain and share RBO documents.

Regards,

Michael S. Gibson
Director
Division of Supervision and regulation

Abbreviations

BHC	bank holding company
Board	Board of Governors of the Federal Reserve System
BOND	Banking Organization National Desktop
CBO	community banking organization
CDTR	Central Document and Text Repository
CPC	central point of contact
DFAST	Dodd-Frank Act Stress Test
FDIC	Federal Deposit Insurance Corporation
LFBO	large and foreign banking organization
LISCC	Large Institution Supervision Coordinating Committee
OCC	Office of the Comptroller of the Currency
PFR	primary federal regulator
RBO	regional banking organization
S&R	Division of Supervision and Regulation
SR Letter	Supervision and Regulation Letter

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