



**BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**

**WASHINGTON, D. C. 20551**

**DIVISION OF BANKING  
SUPERVISION AND REGULATION**

**SR 97-24 (SUP)  
October 27, 1997**

**TO THE OFFICER IN CHARGE OF SUPERVISION  
AT EACH FEDERAL RESERVE BANK**

**SUBJECT: Risk-Focused Framework for Supervision of Large Complex Institutions**

**Introduction**

Over the last several years, a major strategic initiative of the Federal Reserve has been to develop and implement an examination and supervision program for large domestic and foreign banking organizations that focuses more effectively on an organization's principal risks and on its internal systems and processes for managing and controlling these risks. If properly carried out, such an approach can improve supervisors' ability to identify and address weaknesses on a timely basis. It can also be more cost-effective for supervisors and less burdensome to banking organizations. This initiative reflects the fact that best practice in the supervision and regulation of banking organizations is an evolving concept that must continually respond to important developments in banking, including innovations in products, services, and activities; emerging risks and the changing nature of risk-taking; advancements in information technology and risk management techniques; and the globalization and integration of financial institutions and markets. In this context, supervisory policies and procedures must adapt and evolve over time as banking and financial conditions change.

The attached handbook, which sets forth a framework for risk-focused supervision of complex banking organizations, describes certain important aspects of the Federal Reserve's program to enhance the effectiveness of its supervisory processes for state member banks, bank holding companies, and foreign banking organizations. The main objective of this program is to sharpen the focus of the supervisory process on: (1) those business activities which pose the greatest risks to the soundness of a banking organization and the financial system more generally and (2) the assessment of an organization's management systems to identify, measure, monitor, and control its risks. Elements of this program are being utilized or have been pilot-tested in a number of Districts.

Reserve Banks are asked to provide copies of this handbook to their staffs and to ensure that the framework set forth in the handbook is fully implemented going forward. Copies of the handbook should also be shared with state banking departments and the local offices of the FDIC and the Office of the Comptroller of the Currency.

**Large Complex Institutions Covered by the Framework**

For purposes of the risk-focused supervision framework, large complex institutions are defined as those that generally have a functional management structure; a broad array of products, services, and activities; operations that span multiple supervisory jurisdictions; and consolidated assets of \$1 billion or more. These institutions may be domestic or foreign in origin, and include U.S. bank holding companies (together with their nonbank and foreign subsidiaries), state member banks, Edge Act and agreement corporations, and branches and agencies of foreign banks.

The risk-focused supervision framework balances reviews of functional activities and product lines with assessments of legal entities and transactions among legal entities. As part of this functional approach, the framework endorses the concept of conducting, when appropriate, a series of targeted examinations during a supervisory cycle, focusing on a single activity, business line, or legal entity of the banking organization. Consistent with long-standing practice, the findings of these functional, business line, and legal entity examinations are to be coordinated closely with the efforts of other federal and state supervisors. Coordination and avoidance of duplication among federal and state supervisors are essential to effective supervision of complex banking organizations. In carrying out its umbrella supervisory responsibilities for bank holding companies and the U.S. operations of foreign banking organizations, the Federal Reserve should continue, as appropriate, to incorporate the findings and conclusions of other supervisors into its overall assessment of the consolidated banking organization or banking group.

### **Risk-Focused Framework**

The framework specifies six key steps in the risk-focused supervision of large complex institutions, each of which requires the completion of certain analyses, assessments, and plans and the preparation of corresponding documents. These documents include: Institutional Overview, Risk Matrix, Risk Assessment, Supervisory Plan, Examination Program, and Scope Memorandum. As previously requested in SR letter 96-29, for the Top 50 bank holding companies, Reserve Banks should continue to provide the Board's appropriate Supervision Operations sections with copies of these products as they are updated. For those large complex institutions not considered Top 50 bank holding companies, further guidance will be forthcoming on the submission of these products to Board staff. With respect to U.S. branches and agencies of foreign banking organizations, Reserve Banks should continue to prepare and update the products outlined in SR letter 95-22 (SUP.IB). Separate guidance will be issued concerning any future modifications to these products.

### **Examination and Inspection Procedures**

Examination and inspection guidelines and procedures, including those setting forth a risk-focused framework for supervision, have been developed and prescribed in numerous SR letters over the last several years. This guidance has been incorporated into the handbook.<sup>1</sup> Further initiatives are underway to assist examiners in assessing the major business functions and activities of large complex institutions. Procedures are being developed in the form of "examination modules" for major functional areas, including loan portfolio analysis, treasury activities, trading and capital markets activities, and internal control and audit. The modules set forth examination objectives, establish examination procedures, and assist in the documentation of examiners' work. Starting October 1, 1997, several of the modules were released for field testing. As additional modules are developed, they will be released for testing. It is expected that the examination modules will be fully

implemented in mid-1998 and will be made available in an electronic format similar to the examination modules for community banks.

The development and testing of these materials, including the preparation of the handbook, have been part of a Systemwide effort to enhance the effectiveness and efficiency of the supervision process. As already suggested, this is an ongoing effort that will require continuing refinement and modification over time. Success of this process going forward will require the continued outstanding contributions of Reserve Bank and Board staff.

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Additional guidance will be forthcoming as needed on the implementation of the risk-focused supervision framework. Questions or comments concerning the handbook should be directed to Mr. Roger Cole, Associate Director, at (202) 452-2618 and Mr. William A. Ryback, Associate Director, at (202) 452-2733.

Richard Spillenkothen  
Director

ATTACHMENTS

[Handbook transmitted as separate PDF file \(509 KB PDF\)](#)  
[Summary of Changes to Handbook transmitted electronically below](#)

Cross References:

AD letter 97-36 (SUP)  
AD letter 96-50 (GEN) Restricted  
[SR letter 96-29 \(SUP\)](#)  
SR letter 95-22 (SUP.IB)

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**Attachment**  
Summary of Changes  
in the August 8th Handbook  
from the Draft of June 5, 1997

Page No.	Page No.	Modifications
<u>June 5th</u>	<u>August 8th</u>	

In general	The font has been changed to Times New Roman 12 pt. The change in the font has changed the spacing and reduced the number of pages.
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5	4	Deleted footnote 4 from the June 5th draft and clarified discussion on nonbank subsidiaries of domestic institutions and Edge Act corporations.
17	15	Deleted footnote 14 from the June 5th draft.
18	15	Amended footnote 15 in the June 5th draft which is now footnote 13 in August 8th Handbook.
23-24	20	Deleted the discussion on payments system activities as this matter will be addressed in an examination module.
39	35	Amended footnote 22 in June 5th draft which is now footnote 20 in August 8th Handbook.
Appendix K		Replaced draft Loan Portfolio Analysis Examination Module with draft Internal Control and Audit Module as this module provides a better example of a module applicable to both a bank holding company and a state member bank.

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## Footnotes

1. An earlier draft of this handbook was distributed to attendees at the June examiner conference in Dallas. The attachment to this memorandum summarizes the changes made to the handbook since the conference. It is expected that the current version of the handbook will be available on the FEDWEB. [Return to text](#)

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