Supervision and Regulation Report

May 2019

Board of Governors of the Federal Reserve System

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Errata

The Federal Reserve revised this report on May 14, 2019, to reflect corrected data. The revision is listed below.

On p. 6, the data for figure 7, the credit default swap spread series, were corrected for July 2018 through March 2019. Incorrect data were originally listed for July, causing the monthly series to be incorrectly aligned for each subsequent month. The data for July have been corrected from 63.05 basis points to 61.98 basis points, with subsequent months now listing the correct data.

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Preface

The Board of Governors of the Federal Reserve System (Board) believes that publishing periodic information about banking conditions and the Federal Reserve's supervisory and regulatory activities—typically in conjunction with testimony before Congress by the Vice Chair for Supervision—will enhance public transparency and heighten accountability.

The inaugural report, published in November of 2018, looked at trends going back to the financial crisis. This report focuses on how the Federal Reserve tailors its supervisory and regulatory programs based on size and complexity.

This report consists of three main sections, in addition to a Summary of key developments and trends:

- The Banking System Conditions section provides an overview of trends in the banking sector based on data collected by the Federal Reserve and other federal financial regulatory agencies as well as market indicators of industry conditions.
- The Regulatory Developments section provides an overview of the current areas of focus of the Federal Reserve's regulatory policy work, including pending rules.
- The Supervisory Developments section provides background information on supervisory programs and approaches, as well as an overview of key supervisory themes and trends, supervisory findings, and supervisory priorities. In so doing, the report distinguishes between large financial institutions and regional and community banking organizations because supervisory approaches and priorities for these institutions frequently differ.

Contents

Summary

The Federal Reserve tailors regulation and supervision, taking into account both macroprudential and microprudential risks.

The Federal Reserve tailors its regulatory and supervisory approach to account for the size, complexity, risk profile, and systemic importance of regulated institutions. In response to the financial crisis, financial regulators strengthened the existing regulatory and supervisory framework by increasing capital, liquidity, and risk-management requirements for supervised financial institutions, most significantly for the largest institutions.

After a decade of post-crisis regulation, the Federal Reserve is focused on making the current regulatory and supervisory environment more efficient, transparent, and simple and ensuring that compliance burden is minimized without compromising an institution's safety and soundness. The recent passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) presents an opportunity for the Federal Reserve to continue to tailor its regulations to focus on the largest, most systemically important banking firms while reducing burden for less complex firms, especially community banks.

The Federal Reserve's supervisory work is tailored, with the most rigorous standards applied to the most systemically important financial institutions.

The Federal Reserve has substantially strengthened its supervisory program for large institutions since the financial crisis. In addition to shifting supervisory resources to its large institution supervision program, the Federal Reserve has introduced several cross-institutional (horizontal) examinations focusing on capital, liquidity, governance and controls (G&C), and resolution planning. Furthermore, information collections from large institutions have increased, providing supervisors, as well as senior management at the firms, with more timely and better insight into firms' risk profiles and activities.

At the same time, the Federal Reserve has increased its emphasis on risk-focusing examination activities for regional and community banks, conducting more in-depth examinations for banks with high-risk activities and less-intensive examinations for lower-risk banks. In addition, the Federal Reserve has taken steps to reduce the amount of supervisory burden by reducing information collection requirements for smaller banks and minimizing the burden associated with their examinations by conducting larger portions of examinations away from bank premises (off-site).

The Board continues to promote the principles of efficiency, transparency, and simplicity in its approach to supervising and regulating institutions.

Efficiency involves two components. The first is related to methods: efficient methods tailor the requirements and intensity of regulations and supervision programs based on the asset size and complexity of firms. Efficient methods also minimize compliance burdens generally while achieving regulatory objectives. The second is related to goals: the Federal Reserve has a strong public interest in an efficient financial system, just as it does in a safe and sound one. The Federal Reserve includes the efficient operation of the financial sector as one of the goals it seeks to promote through its regulation and supervision.

Transparency involves the presentation of regulations, guidance, and supervisory findings in a manner that regulated institutions and the public can understand. Transparency promotes accountability to the public and an effective regulatory process by exposing ideas to a variety of perspectives. Similarly, transparent supervisory principles and guidance allow firms and the public to understand the basis for a supervisory decision and allow firms the ability to respond constructively to supervisors.

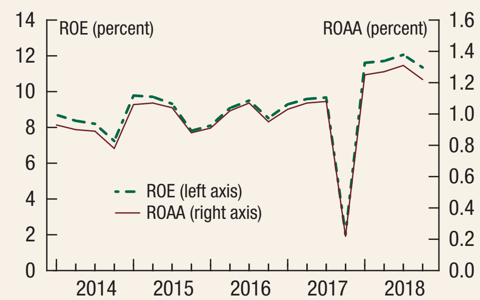
Simplicity involves developing the Federal Reserve's regulations and supervisory framework without unnecessary complexity, and presenting them in a clear and concise manner. The objective of simplicity complements and supports the efforts of the Federal Reserve to be transparent to supervised institutions and the public on its regulations and supervisory programs. Confusion and unnecessary compliance burden resulting from overly complex regulations do not advance the goal of a safe, sound, and efficient financial system.

Banking System Conditions

The financial performance of the banking industry is generally strong.

The strong performance of the economy over the past five years has contributed to the robust financial performance of the United States banking system. During this period, bank earnings saw an overall upward trend. Return on equity (ROE) and return on average assets (ROAA)—two important measures of profitability—both ended 2018 up, year-over-year. Despite market volatility during the second half of the year and a slight drop in late 2018, both measures of earnings remained above their five-year averages (figure 1). Robust growth in net interest income and the recent cut to the federal corporate income tax rate were two key drivers of bank profitability.

Figure 1. Bank profitability

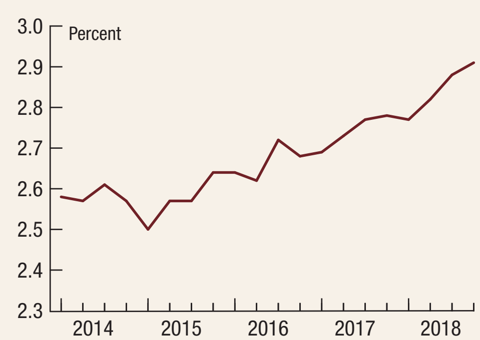


Note: ROAA is net income/quarterly average assets; ROE is net income/average equity capital. Data are annualized.

Source: FR Y-9C, Call Report.

As interest rates trended up over the past several years, banks have managed their balance sheets such that, in the aggregate, yields on loans and securities increased more quickly than liability costs. This in turn has pushed the net interest margin—the difference between interest income and the amount of interest paid out, as a share of average earning assets—along a strong upward trend. The net interest margin ended the year at 2.9 percent, above the low of 2.5 percent from the first quarter of 2015 (figure 2).

Figure 2. Net interest margin



Note: Data are annualized.

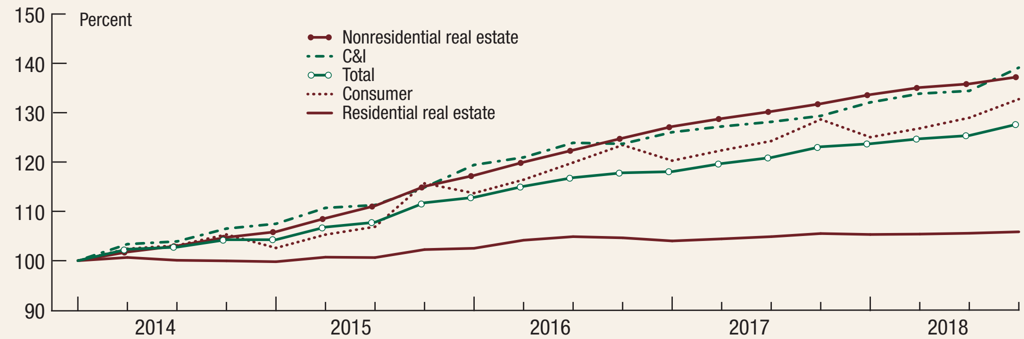
Source: FR Y-9C, Call Report.

Banks have expanded lending throughout the economy.

The last quarter of 2018 saw strong loan growth (figure 3). Over the past five years, the banking system has expanded loans by nearly 30 percent. Commercial and industrial (C&I) and nonresidential real estate loans, in particular, have seen robust growth during this period. Since the beginning of 2014, lending in C&I and nonresidential real estate loans has grown by nearly 40 percent. Growth in consumer loans and residential real estate loans has been slower.

