Guidelines for
Implementing the Interagency Program for Supervising the
U.S. Operations of Foreign Banking Organizations
(the FBO Supervision Program)

RISK-FOCUSED FRAMEWORK

The FBO Supervision Program is a risk-focused supervisory framework designed to provide an efficient, rational, and uniform approach for supervising the U.S. operations of foreign banking organizations, particularly those with numerous entities across multiple U.S. supervisory jurisdictions. The Program consists of four integral and interrelated components: (1) understanding the institution; (2) assessing its risks; (3) planning supervisory activities; and (4) determining the overall condition of its U.S. operations. Carrying out this risk-focused supervisory program results in the development of nine FBO Supervision Program products, which are listed below under their respective risk-focused Program components.

- Understanding the FBO
  1. Review of Home Country Financial System
  2. Review of Home Country Accounting Practices
  3. Institutional Overview
  4. Strength-of-Support Assessment (SOSA)

- Assessing the FBO's Risks
  5. Risk Matrix
  6. Risk Assessment

- Planning Supervisory Activities
  7. Supervisory Plan
  8. Examination Program

- Determining the Overall Condition of the FBO's U.S. Operations
  9. Summary of Condition and Assignment of a Combined U.S. Operations Rating

Preparation of these FBO Program products provides the U.S. supervisory agencies with the means, when applicable, of sharing their risk assessments, examination results, and proposed supervisory follow-up actions. As a result, supervisory efforts can be well-coordinated while avoiding duplication of efforts.

To ensure that an appropriate level of uniformity is achieved for all elements of the Program, basic outlines for the products dealing with (a) understanding the FBO and (b) determining the overall condition of the FBO's U.S. operations are provided here.[1] Each U.S.

[1] Please refer to the companion procedural AD letter to this SR letter for guidance relating to the Program products dealing with (1) assessing the FBO's risks and (2) planning supervisory activities, which are cross referenced in SR letter 97-24 and its companion handbook.

supervisory agency participating in the Program may use judgment in determining which elements of any product should be emphasized depending upon the situation for a particular FBO, its U.S. operations, and its home country banking and regulatory environment.

UNDERSTANDING THE FBO

COUNTRY PRODUCTS

Two important components of the FBO Supervision Program are the reviews of the home country financial system and accounting practices for each country with banking representation in the United States. These reviews provide important reference and background information about an FBO's home country environment and financial reporting practices. As discussed earlier, these reviews frequently highlight broad issues that may be factored into the SOSA for an FBO, and consequently influence the supervisory strategy for its U.S. operations.

Review of the Home Country Financial System

This review, which should be prepared for each country with FBO representation in the United States, consists of the following three separate sub-documents, which, as deemed necessary, may be updated independently with separate as-of-dates. (Please refer to the outline in Appendix I for details.)

1. **Financial System Structure** - This section should incorporate information on the make-up of a country's financial sector, including the types of financial institutions allowed, the range of their permissible activities, and any related ownership restrictions; the current degree and trend of concentration within the financial sector; and the current degree and trend of foreign financial institution participation in the domestic market.

2. **Operating Environment** - This section should discuss the following matters as they may impact the country's banking system: the current economic situation and outlook, the political environment to the extent that it has a significant impact on the economic situation, and any systemic banking issues.

3. **Bank Supervision** - This section should focus on key banking laws, the agencies involved in banking supervision, including their respective responsibilities and the extent of any local interagency coordination; on-site and off-site supervisory and examination practices; the extent to which the supervisors receive sufficient information on banking institutions and their affiliates that would allow evaluation on a consolidated basis; and the treatment of problem/failed institutions, also under applicable law.

Review of Home Country Accounting Practices

A review of the significant accounting policies and procedures for each country with banking representation in the United States should be prepared to highlight significant differences with U.S. GAAP and their supervisory implications. At a minimum, the review should cover the following areas: (1) asset valuation; (2) income and expense items; (3) consolidation rules; (4) off- versus on-balance-sheet items; (5) tax considerations; and (6) disclosure rules. (Please refer to the outline in Appendix II for details.)

Institutional Overview

Preparation of the Institutional Overview is a critical step in tailoring the FBO Supervision Program in accordance with the characteristics of the organization. The Institutional Overview communicates information pertaining to the institution's current condition and current and prospective risk profiles, and also highlights key issues and past supervisory findings. The Institutional Overview consists of four components described below (please refer to Appendix III for details):

1. **Structure** - Includes a description of the FBO's organizational and ownership structure, with comments on the legal and business units, and changes through mergers, acquisitions, divestitures, consolidation or charter conversion since the prior review.

2. **Business Strategy and Operations** - Describes the FBO's strategy, business processes, and financial performance. It should contain a summary of the organization's strategic direction with comments on key business lines, product mix, customer composition, target market clientele, marketing emphasis, growth areas, acquisition or divestiture plans, and new products introduced since the prior review. The description of the business processes focuses on all aspects of risk management, with particular attention given to the management of concentrations and capital markets activities, including the underwriting, distribution, and trading of securities and derivative instruments, as well as proprietary investment positions. The review of financial performance will include an analysis of the FBO's consolidated condition, including earnings, capital, asset quality, liquidity, and other financial factors.

3. **Funding and Liquidity** - Includes an analysis of the depth of local money and capital markets, the components of the FBO's capital structure, and the FBO's funding sources, reliance on volatile funds, and market ratings.

4. **Governance** - Assesses the depth and quality of the FBO's financial transparency; the independence and usefulness of its outside directors; intercompany lending and intercompany transactions generally; issues relating to insider lending; the independence and skills of auditors (if possible, of internal auditors as well); and the managerial oversight of overseas operations.

Strength-Of-Support Assessment for Foreign Banking Organizations with U.S. Operations

Overview

The strength-of-support assessment provides a general framework for evaluating and assimilating significant financial and managerial factors related to an individual FBO as well as key environmental or external factors. The SOSA provides important information to the supervisory agencies that is taken into account in reaching decisions regarding the scope and frequency of examinations and other supervisory assessment initiatives. In this regard, the SOSA provides for the efficient utilization of scarce, expert supervisory resources. The SOSA addresses the overall financial viability of the FBO, as well as several external factors such as the strength of its management oversight and the degree of supervision the FBO receives from its home country supervisor.

Factors considered in assigning the ranking include the FBO's financial condition, the system of supervision in the FBO's home country, the record of home country government support of the banking system or other sources of support for the FBO, and any transfer risk concerns. Therefore, the Review of the FBO's Home Country Financial System and the Review of Home Country Accounting Practices, together with the Institutional Overview, serve as the analytical building blocks for understanding the FBO and deriving the SOSA ranking.

Also included are managerial factors that raise questions about the FBO’s oversight of its U.S. operations, such as internal controls and compliance procedures at its U.S. operations; and current activities (e.g., a recent merger, significant other expansion or changes in operations, or reported control problems at non-U.S. operations) that may pose a potential risk to the U.S. operations. In assigning the ranking, all relevant factors should be weighed and evaluated. The assessment ranking is on a scale of "1" to "3" with "1" representing the lowest level of supervisory concern, and "3" representing the highest. Standards and criteria for the assessment, including the three possible strength-of-support rankings, are discussed in greater detail below.