C&I loans, typically used to finance capital business operations and capital expenditures, tend to be more responsive to economic cycles. Growth in this loan category is a key indicator of growth in the broader economy, though often with a lag. C&I loans are currently one of the largest loan categories in the United States. Banking organizations of all sizes have increased C&I lending, with smaller banks seeing stronger growth in recent years than their larger counterparts.

Figure 3. Loan growth by sector



Note: Data are nominal and indexed to 2014:Q1.

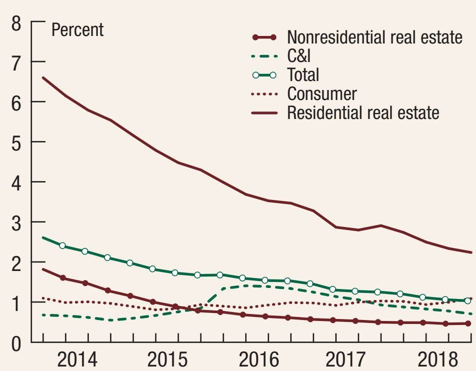
Source: FR Y-9C, Call Report.

Asset quality of the banking industry continues to improve overall.

As lending expands, the Federal Reserve and other regulatory agencies continue to pay close attention to underwriting standards and the quality of loans that banks are taking onto their books. The nonperforming loan ratio—the ratio of loans 90 days or more past due and those in nonaccrual status, to total loans—is an important measure of asset quality. The lower this ratio, the fewer loans on which banks are unable to collect and the less risk to the overall financial system. This measure has seen marked improvement during the past several years, ending 2018 at roughly 1 percent, below its five-year average of 1.6 percent (figure 4).

Measures like the nonperforming loan ratio typically react to, but do not necessarily predict, economic conditions. Changes in asset quality can highlight areas of potential concern that warrant further supervisory monitoring. One such area is the agricultural loan sector. The nonperforming loan ratios for two types of agricultural loans—farmland and agricultural production loans—saw a year-over-year increase in 2018 (figure 5). Nonperforming loan

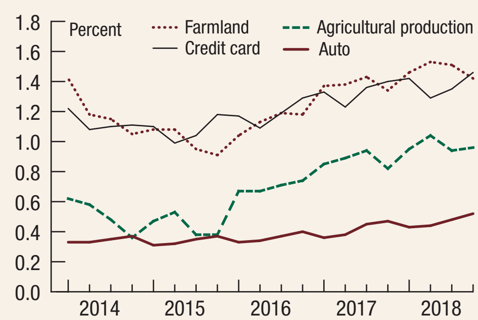
Figure 4. Nonperforming loan ratio



Note: The nonperforming loan ratio is the ratio of loans 90 days or more delinquent and nonaccrual loans to total loans.

Source: FR Y-9C, Call Report.

Figure 5. Sectors with increasing nonperforming loan ratios



Note: The nonperforming loan ratio is the ratio of loans 90 days or more delinquent and nonaccrual loans to total loans. Farmland and agricultural production loans are seasonally adjusted.

Source: FR Y-9C, Call Report.

ratios for credit cards and auto loans also are increasing, partly reflecting expansions of subprime lending.

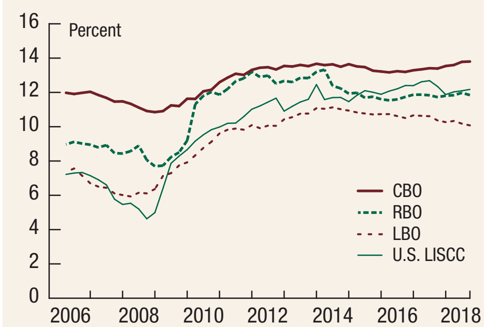
The Federal Reserve continues to monitor the risks from leveraged lending through the Shared National Credit (SNC) program and annual stress testing. While underwriting and risk-management practices generally have improved in agency-supervised institutions, trends in certain loan characteristics, such as fewer and less-stringent protective covenants, more liberal repayment terms, and incremental debt provisions, suggest vulnerabilities that may lead to increased risk of borrower default or loss.[1]

Although capital ratios remain well above regulatory requirements, larger firms have seen a slight decline because of higher payouts and asset growth.

Capital serves as a buffer for the financial industry, enabling financial institutions to absorb losses that may result from unexpected operational, credit, or market events. Maintaining a robust level of capital enables firms to remain resilient in the face of downturns and support economic growth.

All banking portfolios maintained strong capital positions (figure 6), although capital ratios declined slightly in 2018. Capital ratios have been influenced by capital distributions in the form of cash dividends and stock repurchases, and by the growth in total assets held by banks.

Figure 6. Common equity tier 1 ratio by portfolio



Note: Data do not include SLHCs.

Source: FR Y-9C, Call Report.

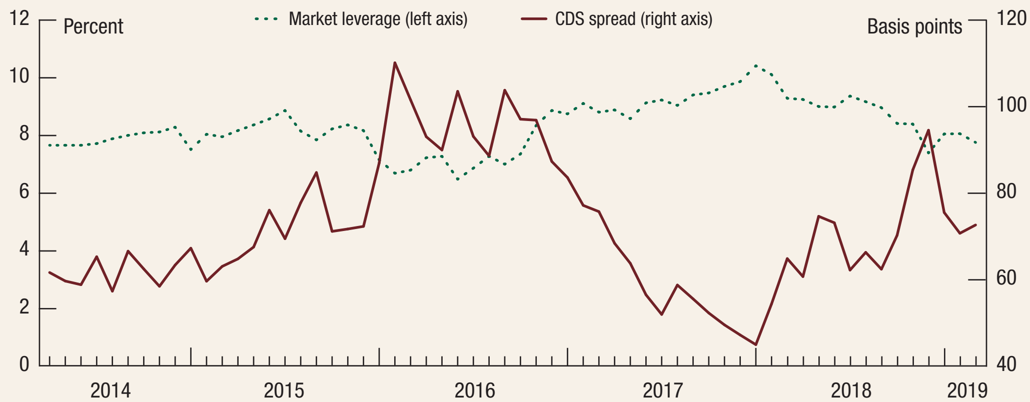
Market indicators continue to reflect generally strong industry performance.

Although there have been some fluctuations in market indicators due to uncertainty around certain macroeconomic issues, indicators of bank health such as the market leverage ratio and credit default swap (CDS) spreads continue to reflect strong banking system conditions.

Overall, CDS spreads—a measure of market assessments of bank risk—have been trending downwards over the past several years, reflecting investor confidence in banks' financial health. CDS spreads moved higher in December 2018 and January 2019 but have since settled back down to levels consistent with those from November 2018. Although not directly related to actual capital strength, the market leverage ratio varies depending on changes in the market value of a firm's equity and thus serves as proxy for market assessments of a firm's position. This indicator has decreased somewhat since the beginning of 2018. Although the decline does not rise to a level of concern, the Federal Reserve continues to closely monitor this, as well as other, market indicators (figure 7).

[1] For more information on the leveraged loan market, please see the "Borrowing by Businesses and Households" section in Board of Governors of the Federal Reserve System, *Financial Stability Report* (Washington: Board of Governors, May 2019), https://www.federalreserve.gov/publications/files/financial-stability-report-201905.pdf.

Figure 7. Average credit default swap (CDS) spread and market leverage ratio



Note: Market leverage ratio is the ratio of market value of equity to market value of equity plus total liabilities. CDS values are for the eight U.S. and four FBO LISCC firms only (U.S.: BAC, BK, C, GS, JPM, MS, STT, and WFC; FBO: BSC, CS, DB, and UBS).

Source: CDS—IHS Markit; market leverage—Bloomberg, Factset.

Box 1. Institutions Supervised by the Federal Reserve

The Federal Reserve is responsible for the supervision and regulation of bank holding companies (BHCs), savings and loan holding companies (SLHCs), state-chartered banks that are members of the Federal Reserve System (state member banks, or SMBs), and U.S. operations of foreign banking organizations (FBOs). The Federal Reserve tailors regulatory and supervisory strategies by the size and complexity of supervised institutions.

For supervisory purposes, the Federal Reserve categorizes supervised institutions into the groups in table A. The Federal Reserve recently increased the asset threshold between large and regional banking organizations from $50 billion to $100 billion.