Strength-of-Support Assessment Indicators

There are three possible rankings for the strength-of-support assessment:

1. Assessment of "1" - The financial profile and outlook are consistent with a low risk that the FBO will be unable to support its U.S. operations. The FBO is viewed as investment grade or equivalent, capital ratios are at or above internationally accepted minima, and access to U.S. dollar funding is readily available. There are no material issues related to management oversight of, or support for, its U.S. operations. The home country has a good record of supervising financial institutions and dealing with problem institutions, and transfer risk is not an issue of concern.

An FBO whose financial profile is consistent with an assessment of "1" could be assigned an assessment of "2" or lower if its home country has a supervisory system that is lacking in significant respects or significant transfer risk considerations exist.

2. Assessment of "2" - The current operating performance of the FBO and its immediate financial outlook, although not posing significant concerns about the ability of the organization to honor its U.S. liabilities, may warrant more than normal review based on such factors as the lack of an investment grade rating, capital ratios at or below internationally accepted minima, or other factors that are considered less than adequate by international standards. Managerial oversight and support of U.S. operations may be lacking in some respects, but are not critically deficient. While the FBO currently may not meet all international financial standards, the home country has demonstrated an ability and willingness to support the FBO or similar financial institutions.

Conversely, the financial profile of the FBO may appear to warrant a stronger ranking; however, supervision by the home country regulator(s) is lacking in material respects or important transfer risk considerations exist.

3. Assessment of "3" - Significant financial or supervisory weaknesses are apparent. The FBO may be expected to continue as a going concern due primarily to government support, ownership, or other significant factors, although resource constraints, transfer risk considerations, operating structure, or other factors may place important limitations on that support. In the most extreme cases, a seriously deficient financial profile and/or poor operating practices, together with the absence of sufficient oversight and support, suggests the possibility that the FBO will be unable to honor its U.S. obligations in the near future or is otherwise considered to present a hazard to U.S. financial markets.

Conversely, the financial profile, based on available information, may imply a higher assessment, but home country supervision is deemed to be substantially or wholly deficient, or there are significant transfer risk concerns.

Strength-of-Support Assessment Factors

Determining whether an individual FBO has the internal or external resources to provide the necessary financial and managerial support to its U.S. operations depends to a great extent upon its financial condition, operating record, and general outlook. A good financial condition combined with capable management is generally sufficient to ensure that support. However, the degree of certainty about the ability of an FBO to provide any necessary financial support may be limited by weaknesses in its home country supervisory system, deficiencies in financial disclosure, or a significant degree of transfer risk associated with its major operations.

Accordingly, the FBO strength-of-support assessment takes into consideration five factors:

1. The financial profile of the FBO based on its present financial condition and outlook, including capital ratios and access to U.S. dollar liquidity;

2. The FBO's home country banking supervisory system;

3. The demonstrated capabilities of the home country in dealing with banking problems;

4. The degree of transfer risk associated with the FBO's home country and any other countries in which the FBO has major operations; and

5. Any other factors pertaining to the FBO's ability to effectively manage its U.S. operations.

All assessment factors are considered as a whole in assigning the strength-of-support assessment. None of the factors should be assigned a separate "ranking" or be considered a discrete component of the final assessment.

The factors used to justify a SOSA ranking will be presented as bullet point comments (as shown in Appendix IV). Full and detailed analysis will be contained in other FBO Supervision Program products, principally, the Institutional Overview and the Review of the Home Country Financial System.

1. Financial Profile - The financial profile of the FBO is based on the institution's current financial condition and outlook. A review of the FBO's financial condition is based on the level and trend in financial performance indicators relating to the FBO's capital, profitability, liquidity, and asset quality. To the extent possible, these indicators should be evaluated in the context of peer performance and knowledge of the FBO's home country financial system and accounting policies and practices.

The financial outlook should consider a broad range of external and internal factors, such as the home country banking system, systemic banking sector issues, and the FBO's political and economic environment, business strategy, market position, risk matrix, ownership, corporate governance, and management. (Detailed information on these topics is contained in the Review of the Home Country Financial System and the Institutional Overview.)

Generally, the FBO's short-term and long-term market ratings are good indicators of its financial outlook. An FBO with the highest market ratings should be able to demonstrate a sound financial condition and outlook. The FBO would likely be assigned an assessment of "1" if other factors are consistent with the assessment. Notwithstanding the significance of market ratings, the FBO's financial profile and resultant assessment should not be based on market ratings alone. Rather, the ratings should serve as a reference point for the independent assessment of the institution, because market ratings may not always reflect the most current view of the FBO, or the supervisory authorities may have information not directly or indirectly available to the market. For example, examination findings of the U.S. operations could raise questions about the FBO's overall operations and management that could lead to a strength-of-support assessment lower than that indicated by the FBO's market ratings. However, any significant difference between the assessment and market ratings should be fully analyzed and justified. (An FBO's market ratings are contained in the Funding and Liquidity section of the Institutional Overview.)

2. System of Home Country Supervision - A review of the home country supervisory system is essential to ensure that the FBO is subject to an appropriate level of supervision of its global operations. In assigning a SOSA ranking, the review of the system of home country supervision should concentrate on the supervisor's general policies and how the supervisory framework applies in practice to the individual FBO. In this context, the mere existence of a home country supervisor is not considered sufficient.

The FBO's home country supervisory system should be evaluated based on those general principles and practices that ensure monitoring of the FBO's principal operations and activities, including those outside the home country. These general supervisory principles and practices usually include some level of periodic reporting, on-site and/or off-site review, prudential guidelines (including capital adequacy requirements), and supervisory enforcement powers. Effective supervisory systems may take many forms; however, the regulatory system of any country should ensure that the internationally active banks operating under that system are subject to a sufficient level of supervision that results in sound oversight of its global operations and activities.

Supervisory systems may also vary with respect to the type of institution. Therefore, the analysis of the supervisory system should evaluate actual practices as applied to the individual FBO. This assessment should be based largely on the information that has been accumulated over time by the U.S. banking supervisory agencies. It is expected that this assessment will be enhanced as additional information on supervisory systems is obtained through improved contacts and informational exchanges.

Note that the analysis of Home Country Supervision as applied to the FBO in question is contained in the Review of the Home Country Financial System.

3. Record of Home Country Support - Related to home country supervision is the matter of the home country's record of ensuring the solvency of its financial institutions, particularly those that operate internationally. This record of support will vary by country with respect to structure, coverage of banks, resources, and supervisory authority as provided under local laws and regulations. Such support may be either direct or indirect in nature and may be widespread or only applicable to banking institutions with specific characteristics.

Some countries are able to take whatever steps are necessary to support their banks unequivocally, while others will have a more limited degree of support for their banks due to legal restrictions or financial constraints. These factors should be reviewed, giving particular emphasis to past performance and an assessment of the country's financial resources.

The detailed analysis of home country support also is discussed in the Review of the Home Country Financial System.

4. Level of Transfer Risk - Transfer risk, which relates to the FBO's ability to access and transmit U.S. dollars, is an essential factor in determining whether the FBO can support its U.S. operations. For some FBOs, transfer risk is increased due to home country heavy debt servicing obligations or other financial restraints, which, in the past, has led to exchange controls and hard currency restrictions in some countries. As a result, these FBOs may have limited ability to provide the necessary support to their U.S. operations.

The assessment of transfer risk for individual countries is uniformly handled by the federal bank supervisory agencies through the Interagency Country Exposure Review Committee (ICERC). As available, these ICERC assessments should be relied upon in determining the level of transfer risk for strength-of-support purposes. **However, the ICERC rating should not be explicitly disclosed in the SOSA**. For those countries not evaluated by the ICERC, the assessments of transfer risk will be made in the same manner as conducted by the ICERC [2].