Table A. Summary of organizations supervised by the Federal Reserve (as of December 2018)

Portfolio	Definition	Number of institutions	Total assets ($trillions)
Large Institution Supervision Coordinating Committee (LISCC)	Eight U.S. globally systemically important banks (G-SIBs): Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street, and Wells Fargo Four FBOs with large and complex U.S. operations: Barclays, Credit Suisse, Deutsche Bank, and UBS	12	12.1
State member banks	SMBs within LISCC organizations	5	0.8
Large and foreign banking organizations (LFBOs)	Non-LISCC U.S. firms with total assets $100 billion and greater and non-LISCC FBOs	179	7.3
Large banking organizations	Non-LISCC U.S. firms with total assets $100 billion and greater	17	3.5
Large foreign banking organizations	Non-LISCC FBOs with combined U.S. assets $100 billion and greater	14	2.7
Less complex foreign banking organizations	FBOs with combined U.S. assets less than $100 billion	148	1.1
State member banks	SMBs within LFBO organizations	8	1.0
Regional banking organizations (RBOs)	Total assets between $10 billion and $100 billion	82	1.8
State member banks	SMBs within RBO organizations	50	0.6
Community banking organizations (CBOs)	Total assets less than $10 billion	3,980	2.4
State member banks	SMBs within CBO organizations	731 (663 SMBs with a holding company and 68 without a holding company)	0.5
Insurance and commercial savings and loan holding companies	SLHCs primarily engaged in insurance or commercial activities	9 insurance SLHCs 4 commercial SLHCs	1.0

Source: Call Report, FFIEC 002, FR 2320, FR Y-7Q, FR Y-9C, FR Y-9SP, and S&P Global Market Intelligence.

Regulatory Developments

The Board continues to identify opportunities to tailor its regulatory framework, focusing on efficiency, transparency, and simplicity.

The Federal Reserve is focused on opportunities to simplify the current regulatory framework and minimize compliance burden in achieving our goal of a safe, sound, and efficient financial system. EGRRCPA presents an opportunity for the Federal Reserve to continue to tailor its regulations to focus on the largest banking firms that represent the highest risk to the U.S. financial system while reducing burden for firms that pose less systemic risk.

Many of the regulations issued by the Federal Reserve over the past year dealt with further tailoring of existing regulations and implementing provisions of EGRRCPA. Table 1 shows proposed and final rules, as well as select Federal Reserve and interagency statements, issued over the past 12 months.

Table 1. April 2018–April 2019 Federal Reserve or interagency rulemakings (proposed and final)

Date issued	Rule/guidance
4/2/2018	Agencies issue final rule to exempt commercial real estate transactions of $500,000 or less from appraisal requirements. *Federal Register* (FR) notice: https://www.federalreserve.gov/newsevents/pressreleases/files/2018-06960.pdf
4/10/2018	Federal Reserve seeks comment on proposal to integrate its stress test and regulatory capital requirements through the stress capital buffer. FR notice: https://www.gpo.gov/fdsys/pkg/FR-2018-04-25/pdf/2018-08006.pdf
4/11/2018	Federal Reserve and the OCC propose rule to tailor enhanced supplementary leverage ratio requirements. FR notice: https://www.gpo.gov/fdsys/pkg/FR-2018-04-19/pdf/2018-08066.pdf
4/17/2018	Agencies issue proposal to revise regulatory capital rules to address and provide an option to phase in the effects of the new accounting standard for credit losses (CECL). FR notice: https://www.gpo.gov/fdsys/pkg/FR-2018-05-14/pdf/2018-08999.pdf
5/7/2018	Board announces approval of final amendments to its Regulation A. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180507a.htm
5/30/2018	Board asks for comment on proposed rule to simplify and tailor compliance requirements relating to the Volcker rule. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180530a.htm
6/5/2018	Agencies ask for public comment on a proposed rule to simplify and tailor the Volcker rule. FR notice: https://www.gpo.gov/fdsys/pkg/FR-2018-07-17/pdf/2018-13502.pdf
6/14/2018	Federal Reserve approves final single-counterparty credit limit rule to prevent concentration of risk between large banking organizations and their counterparties from undermining financial stability. FR notice: https://www.gpo.gov/fdsys/pkg/FR-2018-08-06/pdf/2018-16133.pdf
7/6/2018	Agencies issue statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Statement: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf
7/6/2018	Federal Reserve issues statement describing how, consistent with EGRRCPA, the Board will no longer subject primarily smaller, less complex banking organizations to certain Board regulations. Statement: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf
8/22/2018	Agencies issue interim final rule regarding the treatment of certain municipal securities as high-quality liquid assets. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/2018-18610.pdf

(continued)

Table 1.—*continued*

Date issued	Rule/guidance
8/28/2018	Federal Reserve issues interim final rule expanding the applicability of the Board's Small Bank Holding Company Policy Statement. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/2018-18756.pdf
9/11/2018	Agencies issue statement reaffirming the role of supervisory guidance. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180911a.htm
9/18/2018	Agencies issue proposed rule regarding the treatment of high-volatility commercial real estate. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180918a1.pdf
9/21/2018	Agencies issue final rule to amend swap margin rule. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180921a.pdf
9/21/2018	Board seeks public comment on proposal to amend Regulation H and Regulation K to reflect the transfer of the Board's rulemaking for the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) to the Consumer Financial Protection Bureau. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180921b.htm
10/3/2018	Federal agencies issue a joint statement on banks and credit unions sharing resources to improve efficiency and effectiveness of Bank Secrecy Act compliance. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181003a.htm
10/30/2018	Agencies propose rule to update calculation of derivative contract exposure amounts under regulatory capital rules. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181030a.htm
10/31/2018	Board invites public comment on framework that would more closely match regulations for large banking organizations with their risk profiles. Proposed prudential standards for large bank holding companies and savings and loan holding companies (83 Fed. Reg. 61,408 (November 29, 2018)). Proposed changes to applicable threshold for regulatory capital and liquidity requirements (83 Fed. Reg. 66,024 (December 21, 2018)). FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181031a.htm
11/2/2018	Board finalizes new supervisory rating system for large financial institutions. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181102a.htm
11/7/2018	Agencies issue proposal to streamline regulatory reporting for qualifying small institutions. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181107a.htm
11/21/2018	Agencies propose community bank leverage ratio for qualifying community banking organizations. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181120a.htm
12/4/2018	Agencies seek public comment on proposal to raise appraisal exemption threshold for residential real estate transactions. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181204a.htm
12/21/2018	Agencies issue final rules expanding examination cycles for qualifying small banks and U.S. branches and agencies of foreign banks. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221c.htm
12/21/2018	Agencies invite comment on a proposal to exclude community banks from the Volcker rule. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221d.htm
1/8/2019	Board invites public comment on proposal that would modify company-run stress testing requirements to conform with EGRRCPA. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190108a.htm
2/5/2019	Board finalizes set of changes that will increase the transparency of its stress testing program for nation's largest and most complex banks. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205a.htm
3/6/2019	Board announces it will limit the use of the "qualitative objection" in its Comprehensive Capital Analysis and Review (CCAR) exercise, effective for the 2019 cycle. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm

(continued)

Table 1.—*continued*

Date issued	Rule/guidance
3/15/2019	Agencies adopt interim final rule to amend the swap margin rule to facilitate transfers of legacy swaps. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190315a.htm
3/28/2019	Board releases document providing additional information on its stress testing program. FR press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190328a.htm
4/2/2019	Agencies propose rule to require large banking firms to deduct from regulatory capital investments in long-term debt instruments issued by systemically important banks. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190402a1.pdf
4/8/2019	Board invites public comment on changes to the regulatory framework that would more closely match rules for foreign banks with the risks they pose to U.S. financial system. Prudential Standards for Large Foreign Banking Organizations; Revisions to Proposed Prudential Standards for Large Domestic Bank Holding Companies and Savings and Loan Holding Companies. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/foreign-bank-fr-notice-1-20190408.pdf Proposed changes to applicability thresholds for regulatory capital requirements for certain U.S. subsidiaries of foreign banking organizations and application of liquidity requirements to foreign banking organizations, certain U.S. depository institution holding companies, and certain depository institution subsidiaries. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/files/foreign-bank-fr-notice-2-20190408.pdf
4/16/2019	Agencies invite comment on modifications to resolution plan requirements; proposal keeps existing requirements for largest firms and reduces requirements for firms with less risk. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190416a.htm
4/18/2019	Agencies seek comment on revisions to the supplementary leverage ratio as required by the Economic Growth, Regulatory Relief, and Consumer Protection Act. FR notice: https://www.federalregister.gov/documents/2019/04/30/2019-08448/regulatory-capital-rule-revisions-tothe-supplementary-leverage-ratio-to-exclude-certain-central
4/23/2019	Federal Reserve Board invites public comment on proposal to simplify and increase the transparency of rules for determining control of a banking organization. FR notice: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190423a.htm

Box 2. The Economic Growth, Regulatory Relief, and Consumer Protection Act: Reducing Regulatory Burden

The Economic Growth, Regulatory Relief, and Consumer Protection Act, or EGRRCPA, enacted on May 24, 2018, changed several aspects of banking law to reduce regulatory burden on community banks. EGRRCPA also requires federal banking agencies to further tailor their regulations to reflect the character of the different banking firms that the agencies supervise. Successful implementation of EGRRCPA is an important milestone in the Federal Reserve's ongoing efforts to supervise and regulate the financial industry.

For G-SIBs, which are largely not affected by EGRRCPA, standards remain higher than for smaller firms. For holding companies with more than $250 billion in assets, but below the G-SIB threshold, the Federal Reserve aims to ensure that its regulations are appropriately rigorous given a firm's risk profile and systemic importance.

For firms with total assets greater than $100 billion that are not G-SIBs, the Federal Reserve is revisiting requirements mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and, where appropriate, eliminating or adjusting certain requirements, particularly for firms below $250 billion in total assets. The Federal Reserve has provided relief to less complex firms from supervisory stress testing requirements and the Comprehensive Capital Analysis and Review (CCAR) by effectively moving these firms to an extended stress test cycle for 2019.[1] There are no longer annual supervisory stress testing requirements for firms under $100 billion. Additionally, the Federal Reserve increased from $10 billion to $50 billion the asset threshold requiring a firm to meet risk-committee requirements. Furthermore, banking organizations with less than $10 billion in consolidated total assets, where total trading assets and liabilities are 5 percent or less of total consolidated assets, are no longer subject to the Volcker rule.[2]

For FBOs, the Federal Reserve recently issued a proposal on the regulatory framework for foreign banks with $100 billion or more in U.S. assets. The proposed regulatory framework would more closely match the rules for foreign banks with the risks they pose to the U.S. financial system. Under the proposed framework, FBOs would be sorted into categories of increasingly stringent requirements based on several factors, including asset size, cross-jurisdictional activity, reliance on short-term wholesale funding, nonbank assets, and off-balance-sheet exposure. The proposed framework for FBOs is substantially the same as the framework proposed last year by the Board for large domestic banks, with some adjustments reflecting structural differences in foreign banks' U.S. operations.

For qualifying community banking organizations,[3] the Federal Reserve and the other federal banking agencies issued a proposal to simplify regulatory capital requirements for these organizations by giving them an option to calculate a simple leverage ratio, rather than multiple measures of capital adequacy.[4]

In December 2018, the Federal Reserve, jointly with the FDIC and the Office of the Comptroller of the Currency (OCC), issued final rules expanding the number of insured depository institutions and U.S. branches and agencies of foreign banks eligible for an 18-month on-site examination cycle, rather than a 12-month cycle.[5] Further, in Decem-

continued on next page

Box 2. The Economic Growth, Regulatory Relief, and Consumer Protection Act: Reducing Regulatory Burden—*continued*

ber 2018, the agencies issued a proposal to amend their appraisal regulations that would raise the appraisal threshold for residential real estate transactions from $250,000 to $400,000.[6]

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1 Refer to the *Comprehensive Capital Analysis and Review 2019 and Summary Instructions* (March 2019) at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190306b2.pdf.

2 As background, the Volcker rule generally restricts banking entities from engaging in proprietary trading and from owning, or sponsoring, hedge funds or private equity funds.

3 Under the proposal, a qualifying CBO would have less than $10 billion in total consolidated assets as of the end of the most recent calendar quarter and have total off-balance-sheet exposures of 25 percent or less of its total consolidated assets as of the end of the most recent calendar quarter.

4 See 84 Fed. Reg. 3062 (February 8, 2019).

5 See 83 Fed. Reg. 67,033 (December 28, 2018).

6 See 83 Fed. Reg. 63,110 (December 7, 2018).

Supervisory Developments

This section provides an overview of how the Federal Reserve tailors its supervision of large financial institutions and regional and community banking organizations. The November 2018 *Supervision and Regulation Report* included information on supervisory ratings and outstanding supervisory findings. There have not been significant changes to this information since last November. As appropriate, updated charts will be shared in future reports.[2]

This report focuses on the Federal Reserve's prudential supervisory responsibilities. The Federal Reserve is also responsible for timely and effective supervision of consumer protection and community reinvestment laws and regulations. This consumer-focused supervisory work is designed to promote a fair and transparent financial services marketplace and to ensure that the financial institutions under the Federal Reserve's jurisdiction comply with applicable federal consumer protection laws and regulations. The scope of the Federal Reserve's supervisory jurisdiction varies based on the particular law or regulation and on the size of the state member bank.

More information about the Federal Reserve's consumer-focused supervisory program can be found in the Federal Reserve's *104th Annual Report 2017*.[3] The Federal Reserve also publishes the *Consumer Compliance Supervision Bulletin*, which shares information about examiners' supervisory observations and other noteworthy developments related to consumer protection.[4]

The Federal Reserve takes a risk-focused approach by scaling its supervisory work to the size and complexity of the institution.

In supervising financial institutions, a risk-focused approach to supervision is more efficient and results in more rigorous oversight of firms that pose increased risk to the financial system.

The supervision of the largest, most systemically important financial institutions is conducted by the LISCC program—a national program that uses both horizontal and firm-specific supervisory activities to assess the financial resiliency and risk-management practices of firms. By contrast, the supervision of institutions in the LFBO portfolio includes some horizontal elements, but firm-specific teams at the local Reserve Bank conduct most of the supervisory work, subject to oversight by the Board.

For RBOs and CBOs, the supervision model is more decentralized with greater decisionmaking flexibility provided to Reserve Banks; again, subject to oversight by Board staff.

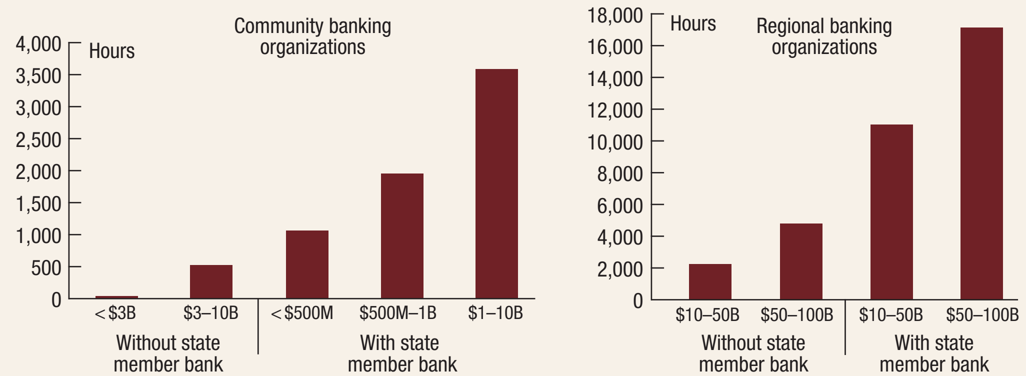
As shown in figures 8 and 9, in 2018, the Federal Reserve, on average, spent the least amount of time supervising the holding companies of community banks whose primary federal regulator was either the OCC or FDIC (CBOs without SMBs). For firms with total assets of less

2 See the *Supervision and Regulation Report*, November 2018, at https://www.federalreserve.gov/publications/files/201811-supervision-and-regulation-report.pdf.

3 See the *104th Annual Report 2017*, section 5, "Consumer and Community Affairs," at https://www.federalreserve.gov/publications/annual-report.htm.

4 See the *Consumer Compliance Supervision Bulletin* at https://www.federalreserve.gov/publications/consumer-compliance-supervision-bulletin.htm.

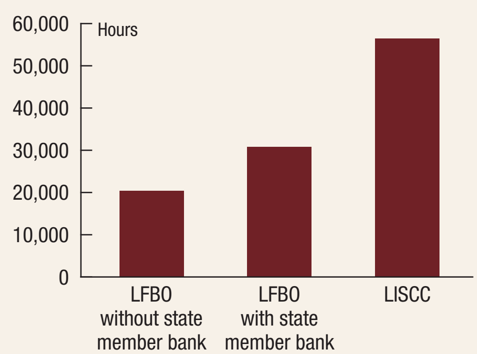
Figure 8. Annual average supervision hours per institution



Note: Data are for 2018.

Source: Federal Reserve.