Generally, FBOs from countries rated substandard or worse by the ICERC would be accorded an assessment of no better than "2." However, a high level of transfer risk associated with the FBO's home country could be mitigated by other considerations that clearly indicate that the FBO has broad access to U.S. dollars.

5. Other Factors - Determining whether an FBO poses any managerial or operational control risks to its U.S. operations can be influenced by a broad range of qualitative factors. One example of such control risks is an FBO that would otherwise have a strength-of-support assessment of "1" but may be experiencing certain operational problems, not necessarily in the United States. The FBO may be undergoing extensive expansion into new markets or products that, over time, could place a strain on its financial and managerial resources. The FBO also could be experiencing well-publicized internal control problems at offices outside the United States. Although these control problems would not necessarily affect the ability of the FBO to meet its obligations, they may be symptomatic of larger control problems that also might exist in the U.S. offices. Any such concerns should be explored to the extent possible, particularly as they may influence the supervisory strategy and examination plan for the FBO's U.S. operations.

Disclosure of SOSAs to FBOs and their Home Country Supervisors

The SOSAs and supporting analyses are for U.S. supervisory use only. These evaluations are to be kept strictly confidential by each of the agencies, in part to ensure that the sharing of information between the agencies for purposes of analyzing the condition of the FBO and assigning its strength-of-support assessment will not violate state or federal regulations.

However, the U.S. bank supervisory agencies now have agreed to disclose to each FBO, and its home country supervisor, its SOSA ranking and a summary of the key points supporting the ranking. This step is being taken for three principal reasons: (1) supervisors have developed a high level of confidence in the quality and consistency of SOSA rankings over the past five years; (2) the rankings have been used to support supervisory decisions requiring a view of an FBO, such as payment system risk actions; and (3) it is believed that many FBOs have been able to derive their SOSA ranking based on the posture taken by U.S. supervisors with respect to their U.S. operations. Therefore, given the expanded use and importance of the SOSA, the U.S. bank supervisory agencies believe it is appropriate that the SOSA process -- specifically, the ranking-- should be made fully transparent to each FBO and its respective home

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[2] For further information about ICERC's assessment of transfer risk, see SR letter 99-35.

country supervisor. As discussed further and shown in Appendices V and VI, the SOSA ranking, and the rationale for the ranking, will be disclosed to the FBO in the Summary of Condition letter, which is, in turn, transmitted to the home country supervisor via a separate transmittal letter.

ASSESSING THE FBO'S RISKS

Risk Matrix and Risk Assessment of the U.S. Operations of Foreign Banking Organizations

As introduced in this document, the risk-focused framework for the supervision of FBOs is intended to provide a coordinated, thorough, and efficient approach for supervising the U.S. operations of FBOs that conduct their business in the United States through multiple operating entities. As such, all operations of an FBO located in the United States, including bank holding companies and commercial banks, should be included in the risk-focused supervisory program for each FBO. Of note is that bank holding companies and commercial banks owned or controlled by an FBO should be subject to an individual analysis in accordance with the Framework for Risk-Focused Supervision of Large Complex Institutions (SR letter 97-24) or the companion guidance for Risk-Focused Supervision of Community Institutions (SR letter 97-25.) Commercial banks supervised by another federal bank supervisory agency would be subject to the risk-focused products adopted by that agency.

The products developed for FBO-owned or -controlled bank holding companies and commercial banks under the risk-focused program for large complex institutions or community institutions should be included as identified items in the products developed for the FBO's U.S. operations so that, in effect, there will be a complete set of documents for an FBO's entire U.S. operations on a combined basis. For example, a risk assessment for an FBO that operates (1) a bank holding company, (2) several branches and agencies, and (3) a directly-owned Edge corporation, should include a risk assessment of the FBO's combined U.S. operations and, within the same document, a separate risk assessment for the bank holding company.

PLANNING SUPERVISORY ACTIVITIES

Development of a Supervisory Strategy

As established under the FBO Supervision Program, one of the principal goals of the SOSA is to identify those FBOs that may pose risks to their U.S. operations or to U.S. financial markets due to any inherent financial or managerial weaknesses and/or external constraints. In this regard, the SOSA ranks all FBOs according to the degree to which they can support their U.S. operations and the level of supervisory attention these operations may require. Accordingly, the SOSA serves as the initial building block for setting the supervisory strategy for the FBO's U.S. operations. In conjunction with the Risk Assessment for the FBO's U.S.

operations, a strong foundation is created for determining the supervisory activities to be conducted as part of the Supervisory Plan and Examination Program.[3]

Therefore, the SOSA, together with the Risk Assessment, should strongly influence the Supervisory Plan and the Examination Program. Ultimately, the SOSA is considered in implementing supervisory follow-up action for the U.S. operations as well. No automatic supervisory strategy, however, is mandated. An assessment of "1" generally would imply little if any concern relating to the ability of the FBO to meet its obligations. If an FBO does raise liquidity or solvency concerns, the FBO should not be accorded an assessment of "1". Moreover, an assessment of "2" or worse implies a level of concern that would, in many cases, subject the FBO's U.S. offices to at least periodic monitoring of its due from/due to positions. Any additional supervisory steps, such as imposing an asset pledge or an asset maintenance requirement, would be implemented based largely on the condition and nature of the U.S. operations. An FBO accorded an assessment of "3" would indicate a higher level of concern, with a presumption of a net due position or possibly asset maintenance regardless of the condition of its U.S. operations.

Suggested guidelines for supervisory follow-up action for each assessment category are as follows:

Assessment of "1" - Normally, any supervisory follow-up action for FBOs with a strength-of-support assessment of "1" would be applied only if warranted by the condition of their U.S. operations. Typically, asset maintenance would not be required for branches and agencies of these FBOs; however, supervisory actions would be undertaken, if necessary, to resolve safety and soundness issues such as deficiencies in risk management, operations and internal controls, or compliance at any of the U.S. offices.

Assessment of "2" - FBOs in this category may require heightened monitoring of funding sources for their U.S. operations, and of their overall liquidity positions, balance sheet composition, growth, and/or other financial factors. The due to/due from position would be closely monitored and any substantial due from position would be fully analyzed for risk implications. If warranted by the condition of the combined U.S. operations or the asset quality at the U.S. offices of such an FBO, asset maintenance would be considered for branches and agencies, and U.S. subsidiary banks could be required to operate at capital levels above the minima.

Assessment of "3" - The FBO would be more closely monitored and may be placed under continuous surveillance and reporting requirements and/or face supervisory restrictions. For example, there would be a strong presumption of a net due to requirement or possibly asset maintenance for branches and agencies of an FBO in this category, and U.S. bank subsidiaries should operate at strong capital levels.

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[3] The Risk Assessment should apply to the six principal risks, credit, market, liquidity, operational, legal, and reputational, that an institution confronts.

DETERMINING THE OVERALL CONDITION OF THE FBO'S U.S. OPERATIONS

Summary of Condition and Assignment of a Rating for the Combined U.S. Operations

An important component of this program is the integration of individual examination findings into an assessment of an FBO's entire U.S. operations. At a minimum, following the conclusion of the last examination of an FBO's U.S. operations in a given annual supervisory cycle, a Summary of Condition should be prepared for all FBOs with multiple U.S. operations. (Please see Appendix V for a sample Summary of Condition letter. Please also note that for FBOs whose U.S. operations include a commercial bank supervised directly by the OCC or the FDIC, the Reserve Bank drafting the Summary of Condition should include appropriate language in the document identifying the primary supervisory agency for the bank, and that agency's appropriate contact person.) The responsible Reserve Bank, or other U.S. bank supervisory agency, should prepare an evaluation of the condition of the FBO's U.S. operations, which will lead to the assignment of a single-component rating between "1" and "5" for those operations on a combined basis.