Figure 9. Annual average supervision hours per institution, larger domestic and foreign banking organizations



Note: Data are for 2018.

Source: Federal Reserve.

than $3 billion, average supervisory time was approximately 40 hours per firm. For firms with total assets between $3 billion and $10 billion, the average supervisory time was 500 hours per firm. For community banks where the Federal Reserve is the primary federal regulator (CBOs with SMBs), Federal Reserve staff cannot leverage work done by other federal agencies. Therefore, more time is spent supervising these firms—on average between 1,000 and 3,500 hours per firm. For the larger and more complex firms in the RBO and LFBO portfolios, supervisors spent, on average, 17,000 and 30,000 hours per firm, respectively.

LISCC firms, which are considered systemically important, are subject to the most rigorous supervision with the most supervisory resources per firm—over 55,000 hours on average. For these institutions, Federal Reserve staff engage firm management on a more regular basis and conduct more examinations, including more horizontal examinations. Because of these firms' structures and activities, and the risks they could pose to the financial system, the supervisory program for larger institutions includes rigorous expectations for internal stress testing practices, quality of modeling, and other risk-management practices (figure 9).

Large Financial Institutions

This section discusses the supervisory program for LISCC and LFBO firms and tailoring by the Federal Reserve of its supervisory activities in the areas of capital, liquidity, governance and controls, and resolution planning.

The supervision framework for large financial institutions has two primary objectives: to enhance the resiliency of the firms while simultaneously reducing the impact to the economy in the event of failure.

In supervising large financial institutions, the Federal Reserve focuses on

- enhancing the resiliency of a firm to lower the probability of its failure through monitoring capital, liquidity, and governance and controls; and
- reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness through resolution plan reviews.

The Federal Reserve accomplishes this through regular communication with the firms using targeted examinations, horizontal examinations, and continuous monitoring.

Enhancing Resiliency

Capital

Capital levels at large financial institutions are strong. These firms have experienced a more significant increase in capital ratios as compared with other portfolios. For example, the common equity tier 1 risk-based capital ratio has increased most significantly for LISCC firms and LBOs since the financial crisis (see figure 6).

To develop an understanding of firms' capital adequacy, the Federal Reserve evaluates

- a firm's planning processes used to determine the amount of capital necessary to cover risks and exposures and to support activities through a range of conditions and events; and
- capital position, which is the firm's ability to comply with applicable regulatory requirements and to support the firm's ability to continue to serve as a financial intermediary through a range of conditions.

Supervisory Stress Testing

The Federal Reserve conducts annual supervisory stress tests through two complementary, but distinct, programs: (1) the Dodd-Frank Act stress tests (DFAST); and (2) the quantitative assessment portion of CCAR. Together, DFAST's and CCAR's quantitative assessments help ensure that firms with total assets of $100 billion or more maintain sufficient capital to continue operations and lending to households and businesses during times of stress.

As noted in the prior section on Regulatory Developments, in February 2019, the Federal Reserve announced that it would provide relief to the less complex firms subject to the supervisory stress tests—generally those with total assets between $100 billion and $250 billion—by effectively moving them to an extended stress testing cycle for this year. As a result, those firms are not subject to supervisory stress tests during the 2019 cycle. These firms are still expected to maintain capital plans, which should include the results of a firm's internal stressed analysis. These firms' capital planning activities are assessed in the Horizontal Capital Review (HCR).

Capital Planning

The largest firms' capital planning processes are assessed annually through the Federal Reserve's CCAR exercise. In CCAR, the Federal Reserve conducts a quantitative assessment

Box 3. Types of Examinations

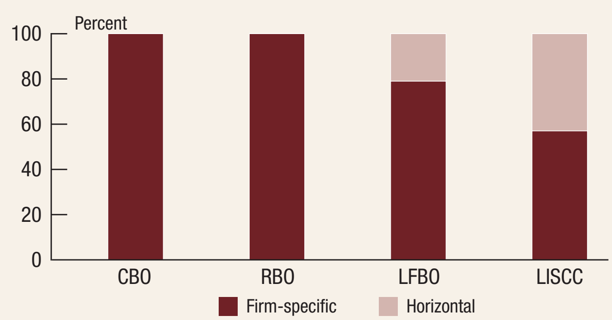
Both LISCC and LFBO firms are subject to continuous supervision, where supervisors engage with a firm on a regular basis through both examinations and ongoing monitoring. By contrast, CBO firms are subject to point-in-time examinations every 12–to–18 months, depending on their asset size and financial condition, and RBO firms are subject to a limited number of targeted reviews and off-site monitoring conducted throughout the examination cycle.

Supervisory activities for larger firms include horizontal examinations, firm-specific examinations, and continuous monitoring. Large firms are generally the subject of multiple horizontal and firm-specific examinations throughout the year. For these firms, supervisors choose areas to focus their examinations each year through an analysis of emerging risks or areas where firms seem to be exhibiting weaknesses, may not be in compliance with regulatory requirements, or have elevated underlying risks.

These supervisory activities are in addition to foundational supervisory activities in the area of firms' risk management and financial resilience.

As shown in figure A, in 2018, nearly half of the examinations conducted on LISCC firms were horizontal examinations. LFBO firms have some horizontal examinations, but over three-quarters of their examinations are on firm-specific activities. The Federal Reserve did not conduct any on-site horizontal examinations of RBOs and CBOs.

Figure A. Exam type by supervisory portfolio



Source: Federal Reserve.

Firm-specific examinations: These examinations are conducted at an individual firm and are designed to take into account the firm's particular activities and risks, as well as any outstanding supervisory issues.

Horizontal examinations: In order to assess firms on a consistent basis, both LISCC and LFBO supervisors will examine a number of firms at the same time. Supervisors frequently use horizontal examinations on a single topic across several firms to identify risks and common trends. Horizontal reviews also provide a clear picture of the relative risk in an individual firm and allow supervisors to align supervisory expectations with

continued on next page

Box 3. Types of Examinations—*continued*

the firm's risk profile. Horizontal reviews may be conducted by a centralized team of examiners or through a common scope or work program executed by the dedicated supervisory teams.

One example of a horizontal exam is the interagency Shared National Credit (SNC) program, a semiannual review of large syndicated commercial loans. This program assesses credit risk trends as well as risk-management practices associated with the largest and most complex loans. In particular, the exam focuses on loans that are highly leveraged, covenant-lite, and/or have other potential credit and structural weakness embedded in them. The examination is conducted primarily at LISCC banking organizations and LFBOs, and the results are communicated to all regulated lenders that hold a share of the reviewed loans.

Continuous monitoring: In continuous monitoring, supervisors engage with a firm on a regular basis through informal monitoring of financial positions and risk management. Supervisors are in regular contact with the firm's staff and senior management in order to identify emerging risks and operational changes on a timely basis, as well as monitor remediation progress.

Coordination with other regulators: In addition to its own supervisory work, consistent with long-standing practice and as mandated by law, the Federal Reserve leverages the work of other regulators (such as the OCC and FDIC) to ensure efficient use of supervisory resources and to avoid unnecessary supervisory burden.

of firms' capital adequacy, as noted above, as well as an intensive qualitative assessment of the strength of each firm's internal capital planning processes through an in-depth analysis of its annual capital plan.

CCAR's qualitative assessment includes an evaluation of the extent to which the analysis underlying each firm's capital plan comprehensively captures and addresses potential risks stemming from companywide activities as well as the reasonableness and robustness of each capital plan. CCAR's qualitative assessment applies to LISCC firms and other large firms with total assets exceeding $250 billion. These firms are also subject to supervisory stress testing and other capital-related horizontal and firm-specific examinations conducted throughout the year.

In 2017, LFBO firms with total assets of $250 billion or less were removed from CCAR's qualitative assessment because they generally have a lower systemic risk profile compared to the largest and most complex firms. This change reduced supervisory burden for these LFBO firms. Instead, these firms are subject to the HCR. As compared to CCAR's assessment of capital planning practices, HCR is more limited in scope, includes targeted horizontal evaluations of specific areas of capital planning, and focuses on the more tailored standards set forth in supervisory guidance specific to these firms.

Because of the improvements in capital planning made by the largest firms, the Federal Reserve announced in March of this year that it is limiting the use of the "qualitative objection" in its CCAR exercise, effective for the 2019 cycle. These changes eliminate the qualitative objection for most firms.

The focus of CCAR in 2019 is on governance of capital planning, model sensitivity analysis, and use of model overlays. For firms with significant trading exposures, CCAR is focusing on the identification and capture of trading risks in the capital planning process. Outside of CCAR, the LISCC firms are subject to horizontal examinations that assess their capital policies, risk appetites, and limit setting; wholesale credit underwriting standards; and nonbank financial institution risk exposures. The focus of the HCR in 2019 is on loss estimation methodologies and governance for residential mortgage and commercial real estate portfolios, as well as governance of the capital planning process.

Liquidity

Similar to the supervision of firms' capital, supervisors hold large firms to the highest regulatory liquidity requirements (such as the liquidity coverage ratio (LCR) and liquidity stress testing requirements) and supervisory expectations. As a result, domestic LISCC firms and LBOs have greatly increased their liquidity positions since the financial crisis and currently hold substantial amounts of high-quality liquid assets (figure 10).

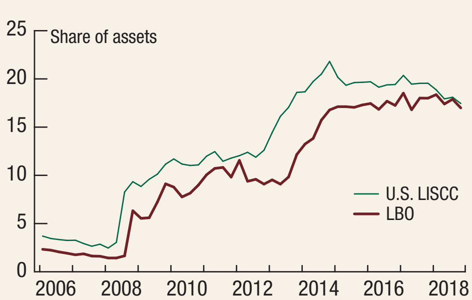
To develop an understanding of large firms' liquidity, the Federal Reserve evaluates

- liquidity risk management, which is a firm's governance and risk-management processes used to determine the amount of liquidity necessary to cover and limit risks and exposures and to support activities through a range of conditions; and
- liquidity position, which is the sufficiency of a firm's liquidity buffer and funding profile to comply with applicable regulatory requirements and to support the firm's ongoing obligations through a range of conditions.

The Federal Reserve conducts various horizontal reviews to evaluate the adequacy of liquidity positions and the effectiveness of liquidity risk-management practices and liquidity stress testing on the largest financial institutions. Additionally, the Federal Reserve conducts focused analysis on institutions' liquidity positions using data derived from regulatory reports to supplement the horizontal reviews. These reviews are tailored to account for differences in the size, complexity, and risk profile between firms in the LISCC and LFBO portfolios.

The LISCC liquidity program assesses the adequacy of LISCC firms' liquidity position and liquidity risk-management practices through both horizontal and firm-specific examinations, in-depth reviews, and analyses conducted throughout the year. The Comprehensive Liquidity Analysis and Review (CLAR) is the horizontal component of this program. CLAR and the firm-specific liquidity assessments are conducted on a forward-looking basis, analyzing the firms' liquidity risk-management practices and resiliency under normal and stressed conditions. Since CLAR only targets a select population of liquidity risk topics in a given year, firm-specific events help ensure that the Federal Reserve evaluates and considers the most critical inherent risk and risk-management areas in the assessment of a firm.

Figure 10. HQLA by portfolio



Note: High-quality liquid assets (HQLA) are estimated by adding excess reserves to an estimate of securities that qualify for HQLA. Data only include firms that were designated as LBO or LISCC as of 2018:Q4. Data do not include SLHCs.

Source: FR Y-9C, FR 2900, Federal Reserve accounting system.

In the LFBO portfolio, an annual Horizontal Liquidity Review (HLR) is conducted for all firms with total assets in excess of $100 billion that are not in the LISCC portfolio. Similar to CLAR, assessments of liquidity risk management and liquidity positions for the LFBO portfolio are forward looking, analyzing a firm's liquidity under normal and stressed conditions. The scope of the HLR review is adjusted to factor in a firm's size and complexity, and expectations are tailored given the lower systemic risk posed by these institutions. Similar to CLAR, HLR targets a select number of liquidity risk topics in a given year.

In 2019, LISCC liquidity supervision is focusing on the adequacy of a firm's cash-flow forecasting capabilities, practices for establishing liquidity risk limits, and measurement of intraday liquidity risk. Topics for evaluation in the 2019 HLR included an assessment of an LFBO's liquidity buffer and contingency funding plans. In addition, a review of liquidity stress testing practices at branches of foreign banks in the LFBO portfolio was conducted to ensure consistency with supervisory expectations.

Governance and Controls (G&C)

To develop an understanding of governance and controls, the Federal Reserve evaluates the effectiveness of a firm's board of directors, and management of business lines and independent risk management and controls.

The LISCC G&C program uses horizontal and firm-specific examinations to assess the strength of firms' governance, risk management, and internal controls. This includes compliance risk management, operational risk management, operational and cyber resilience, model risk management, internal audit, and other nonfinancial areas. Financial risk management practices are examined under the capital and liquidity programs. There are also firm-specific exams depending on a firm's risk profile and outstanding supervisory issues.

In contrast to the LISCC G&C program, given the diverse nature of the LFBO firms, much of the G&C-related supervisory work in this portfolio is firm-specific, based on the size and complexity of the firm and firm-specific risks. Given the significance of the risk, the LFBO portfolio assesses cyber resilience on a horizontal basis. A limited number of coordinated reviews have been conducted including ones assessing Bank Secrecy Act and anti-money-laundering (BSA/AML) and Office of Foreign Asset Control (OFAC) compliance, model risk management, and vendor management.

In 2019, several horizontal examinations and firm-specific examinations are being con-

Box 4. LISCC Supervisory Horizontal Priorities

Capital

- Governance of capital planning
- Model sensitivity analysis and use of model overlays
- Capital policy, risk appetite, and limit setting
- Wholesale credit underwriting standards
- Nonbank financial institution risk exposure

Liquidity

- Cash flow forecasting capabilities
- Liquidity risk limits
- Intraday liquidity risk

Governance and Controls

- Operational and cyber resilience
- Management of business lines
- Compliance risk management
- Board effectiveness

Recovery and Resolution Planning

- Resolution capital and liquidity
- Operational capabilities and governance
- Comprehensive recovery plan framework

Box 5. LFBO Supervisory Horizontal Priorities

Capital

- Loss-estimation methodologies and governance for residential mortgage and commercial real estate portfolios
- Governance of the capital planning process

Liquidity

- Liquidity buffer
- Contingency funding plans

Governance and Controls

- Operational and cyber resilience
- Risk reporting
- Use of artificial intelligence for fraud and BSA/AML detection
- Compliance metrics

Recovery and Resolution Planning

- Resolution plan reviews

ducted on LISCC firms to assess G&C. Topics include operational and cyber resiliency, management of business lines, compliance risk management, and board effectiveness. In the LFBO portfolio, in addition to firm-specific reviews and the cyber-resiliency horizontal, coordinated reviews are planned in the areas of compliance metrics, risk reporting, and the use of artificial intelligence for fraud and BSA/AML detection.

Reducing the Impact of a Firm's Failure: Recovery and Resolution Preparedness Planning

The Federal Reserve's recovery and resolution preparedness (RRP) program for LISCC firms is conducted through horizontal and firm-specific supervisory assessments of recovery and resolution preparedness and capabilities. This includes the Federal Reserve's annual horizontal supervisory program for evaluating recovery and resolution plans of LISCC firms. With regards to Title I Resolution Plan reviews,[5] the program works closely with the FDIC and produces joint work products. The review culminates in determinations by the Board and the FDIC regarding LISCC firms' resolution plans. Additionally, the LISCC program reviews recovery plans, which culminates in assessments that are included as inputs into supervisory messages to the firms.

The LISCC RRP program consists of dedicated staff specializing in various areas. The 2019 LISCC RRP reviews target areas of high risk to recovery and resolution plan execution and other capabilities not previously reviewed. Review of the 2019 resolution plans includes areas such as resolution capital and liquidity; legal entity rationalization and separability; payments, clearing and settlement activities; derivatives and trading activities; and governance. In addition, the Federal Reserve is conducting a full review of firms' 2019 recovery plans.

For LFBO firms, the Federal Reserve and FDIC conduct joint point-in-time reviews of Title I resolution plan submissions, which are comprehensive but more tailored than the reviews of the LISCC firms' plans. There are no separate supervisory activities to assess resolution capabilities apart from the Title 1 plan reviews. In addition, LFBO firms are not required to submit recovery plans, and there is no distinct review of these firms' recovery strategy due to the firms' simpler, less complex structures and activities.

[5] These are reviews of resolution plans mandated under section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 USC 5365(d)).

Regional and Community Banking Organizations

The Federal Reserve tailors its regional and community bank supervisory programs in a way that avoids imposing excessive burden.

While weaknesses at small banks are less likely to cause systemic problems, by their nature—and relative lack of geographic and portfolio diversification—many regional and community banking organizations are vulnerable to localized economic problems. Accordingly, the Federal Reserve supervises and regulates smaller banks with a tailored approach based on a variety of factors, including size, condition, risk profile, and organizational structure.