This evaluation should include an assessment of all risk factors, and (1) all elements of the ROCA rating system, (2) quality of risk management oversight employed by all levels of management in the FBO's U.S. operations, and (3) the examinations of all entities of the FBO conducted during the year. The Summary of Condition and rating of the FBO's combined U.S. operations represent important tools in reaching decisions regarding the scope and frequency of future examinations and appropriate supervisory measures. This information also should provide the basis for a more efficient utilization of supervisory resources (i.e., recognizing, where appropriate, a low or high level of supervisory concern for the FBO's combined U.S. operations).

In arriving at the rating for the combined U.S. operations of the FBO, all of the FBO's U.S. entities should be considered; however, this rating should not be based merely on an arithmetic average of the examination ratings of the entities examined. The strengths or weaknesses exhibited within individual entities should be evaluated based on their size and importance relative to the FBO's overall U.S. operations, and the materiality and extent of the weaknesses.

The five ratings are defined as follows:

Combined Rating of "1" - The overall operations are fundamentally sound in every respect. They cause no supervisory concern and require only normal supervisory attention.

Combined Rating of "2" - The combined U.S. operations operate in a basically sound manner, but may have modest weaknesses that can be corrected by management in the normal course of business. They do not require more than normal supervisory attention.

Combined Rating of "3" - Overall U.S. operations are weak in risk management, operational controls, and compliance, or have numerous asset quality problems that in combination with the condition of the FBO cause supervisory concern. U.S. and/or head office management may not be taking the necessary corrective actions to address any weaknesses. This rating may also be assigned when either risk management, operational controls, or compliance is individually viewed as unsatisfactory. Generally, these operations raise supervisory concern and require more than normal supervision to address their weaknesses.

Combined Rating of "4" - The combined U.S. operations have a significant volume of serious weaknesses. Serious problems or unsafe and unsound banking practices or operations exist, which have not been satisfactorily addressed or resolved by U.S. or head office management. These operations require close supervisory attention and surveillance monitoring, and a definitive plan for corrective action by head office management.

Combined Rating of "5" - The combined U.S. operations have so many severe weaknesses or unsafe and unsound conditions that they require urgent restructuring by head office management.

Disclosure

The Summary of Condition is prepared as a letter addressed to the FBO's head office management; it highlights those areas of overall strength and supervisory weaknesses in the FBO's combined U.S. operations. This letter also is used to disclose to the FBO the combined rating of its U.S. operations and its SOSA ranking. In the event of a mid-cycle SOSA ranking change, a new Summary of Condition letter should be prepared that discloses the revised SOSA ranking and provides updated information on the U.S. supervisors' view of the FBO's U.S. operations. This information is also transmitted to the FBO's home country supervisor via a cover letter. (Please see Appendices V and VI for a sample of each letter.)

RATING SYSTEM FOR U.S. BRANCHES AND AGENCIES OF FOREIGN BANKING ORGANIZATIONS

The rating system for U.S. branches, agencies and commercial lending companies[5] of foreign banking organizations is a management information and supervisory tool designed to assess the condition of a branch and to identify significant supervisory concerns at a branch in a systematic, consistent fashion. The rating system (ROCA) was specifically designed to assess the condition of a branch within the context of the FBO, of which it is an integral part, and to pinpoint the key areas of concern in a branch office.

For evaluation purposes, the rating system divides a branch's overall activities into three individual components: risk management, operational controls, and compliance. These components represent the major activities or processes of the branch that may raise supervisory

[5] Branches, agencies, and commercial lending companies are hereafter collectively referred to as branches.

concern. The rating system also provides for a specific rating of the quality of the branch's stock of assets as of the examination date.

A. Composite Rating

The overall or composite rating indicates whether, in the aggregate, the operations of the branch may present supervisory concerns and the extent of any concerns. While the individual component ratings will be taken into consideration in arriving at the branch's overall assessment, the composite rating should not be considered merely an arithmetic average of the individual components. The examiner should assign and justify in the report a composite rating using definitions provided below as a guide.[6]

The composite rating is based on a scale of one through five in ascending order of supervisory concern. Thus, one represents the lowest level of supervisory concern while five represents the highest level. The five composite ratings are defined as follows:

Composite Rating of "1" - Branches in this group are strong in every respect. These branches require only normal supervisory attention.

Composite Rating of "2" - Branches in this group are in satisfactory condition, but may have modest weaknesses that can be corrected by branch management in the normal course of business. Generally, they do not require additional or more than normal supervisory attention.

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[6] Assessment of asset quality is an integral part of any examination; however, under certain circumstances, it may be appropriate to give the individual asset quality rating component greater or lesser weight in arriving at an overall composite rating. In ensuring the protection of branch creditors, an important factor is the strength of the FBO. As the financial strength of the FBO weakens, it becomes increasingly important to look to the quality of the assets booked in the United States as the source of protection for local creditors, and, at a certain point, asset maintenance should be imposed. Similarly, where the FBO is strong, and the need to look to local assets for protection of creditors seems remote, the relative weighing of the asset quality component in the overall evaluation diminishes.

It also should be recognized that different offices of the FBO can be assigned widely different roles in the FBO's overall strategy. Thus, an individual office that books very few loans, but is otherwise poorly managed should not be given undue credit for having good asset quality. Alternatively, a branch that is designated to hold problem assets generated by other offices of the FBO, in order to better manage the workout process, should not be penalized, so long as the FBO has the ability to support the level of problem assets.

Finally, it should be recognized that asset quality tends to be a "trailing" indicator of branch performance. In instances where risk management systems are weak, but problem assets are currently nominal, it is realistic to assume there will be future deterioration in asset quality. By the same measure, management should be given credit in the overall evaluation where the causes of past asset quality problems have been corrected.

Composite Rating of "3" - Branches in this group are viewed as fair due to a combination of weaknesses in risk management, operational controls, and compliance, or asset quality problems that, in combination with the condition of the FBO or other factors, cause supervisory concern. In addition, branch and/or head office management may not be taking the necessary corrective actions to address substantive weaknesses. This rating may also be assigned when risk management, operational controls, or compliance is individually viewed as unsatisfactory. Generally, these branches raise supervisory concern and require more than normal supervisory attention to address their weaknesses.

Composite Rating of "4" - Branches in this group are in marginal condition due to serious weaknesses as reflected in the assessments of the individual components. Serious problems or unsafe and unsound banking practices or operations exist, which have not been satisfactorily addressed or resolved by branch and/or head office management. Branches in this category require close supervisory attention and surveillance monitoring and a definitive plan for corrective action by branch and head office management.

Composite Rating of "5" - Branches in this group are in unsatisfactory condition due to a high level of severe weaknesses or unsafe and unsound conditions, and consequently require urgent restructuring of operations by branch and head office management.

B. Disclosure

Following approval of the rating by appropriate senior supervisory officials at the examining agency, the composite numeric rating should be disclosed in the open, summary section of the examination report. In disclosing the rating, its meaning should be explained clearly using the appropriate composite rating definition. The report should also make it clear that the rating is part of the overall findings of the examination and is thus confidential. Pending receipt of the report of examination, any composite rating disclosed or discussed at an examination closeout meeting should be clearly conveyed as preliminary by the examiner-in-charge.