Supervision of CBO SMBs is carried out generally through a single, point-in-time examination and is supplemented by off-site surveillance using quarterly financial data that are submitted by banks via the Consolidated Report of Condition and Income (Call Report). The Federal Reserve's CBO SMB examinations are conducted in accordance with statutory mandates (generally one examination per every supervisory cycle—12 or 18 months). In 2018, the Federal Reserve conducted 259 examinations independently or jointly with another supervisor at CBO SMBs.

Supervision of regional banks consists of a limited number of targeted reviews and off-site monitoring conducted throughout an examination cycle, which is slightly more intensive than the singular point-in-time examination conducted at community banks. In contrast to the Federal Reserve's supervisory program for larger institutions, large-scale, centrally coordinated on-site horizontal reviews are rarely used for the supervision of RBOs. In 2019, one review with common work programs on credit-underwriting practices is scheduled for RBO SMBs. This review will be conducted off-site and is designed specifically to inform the RBO risk-assessment and scoping process for future credit examinations.

CBO and RBO examinations are executed by local Reserve Bank staff. Further, the Federal Reserve works very closely and coordinates with state banking departments for the supervision of SMBs. One example is the protocol that allows for alternating the lead between the Federal Reserve and the responsible state banking department on SMB examinations, generating efficiencies in the supervisory programs.

Within the CBO and RBO portfolios, supervision is tailored based on organizational structure. For example, the supervisory processes for SMBs and holding companies vary significantly. In its assessments of noncomplex holding companies where the depository institution is not a state member bank, the Federal Reserve relies on, and coordinates with, to the fullest extent possible, the insured depository institution's primary regulator's assessment of capital, liquidity, and management function at the depository subsidiary.[6] The Federal Reserve will also conduct a limited review of the financial condition of a holding company and any nonbank subsidiaries that are not owned by the depository subsidiary. This review assesses the likelihood of a potential negative impact on the depository institution from the holding com-

[6] In June 2018, the Federal Reserve's Office of Inspector General (OIG) issued a report that concluded that "[i]n accordance with applicable guidance related to consolidated supervision, we determined that the Federal Reserve Banks relied on the primary federal regulator of regional banking organizations' (RBOs) insured depository institutions to supervise the RBOs we sampled." See Evaluation Report 2018-SR-B-010, June 20, 2018, on the OIG website at https://oig.federalreserve.gov/reports/board-consolidated-supervision-jun2018.htm.

pany or its nonbank activities, as well as the holding company's ability to act as a source of strength to the depository subsidiary.

In cases where the control functions are centrally managed at the holding company level, examiners conduct coordinated reviews with the primary federal regulators of these control functions. The Federal Reserve has developed and regularly updates programs to efficiently and accurately assess holding companies while minimizing burden on the institution. This has included the development and implementation of standardized examination programs, tools, and report templates for smaller, noncomplex holding companies. The Federal Reserve also implemented an abbreviated ratings framework for noncomplex holding companies with less than $3 billion in total consolidated assets.

The Federal Reserve continues to take steps to address concerns about regulatory burden on community banks.

As a result of recent legislative changes, the Federal Reserve has extended the examination cycle for eligible banks with between $1 billion and $3 billion in assets from every 12 months to every 18 months (placing these banks on the same cycle as banks below $1 billion). The Federal Reserve has also exempted noncomplex holding companies with between $1 billion and $3 billion in assets from holding company capital and reporting requirements (holding companies below $1 billion were already exempted from these requirements). These changes reduced exam frequency and reporting requirements for roughly 100 SMBs (12 percent of the SMB population), bringing the total number of SMBs supervised on the longer cycle and with lower reporting requirements to roughly 725 (91 percent of the SMB population). Similarly, these changes reduced examination frequency and reporting requirements for roughly 360 holding companies (8 percent of the holding company population), bringing the total number of holding companies exempted from holding company capital and reporting requirements to more than 3,700 holding companies (87 percent of the holding company population).

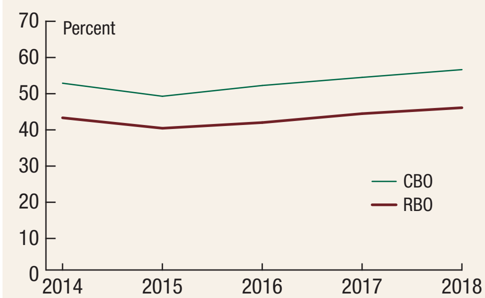
With respect to regulatory reporting, financial regulators finalized a new and streamlined Call Report for small financial institutions (FFIEC 051), which became effective for March 31, 2017, reporting. The streamlined Call Report has approximately 40 percent fewer data items. Additional changes effective June 30, 2018, further streamlined the report by combining data items, increasing reporting thresholds, or reducing the reporting frequency of data items affecting an additional 10 percent of the report.

Additionally, a notice of proposed rulemaking for the community bank leverage ratio was issued (discussed previously in the Regulatory Developments section), which would allow electing community banks to opt-in to a simpler regulatory capital framework.

To ease the burden associated with examinations, the Federal Reserve is conducting more supervisory activities off-site and simplifying pre-examination requests for documentation. The Federal Reserve recognizes there are differences in risk among community banks and has further tailored the supervision of these banks. The Federal Reserve continues to follow a risk-focused approach that aims to deploy examination resources to higher-risk banks. This risk-focused approach contributes to reduced regulatory burden, allowing banks more time and resources to serve the credit needs of their local community (figure 11).

The Federal Reserve uses the metrics-based Bank Exams Tailored to Risk (BETR) program in its implementation of a risk-focused supervisory program.[7] The BETR program relies upon regulatory reporting (largely quarterly Call Report) data and examiner judgement to appropriately classify institutions into low, moderate, and high risk. This allows Reserve Bank staff to direct their resources effectively to areas of heightened risk and to minimize excessive burden on low- and moderate-risk institutions. The Federal Reserve has developed exam procedures that are tailored to the BETR risk classification. The median time estimated to review low-risk SMBs is roughly one-half to two-thirds of the estimated time required to review high-risk SMBs. The median resources devoted to reviewing instances of low credit risk is less than half the estimated time to review instances of high credit risk (figure 12).

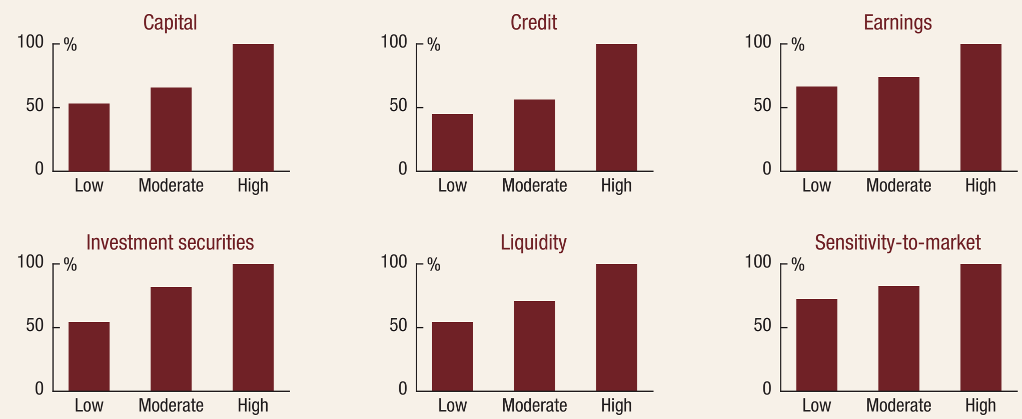
Figure 11. Percent of time spent off-site



Note: Data exclude small shell holding companies with assets of less than $1 billion.

Source: Federal Reserve.

Figure 12. Median exam hours by risk metric, indexed to high-risk tiers



Exam hours (high tier = 100%)

Note: Includes Federal Reserve exams closed in 2018.

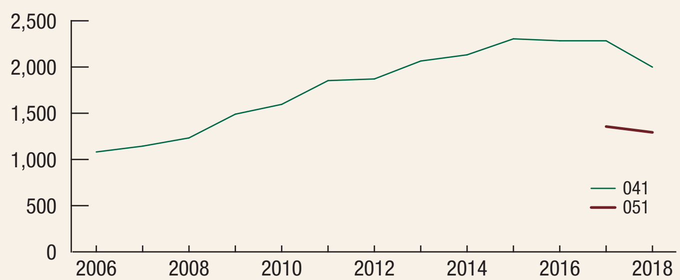
Source: Federal Reserve.