C. Component Evaluations

Similar to the composite rating, the individual rating components are evaluated on a scale of one to five, where one represents the lowest level of supervisory concern and five represents the highest. Each component is discussed below followed by a description of the individual performance ratings.

D. Risk Management

Risk is an inevitable component of any financial institution. Risk management, or the process of identifying, measuring, and controlling risk, is therefore an important responsibility of any financial institution. In a branch, which is typically removed from its head office by location and time zone, an effective risk management system is critical not only to manage the scope of its activities, but to achieve comprehensive, ongoing oversight by branch and head office management. In the examination process, examiners will therefore determine the extent to which risk management techniques are adequate (i) to control risk exposures that result from the branch's activities and (ii) to ensure adequate oversight by branch and head office management, and thereby promote a safe and sound banking environment.

The primary components of a sound risk management system are a comprehensive risk assessment approach; a detailed structure of limits, guidelines, and other parameters used to govern risk-taking; and a strong management information system for monitoring and reporting risks.

The process of risk assessment includes the identification of all the risks associated with the branch's balance sheet and off-balance-sheet activities and grouping them into appropriate risk categories. These categories broadly relate to credit, market, liquidity, operational, and legal risks.[7] All major risks should be measured explicitly and consistently by branch management; risks should also be reevaluated on an ongoing basis as underlying risk assumptions relating to economic and market conditions vary and as the branch's activities change. The branch's expansion into new products or business lines should not outpace proper risk management or supervision by head office. Where risks cannot be explicitly measured, management should demonstrate knowledge of their potential impact and a sense of how to manage such risks.

Risk identification and measurement are followed by an evaluation of the tradeoff between risks and returns to establish acceptable risk exposure levels, which are stated primarily in the branch's lending and trading policies subject to the approval of head office management. These policies should give standards for evaluating and undertaking risk exposure in individual branch activities as well as procedures for tracking and reporting risk exposure to monitor compliance with established policy limits or guidelines.

Head office management has a role in developing and approving the branch's risk management system as part of its responsibility to provide a comprehensive system of oversight for the branch. Generally, the branch's risk management system, including risk identification, measurement, limits or guidelines, and monitoring should be modeled on that of the FBO as a whole to provide for a fully-integrated risk management system.[8]

In assigning the risk management rating, examiners should evaluate the current, ongoing situation and concentrate on developments since the previous examination. The rating should not concentrate on past problems, such as those relating to the current quality of the

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[7] While operational risks are identified as part of the branch's overall risk assessment process, the effectiveness of the branch's operational controls is separately evaluated under ROCA.

[8] For a more detailed overview of the risk management process in trading operations, refer to the Federal Reserve's *Trading Activities Manual*.

branch's stock of assets, if risk management techniques have improved significantly since those problems developed.[9]

More specifically, in rating the branch's risk management procedures, examiners should consider the following points:

- The extent to which the branch is able to manage the risks inherent in its lending, trading, and other activities; specifically, its ability to identify, measure, and control these risks.

- The soundness of the qualitative and quantitative assumptions implicit in the risk management system.

- Whether risk policies, guidelines, and limits at the branch are consistent with its lending, trading, and other activities; management's experience level; and the overall financial strength of the branch and/or the FBO.

- Whether the management information system and other forms of communication are consistent with the level of business activity at the branch and sufficient to accurately monitor risk exposure, compliance with established limits, and sufficient to enable the head office to monitor the real performance and risks of the branch.

- Management's ability to recognize and accommodate new risks that may arise from the changing environment, and to identify and address risks not readily quantified in a risk management system.

For example, in the lending area, a branch would be expected to have (1) experienced lending officers, an effective credit approval and review function, and, where appropriate, credit work-out personnel; (2) a credit risk evaluation system that was viewed as adequate in assessing relative credit risks; (3) branch officer lending limits, lending guidelines, and portfolio policies consistent with the abilities of branch personnel and the financial expertise and resources of the FBO; (4) a system that identified existing and potential problem credits, a method for assessing the likely impact of those credits on existing and future profits, and procedures for accurately informing head office of the credit quality of the portfolio and possible credit losses; and (5) procedures for assessing the impact on the portfolio of specific or general changes in the business climate.

A rating of "1" indicates that management has a fully-integrated risk management system that effectively identifies and controls all major types of risk at the branch, including

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[9] Thus, for example, the change in the level of problem assets since the previous examination would normally be more important than the absolute level of problem assets. At the same time, a loan portfolio that has few borrowers experiencing debt service problems does not necessarily indicate a sound risk management system because weak underwriting standards may make the branch vulnerable to credit problems during a future economic downturn.

those from new products and the changing environment. This assessment, in most cases, will be supported by a superior level of financial performance and asset quality at the branch. No supervisory concerns are evident.

A rating of "2" indicates that the risk management system is fully effective with respect to almost all major risk factors. It reflects a responsiveness and ability to cope successfully with existing and foreseeable exposures that may arise in carrying out the branch's business plan. While the branch may have residual risk-related weaknesses, these problems have been recognized and are being addressed by the branch and/or head office. Any such weaknesses will not have a material adverse affect on the branch. Generally, risks are being controlled in a manner that does not require additional or more than normal supervisory attention.

A rating of "3" signifies a risk management system that is lacking in some important measures. Its effectiveness in dealing with the branch's level of risk exposures is cause for more than normal supervisory attention, and deterioration in financial performance indicators is probable. Current risk-related procedures are considered fair, existing problems are not being satisfactorily addressed, or risks are not being adequately identified and controlled. While these deficiencies may not have caused significant problems yet, there are clear indications that the branch is vulnerable to risk-related deterioration.

A rating of "4" represents a marginal risk management system that generally fails to identify and control significant risk exposures in many important respects. Generally, such a situation reflects a lack of adequate guidance and supervision by head office management. As a result, deterioration in overall performance is imminent or is already evident in the branch's overall performance since the previous examination. Failure of management to correct risk management deficiencies that have created significant problems in the past warrants close supervisory attention.

A branch rated "5" has critical performance problems that are due to the absence of an effective risk management system in almost every respect. Not only are there a large volume of problem risk exposures, but the problems are also intensifying. Management has not demonstrated the ability to stabilize the branch's situation. If corrective actions are not taken immediately, the operations of the branch are severely endangered.

E. Operational Controls

This component assesses the effectiveness of the branch's operational controls, including accounting and financial controls. The assessment is based on the expectation that branches should have an independent internal audit function and/or an adequate system of head office or external audits as well as a system of internal controls consistent with the size and complexity of their operations. In this regard, internal audit and control procedures should ensure that operations are conducted in accordance with internal guidelines and regulatory policies, and that all reports and analyses provided to the head office and branch senior management are timely and accurate.

The rating of operational controls should include the following items:

- The adequacy of controls and the level of adherence to existing procedures and systems. (These are separate but related factors.)

- The frequency, scope, and adequacy of the branch's internal and external audit function, relative to the size and risk profile of the branch, and the independence of the internal audit function from line management.

- The number and severity of internal control and audit exceptions.

- Whether internal control and audit exceptions are effectively tracked and resolved in a timely manner.

- The adequacy and accuracy of management information reports. This assessment should be based primarily on whether reports and analyses are sufficient to properly inform head office management of the branch's condition on a timely basis, and whether there are sufficient procedures to ensure the accuracy of those reports.

- Whether the system of controls is regularly reviewed to keep pace with changes in the branch's business plan and laws and regulations.

A branch that is rated "1" has a fully comprehensive system of operational controls that protects against losses from transactional and operational risks and ensures accurate financial reporting. Branch operations are fully consistent with sound market practices. The branch also has a well-defined and independent audit function that is appropriate to the size and risk profile of the branch. No supervisory concerns are evident.

A rating of "2" may indicate some minor weaknesses, such as the presence of new business activities where some modest control deficiencies exist, but which management is addressing. Some recommendations may be noted. Overall, the system of controls, including the audit function, is considered satisfactory and effective in maintaining a safe and sound branch operation. Only routine supervisory attention is required.

A rating of "3" indicates that the branch's system of controls, including the quality of the audit function, is lacking in some important respects, particularly as indicated by continued control exceptions and/or substantial deficiencies in or failure to adhere to written policies and procedures. As a result, more than normal supervisory attention is required.

A branch that is rated "4" signifies that the system of operational controls has serious deficiencies that require substantial improvement. In such a case, the branch may lack control functions, including those related to the audit function, that meet minimal expectations; therefore, adherence to bank and regulatory policy is questionable. Head office management has failed to give the branch proper support to maintain operations in accordance with U.S. norms. Close supervisory attention is required.

A branch that is rated "5" lacks a system of operational controls to such a degree that its operations are in serious jeopardy. The branch either lacks or has a wholly deficient audit function. Immediate substantial improvement is required by branch and head office management, along with strong supervisory attention.

F. Compliance

In addition to maintaining an effective system of operational controls, branches should also demonstrate compliance with all applicable state and federal laws and regulations, including reporting and special supervisory requirements. To the extent possible, given the size, risk profile and organizational structure of the branch, these responsibilities should be vested in a branch official or compliance officer whose function is separate from line management. Branch management should also ensure that all appropriate personnel are properly trained in meeting regulatory requirements on an ongoing basis. The scope of the branch's audit function also should ensure that the branch is meeting all applicable regulatory requirements.

Accordingly, the branch's level of compliance should be rated based on the following factors:

- The level of adherence to applicable state and federal laws and regulations and any supervisory follow-up actions.
- The effectiveness of (i) written compliance procedures and (ii) training of line personnel charged with maintaining compliance with regulatory requirements.
- Management's ability to submit required regulatory reports in a timely and accurate manner.
- Management's ability to identify and correct compliance issues.
- Whether the internal audit function checks for compliance with applicable state and federal laws and regulations.

A branch accorded a rating of "1" demonstrates an outstanding level of compliance with applicable laws, regulations, and reporting requirements. No supervisory concerns are evident.

A rating of "2" indicates that compliance is generally effective with respect to most factors. Compliance monitoring and related training programs are sufficient to prevent significant problems. Minor reporting errors may be present, but they are being adequately addressed by branch management. Only normal supervisory attention is warranted.

A branch that is rated "3" has deficiencies in management and training systems that result in an atmosphere where significant compliance problems could and do occur. Such deficiencies could include a lack of written compliance procedures, no system for identifying possible compliance issues, or a substantial number of minor or repeat violations or deficiencies. More than normal supervisory attention is warranted.

A rating of "4" indicates that compliance matters are not given proper attention by branch and head office management and close supervisory attention is warranted. The lack of an effective compliance program, including an ongoing training program, may be evident along with a failure to meet significant regulatory requirements and/or significant, widespread inaccuracies in regulatory reports.

A rating of "5" would signal that attention to compliance matters is wholly lacking at the branch to the extent that immediate supervisory action is warranted.

G. Asset Quality

Generally, asset quality is evaluated to determine whether a financial entity has sufficient capital to absorb prospective losses and, ultimately, whether it can maintain its viability as an ongoing entity. The evaluation of asset quality in a branch does not have the same result because a branch is not a separately capitalized entity. Instead, a branch relies on the financial and managerial support of the FBO as a whole.

Nonetheless, the evaluation of asset quality is important both in assessing the effectiveness of credit risk management and in the event of a possible liquidation of a branch. However, as indicated above, a branch is not strictly limited by its own internal and external funding sources in meeting solvency and liquidity needs. The ability of a branch to honor its liabilities ultimately is based upon the condition and level of support from the FBO, a concept that is integral to the FBO supervision program.

This concept states that if the condition of the FBO is satisfactory, the FBO is presumed to be able to support the branch with sufficient resources on a consolidated basis. As a result, the assessment of asset quality in such circumstances would not in and of itself be a predominant factor in the branch's overall assessment, if existing risk management techniques are satisfactory. If, however, support from the FBO is questionable, the evaluation of asset quality should be carefully considered in determining whether supervisory actions are needed to improve the branch's ability to meet its obligations on a stand-alone basis. In cases where a branch is subject to asset maintenance, it is expected that asset quality issues will be addressed by disqualifying classified assets as eligible assets.

The quality of the branch's stock of assets is evaluated based on the following factors. Generally, credit administration concerns should be addressed in rating risk management in light of:

- The level, distribution, and severity of asset and off-balance-sheet exposures classified for credit and transfer risk.[10]

[10] For specific guidance on evaluating the amount of risk inherent in classified assets and off-balance-sheet or contingent exposures, examiners should refer to the Federal Reserve examination manuals and any applicable supervisory policies.

- The level and composition of nonaccrual and reduced rate assets.

  A branch accorded a rating of "1" has strong asset quality.
  A branch accorded a rating of "2" has satisfactory asset quality.
  A branch accorded a rating of "3" has fair asset quality.
  A branch accorded a rating of "4" has marginal asset quality.
  A branch accorded a rating of "5" has unsatisfactory asset quality.

H. Assignment of a Combined ROCA Rating

The U.S. bank supervisors will assign a combined ROCA rating for all of the FBO's U.S. branches, agencies, and commercial lending companies. This composite assessment of risk management, operational controls, compliance, and asset quality at the FBO's U.S. branch, agency, and commercial lending company operations will in turn be factored into the FBO's overall combined U.S. operations rating.

LIST OF APPENDICES

I. OUTLINE FOR THE REVIEW OF THE HOME COUNTRY FINANCIAL SYSTEM

II. OUTLINE FOR THE REVIEW OF HOME COUNTRY ACCOUNTING PRACTICES

III. OUTLINE FOR THE INSTITUTIONAL OVERVIEW

IV. STRENGTH-OF-SUPPORT ASSESSMENT EXAMPLE

V. SUMMARY OF CONDITION LETTER TO FBO MANAGEMENT

VI. TRANSMITTAL LETTER TO THE HOME COUNTRY SUPERVISOR FOR THE SUMMARY OF CONDITION

Note: Samples of the products for the risk-focused supervisory process are included in the handbook on *Framework for Risk-Focused Supervision of Large Complex Institutions*, which is attached to SR letter 97-24.

Appendix I

OUTLINE FOR THE
REVIEW OF THE HOME COUNTRY FINANCIAL SYSTEM

I. Financial System Structure

A. Types of institutions
   1. Permissible activities/investments
   2. Ownership restrictions

B. Concentration of the banking market

C. Existence of financial conglomerates

D. Presence of foreign banks

II. Operating Environment

A. Condition of economy and political environment

B. Systemic banking issues

C. Transfer risk

III. Bank Supervision

A. Key banking law(s)

B. Agencies involved in banking supervision

C. Supervisory techniques
   1. Chartering criteria
   2. Prudential rules (including an in-depth discussion of capital requirements and permissible capital components)
   3. Examinations vs. reliance on external auditors
   4. Reporting requirements/off-site surveillance
   5. Corrective measures/sanctions
   6. Powers of intervention

D. Extent to which supervisor assesses the consolidated worldwide operations

E. Treatment of problem/failed institutions:
   1. History of government support of individual banking institutions
   2. Lender of last resort
   3. Deposit insurance program
   4. Bankruptcy laws
   5. Other legal issues

Appendix II

OUTLINE FOR THE
REVIEW OF HOME COUNTRY ACCOUNTING PRACTICES

I. Asset Valuation

A. Nonperforming definition/accrual practices
B. Provisioning policies
C. Charge-off policies
D. Revaluation reserves
   1. Fixed assets
   2. Securities portfolio
E. Undisclosed reserves
F. Inflation accounting/monetary correction
G. Intangibles/goodwill
H. Accounting for subsidiaries and affiliates

II. Income and Expense Items

A. Provisioning policies
B. Income recognition and accrual methods
C. Inflation accounting/monetary correction

III. Consolidation Rules

A. Accounting for subsidiaries and affiliates
B. Accounting for intercompany transactions

IV. Off- versus On-Balance Sheet Items

V. Tax Considerations

VI. Disclosure Rules

A. Adoption of internationally accepted accounting standards
B. Financial reporting requirements
C. Comparability to recommended disclosures of the Basel Committee on Banking Supervision

Appendix III

OUTLINE FOR THE INSTITUTIONAL OVERVIEW

A significant portion of the information required to complete the SOSA analysis will be found in the Institutional Overview. The Overview provides a logical, concise assessment of the FBO's organization, business strategy, and financial performance. It should be noted, however, that in a number of developing countries there is limited available information and disclosure. As such, credible information for all of these topics may not be available for all FBOs.

I. **Structure** - This section should provide background information on the FBO. Information contained in this section will not necessarily change substantially from year to year unless there is a significant acquisition, divestiture, or strategic reorganization.

   A. Description of the FBO (including type of charter) and organization.
   B. Ownership.
   C. Comments on key business units, subsidiaries, affiliates, and joint ventures.
   D. Changes through merger, acquisition, divestitures, consolidation or charter conversion.

II. **Business Strategy and Operations** - This section should provide information on the FBO's global business strategy, especially as it relates to its U.S. operations; a description of key business lines and major new initiatives as they are introduced; and identification of key risk management issues in pursuit of business objectives.

   A. Business strategy: Marketing emphasis, growth areas, acquisitions, and assessment of market position and prospects.
   B. Major business activities and related risk management processes: Key business lines; product mix; customers and counterparties for credit products; trading, proprietary investment, and capital markets activities; and other significant business activities, such as asset management, trust, and custodial.
   C. Financial performance and financial outlook: Consolidated financial information including earnings, capital, asset quality, and other financial performance factors; peer comparisons; transfer risk concerns; market reviews; and internal and market-based projections, if available.

III. **Funding and Liquidity** - This section analyses the depth of local money and capital markets; components of the FBO's capital structure; other funding sources; reliance on, and types of, market funding; and credit agency and market ratings.

IV. **Governance** - This section provides an assessment of financial disclosure; composition, background, and involvement of outside (i.e., non-executive) directors; intercompany transactions (especially intercompany loans); auditors; and management oversight of foreign operations.

Appendix IV

STRENGTH- OF- SUPPORT ASSESSMENT EXAMPLE

Ranking and Rationale:
Bank of Country X (BCX) is assigned a Strength-of-Support Assessment ranking of "2" based on declining capital ratios, deteriorating earnings, and weakening but better-than-peer asset quality. The ranking is further supported by BCX's uncertain financial prospects following the sector-wide mergers, during which time BCX is expected to absorb much smaller and weaker institutions and, as a result, damage its financial condition even further. Generally, external factors, such as the home country supervisory system and lender of last support issues, are consistent with the SOSA ranking of "2." A number of uncertainties for BCX remain, particularly the possibility of increased interference from government shareholders in lending decisions.

Given the continuance of the "2" SOSA ranking, no changes to BCX's supervisory strategy are recommended at this time. (Please see the Supervisory Plan for a full discussion of BCX's supervisory strategy.)

Financial Condition:

***Capital*:**
Reported total and tier 1 capital ratios of 8.7 percent and 4.1 percent, respectively, are only slightly above Basel minima.

Asset Quality:
Better than the industry average, but markedly affected by the domestic economic downturn.

Earnings:
ROAA declined to 0.5 percent from 0.8 percent prior year, while overhead remains high.

***Liquidity*:**
Adequate.

Structure and Governance:
BCX possesses a large retail network and conducts a complex range of banking activities. However, the government of Country X has frequently interfered in the lending decisions of BCX by instructing the bank to lend to government-supported industries. Not surprisingly, BCX was chosen to remain intact in the government’s merger plan and absorb four much smaller institutions. The new board of directors will likely retain the former BCX members.

Funding:
As the largest bank in Country X, BCX relies on an extensive branch network that provides ample and dependable core deposit funding.

Financial System Structure:
By year-end 2000, the country’s 15 domestic financial institutions are to be merged into 4 anchor banks. ABC, one of the surviving institutions, just completed a merger at the end of June 2000.

Economic and Political Environment:
The Country X economy is recovering along with those of its neighbors, driven by exports. In addition, the government was reelected for another four-year term, which provides continuity to economic policies. There are no transfer risk concerns associated with Country X.

Banking Environment:
Government control of the banking sector is absolute, as seen by the central bank's merger plan for all domestic financial institutions, regardless of ownership type. On the other hand, although the central bank has imposed a 3 percent annual loan growth target since 1998, no banks were penalized for failing to meet this target.

Bank Supervision:
Banks are supervised by the Central Bank of Country X, which requires the approval of the Minister of Finance for certain actions. Although a rigid supervisory structure is in place, rules and regulations can be, and are, adjusted by the central bank, if advantageous to the country or the banking system. In all these respects, the two agencies appear to present a united front. Country X bank supervisors have a solid record of supporting troubled financial institutions.

Accounting Issues:
In response to the regional economic crisis, the central bank relaxed some accounting standards for banks. Separately, bank annual reports must be approved by the central bank prior to publication, so public information may be filtered. For additional information, see the February 1999 Country X Accounting System Review.

Appendix V

SUMMARY OF CONDITION LETTER
TO FBO MANAGEMENT

[ADDRESSEE]

(Letter to appropriate head office management of the FBO with copies to appropriate management in the United States responsible for the FBO's U.S. operations.)

Dear [Name of FBO Official]:

This letter summarizes the Federal Reserve's Assessment of the Combined U.S. Operations of [Name of FBO ("FBO")] and also provides notification of the Strength-of-Support Assessment ("SOSA") ranking of FBO.

ASSESSMENT OF COMBINED U.S. OPERATIONS

Scope

(Suggested Text:)

The evaluation of U.S. operations was prepared by the Federal Reserve Bank of XXX ("FRBXX"), using the most recent reports of examination and inspection of your bank's U.S. operations, which were conducted as of (coordinated as of date), updated with available financial information to (appropriate later date). A copy of this letter also has been sent to FBO's regional management in (regional headquarters location).

The scope of our review included all banking and nonbanking activities of FBO in the United States, and focused on risk management, operations, compliance, and asset quality. This process involved reviewing reports of examination and inspection of the U.S. operations of FBO; conducting any necessary financial and regulatory analysis; and holding discussions about the condition of FBO's U.S. operations with other Federal regulatory agencies and Reserve Banks, State Banking Departments, and with staff of the Board of Governors.

Overall Condition

[Indicate overall condition, referencing overall evaluations of risk management, operations, compliance, and asset quality. Cite composite ratings of individual units if appropriate. Identify weaknesses in critical areas (see below for individual headings). State whether these weaknesses are considered correctable in the normal course of business, and if not, cite specific results required to resume satisfactory operations. Conclude with qualitative evaluation of overall operations.]

Trading Risk Management

Credit Risk Management

Operations and Audit

Compliance

Asset Quality

Other Matters

[Discuss other matters relating to non-ROCA component ratings of insured banks or nonbanks.]

Combined U.S. Rating

(Suggested Text:)

As noted earlier, we consider the U.S. operations to be [qualitative evaluation.] Specifically, we have accorded a rating of [numeric rating] to FBO's combined U.S. operations. In general, a [numeric rating] rating is assigned when… (See section V, Summary of Condition and Assignment of a Rating for the Combined U.S. Operations, of this SR letter for the appropriate description of the assigned 1-5 component rating.)

Combined ROCA Rating

The ROCA rating system is designed to assess the condition of FBO's branch and agency network in the United States and to pinpoint the key areas of concern. For evaluation purposes, the rating system divides the branch network's overall activities into three individual components: risk management, operational controls, and compliance. These components represent the major activities or processes that may raise supervisory concern. The rating system also provides for a specific rating of the quality of the stock of assets as of the examination date. The overall or composite rating indicates whether, in the aggregate, the operations of the branch network may present supervisory concerns and the extent of these concerns. We have accorded a rating of [numeric 5 digit rating] to FBO’s branches and agencies [and commercial lending companies if applicable] only on a combined basis.

Corrective Actions

[Describe action taken to date to address weaknesses outlined earlier in the assessment. Acknowledge, where appropriate, any other previous contact, i.e., meetings, conference calls or correspondence, in which these overall findings and corrective action may have been discussed.]

Outstanding U.S. Supervisory Action

[For existing actions, discuss any areas of partial or noncompliance, and related remedial action.]

STRENGTH-OF-SUPPORT ASSESSMENT

In assigning the Strength-of-Support Assessment ("SOSA") ranking, a number of factors are considered, including FBO's financial condition and outlook, managerial oversight of its U.S. operations, and factors relating to the home country banking and supervisory systems of FBO.

The SOSA ranking, which is one element in the development of a supervisory strategy for the U.S. operations of FBO, is based on a scale of "1" to "3", with "1" representing the lowest level of supervisory concern and "3" representing the highest. The assessment of FBO resulted in the assignment of a SOSA ranking of ["1," "2" or "3"]. [Select the appropriate sentence corresponding to the SOSA ranking: (a) In general, an institution assigned a ranking of "1" is a foreign banking organization whose financial profile and outlook pose a low risk that it will be unable to support its U.S. operations. (b) In general, an institution assigned a ranking of "2" possesses a current operating performance and immediate financial outlook that, although not posing significant concerns about its ability to honor its U.S. liabilities, may warrant more than normal supervisory attention. (c) In general, an institution assigned a ranking of "3" possesses significant financial or supervisory weaknesses, and a high degree of supervisory oversight of its U.S. operations may be warranted.] Provide a brief summary of the key points supporting the SOSA ranking.

DISCLOSURE

(Required Text:)

Please note that the assessment and rating of FBO's U.S. operations, combined ROCA rating, and its SOSA ranking, are parts of the overall findings of U.S. supervisory activities. The contents of this letter are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information. Under no circumstances shall the bank or any of its directors, officers, or employees disclose or make public in any manner this letter, the combined U.S. rating, combined ROCA rating, or the SOSA ranking. A copy of the "The Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations", SR letter 00-XX, is available through the Federal Reserve Board's web site. Please direct any questions or comments to [Name of Contact] at [phone number] or [e-mail address].

(Signed) Senior Officer for BS&R

cc: Regional U.S. FBO management
BOG Staff

Appendix VI

TRANSMITTAL LETTER TO THE HOME COUNTRY SUPERVISOR FOR THE SUMMARY OF CONDITION

[HOME COUNTRY SUPERVISORY CONTACT]
[NAME OF SUPERVISORY AGENCY]
[ADDRESS]
[CITY, COUNTRY]

Dear:

The enclosed letter summarizes the Federal Reserve System's assessment of the combined U.S. operations, combined ROCA rating, and Strength of Support Assessment ranking of [Name of FBO ("FBO")], and was recently sent by this Reserve Bank to FBO. This evaluation reflects the examination findings for the entities operated by FBO, which were examined during [year of examination, or as of examination date]. A listing of the entities examined also is enclosed. As a result of these examinations, FBO was assigned a Combined U.S. Operations Rating of [numerical rating]. An institution whose U.S. operations are rated a [numerical rating] has [definition of the numerical rating]. Furthermore, a combined ROCA rating of [numeric 5-digit rating] has been accorded to FBOs U.S. [branches, agencies and commercial lending companies (select appropriate text)].[11]

Please take particular note of the following matters of supervisory significance:

[discuss briefly as necessary].

This letter also serves to notify you of the Strength-of-Support Assessment ("SOSA") for FBO prepared by the [name of U.S. bank supervisory agency]. In assigning a SOSA ranking, a number of factors are considered, including FBO's financial condition, managerial oversight of its U.S. operations, and the condition of the banking system in which FBO operates.

The SOSA ranking is based on a scale of "1" to "3", with "1" representing the lowest level of supervisory concern and "3" representing the highest. The assessment of FBO resulted in the assignment of a SOSA ranking of ["1," "2" or "3"]. [Select the appropriate sentence

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[11] The ROCA rating system is designed to assess the condition of FBO's branch and agency network in the United States and to pinpoint the key areas of concern. For evaluation purposes, the rating system divides the branch network's overall activities into three individual components: risk management, operational controls, and compliance. These components represent the major activities or processes that may raise supervisory concern. The rating system also provides for a specific rating of the quality of the stock of assets as of the examination date. The overall or composite rating indicates whether, in the aggregate, the operations of the branch network may present supervisory concerns and the extent of these concerns.

corresponding to the SOSA ranking: (a) In general, an institution assigned a ranking of "1" is a foreign banking organization whose financial profile and outlook pose a low risk that it will be unable to support its U.S. operations. (b) In general, an institution assigned a ranking of "2" possesses a current operating performance and immediate financial outlook that, although not posing significant concerns about its ability to honor its U.S. liabilities, may warrant more than normal supervisory attention. (c) In general, an institution assigned a ranking of "3" possesses significant financial or supervisory weaknesses, and a high degree of supervisory oversight of its U.S. operations may be warranted.] Provide a brief summary of the key points supporting the SOSA ranking.

The Federal Reserve is providing this supervisory information to you with the understanding that your agency will maintain its confidentiality to the extent possible under applicable law, and that such information will be used only for lawful supervisory purposes.

We have advised FBO that the contents of the letter providing the Federal Reserve System's summary assessment and supervisory rating of its U.S. operations, combined ROCA rating, as well as its SOSA ranking, are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information, and that under no circumstances should the bank disclose or make public in any manner the contents of the attached letter.

Please direct any questions regarding this letter to [name of Reserve Bank Official, Title], at [phone number and/or email address].

Sincerely,

Name of Reserve Bank Official]
[Title]

Enclosures