[7] For further details on BETR, see the discussion in Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (Washington: Board of Governors, November 2018), https://www.federalreserve.gov/publications/files/201811-supervision-and-regulation-report.pdf.

Box 6. Reduction in Reporting

The Call Report is a key source of information used in monitoring the condition, performance, and risk profile of individual banks and the banking industry as a whole. The Call Report form that a bank is required to fill out is determined by the asset size and location of the bank's offices. Over the decades, the quarterly Call Report (FFIEC 041) has tended to expand, responding to major regulatory rule changes, as well as evolving supervisory needs. This expansion was particularly large following the financial crisis (figure A).

Figure A. Number of items per Call Report form



Note: Values based on third-quarter Call Report forms.

Source: FFIEC.

In 2017, a new Call Report form (FFIEC 051) was implemented for banks with assets less than $1 billion, containing significantly fewer items than the alternate form. This streamlined Call Report resulted in 24 fewer pages and reduced data items required to be reported by small banks by 40 percent. In many cases, the removed items had historically not been applicable to small banks.

In late 2018, the federal banking agencies proposed additional burden reductions related to the Call Report form (FFIEC 051), including an increase in the asset threshold for qualifying banks to use the FFIEC 051 from less than $1 billion to less than $5 billion. The agencies also proposed to reduce by 37 percent the number of existing data items reportable in the FFIEC 051 Call Reports for all eligible filers for the first- and third-quarterly filings. These proposed revisions would expand eligibility for reporting reductions to over 95 percent of all banks.

Further, the Federal Reserve implemented changes to the holding company regulatory report series collecting consolidated and parent-company-only financial statements. Effective September 2018, the Board increased the reporting asset threshold for holding companies from $1 billion to $3 billion. As a result of this change, nearly 55 percent of holding companies filing quarterly consolidated and parent-company-only forms are eligible to file a substantially shorter parent-company-only form semiannually.

The Federal Reserve continues to actively consider, where appropriate, further reductions in regulatory reporting for smaller and less complex financial institutions.

In its efforts to minimize burden, the Federal Reserve relies upon standardized regulatory reports and the results from internal control functions within the supervised institutions in assessing their condition.

In its review of community and regional SMBs, the Federal Reserve relies heavily on data collected from standardized regulatory reporting and the results and materials produced by internal control functions (e.g., internal audit and loan review) in its assessment of the financial condition and management of the supervised institution. When assessing the adequacy of an institution's management and risk-management functions at community and regional SMBs, the Federal Reserve focuses on major control functions of the bank, allowing examiners the ability, when warranted, to reduce the intensity of their review and rely on an institution's internal independent testing.

For ongoing surveillance, the Federal Reserve relies almost exclusively on data reported in the Call Report to assess the financial condition at community SMBs. The Federal Reserve may request additional materials for institutions that are in less-than-satisfactory condition to ensure that the institution is addressing any areas of concern.

For regional SMBs, the Federal Reserve supplements its reliance on Call Report data with additional information gathered during its continuous monitoring processes. The Federal Reserve only requires supplemental regulatory reporting for higher-risk institutions or institutions that are engaged in certain activities, hold certain investments, or have operations in foreign countries.

Box 7. RBO Supervisory Priorities

Credit Risk

- Concentrations of credit
  —Commercial real estate & Construction and land development
- Underwriting practices

Operational Risk

- Merger and acquisition risks
- Internal audit
- Information technology & cybersecurity

Other

- Bank Secrecy Act/Anti-money laundering

Box 8. CBO Supervisory Priorities

Credit Risk

- Concentrations of credit
  —Commercial real estate & Construction and land development
  —Agriculture

Operational Risk

- Information technology & cybersecurity

Other

- Bank Secrecy Act/Anti-money laundering
- Liquidity risk

Appendix A: Data

Definition of Data Sources

The *Supervision and Regulation Report* consists of data from institutions supervised in whole, or in part, by the Federal Reserve System. This appendix details these sources. All financial and table data presented in this report are as of December 31, 2018, unless specified otherwise.

FFIEC Call Reports

The FFIEC Consolidated Reports of Condition and Income, also known as the Call Report, is a periodic report that is required to be completed by every national bank, state member bank, insured nonmember bank, and savings association as of the last day of each calendar quarter. The details required to be reported depend on the size of the institution, the nature of the institution's activities, and whether or not it has foreign offices. Call Report data are a widely used source of timely and accurate financial data regarding a bank's financial condition and the results of its operations. The data collected from the Call Report are used to monitor the condition, performance, and risk profiles of the institutions as individuals and as an industry.

FR Y-9C

The Consolidated Financial Statement for Holding Companies, also known as the FR Y-9C report, collects basic financial data from domestic BHCs, SLHCs, U.S. IHCs, and securities holding companies (SHCs). Respondent burden reduction initiatives led to the asset-sized threshold change from $500 million to $1 billion, and from $1 billion to $3 billion effective March 2015 and September 2018, respectively. In addition, BHCs, SLHCs, IHCs, and SHCs meeting certain criteria may be required to file this report, regardless of size. However, when such BHCs, SLHCs, IHCs, or SHCs own or control, or are owned or controlled by, other BHCs, SLHCs, IHCs, or SHCs, only top-tier holding companies must file this report for the consolidated holding company organization. The information contained in the report is as of the last day of each calendar quarter.

Notes on Specific Data

Top Holder

All data, unless otherwise noted, use top-holder data. This population comprises top-tier Call Report filers and top-tier Y-9C filers. In instances where a top-tier HC does not file the Y-9C, financial data of subsidiary banks or savings associations arecombined to approximate the consolidated financial data of the holding company.

Savings and Loan Holding Companies (SLHCs)

Supervisory and regulatory responsibilities for SLHCs were transferred to the Federal Reserve in 2011. Most SLHCs migrated to the Federal Reserve's standardized report forms for holding companies in 2012, with the exception of certain SLHCs engaged primarily in insurance and commercial activities, which continued to submit a tailored report form. In this report, SLHCs that are depository in nature are included in the portfolio that corresponds with their relative size, while SLHCs that are primarily engaged in insurance and commercial activities are considered their own portfolio. Unless otherwise noted, the data presented exclude insurance and commercial SLHCs.

Net Interest Margin (NIM)

Net interest margin comprises annualized total interest income, less total interest expense, divided by average earning assets.

Consumer Loans

Consumer loans include credit cards, other revolving credit lines, automobile loans, and other consumer loans (includes single-payment and installment loans other than automobile loans, and all student loans).

Nonperforming Loans

Nonperforming loans, or problem loans, are those loans that are 90 days or more past due, plus loans in nonaccrual status.

Common Equity Tier 1

The Federal Reserve's evaluation of a firm's common equity capital was initially measured using a tier 1 common capital ratio but now is evaluated using a common equity tier 1 (CET1) capital ratio, which was introduced into the regulatory capital framework with the implementation of Basel III. From 2006 through 2013, tier 1 common was used to measure common equity capital for all firms. In 2014, both tier 1 common capital (for non-advanced approaches firms) and common equity tier 1 capital (for advanced approaches firms) were used. From 2015 to present, common equity tier 1 capital has been used for all firms.

Common equity tier 1 capital ratio is defined as common equity tier 1 as a percent of risk-weighted assets. Advanced approaches institutions are required to report risk-weighted assets using an internal model-based approach and a standardized approach. The higher value of the two risk-weighted assets calculations is taken, per requirements under the Collins Amendment.

Credit Default Swap (CDS) Spread

The CDS spread represents the annual cost of protection against a company defaulting on a loan or bond. The spread is represented as a percentage of a notional amount and is shown as basis points, so a spread of 100 basis points equates to an annual protection cost of $100,000 (i.e., 1.0 percent of $10 million). Data displayed in figure 7 are five-year CDS spreads based on daily polls of individual broker–dealers worldwide. Note that these broker quotes are typically not transaction prices. Data provided are for LISCC (domestic and foreign) firms only.

Market Leverage

The market leverage ratio—defined as the ratio of the firm's market capitalization to the sum of market capitalization and the book value of liabilities—can be considered a market-based measure of firm capital (expressed in percentage points). Data provided are for LISCC (domestic and foreign) firms only.

Supervision Hours

The average supervision hours are estimated by totaling all direct supervisory time going to institutions within a peer group along with the estimated allocated time for horizontal reviews, application processing, enforcement actions, risk and surveillance, and other general supervisory time, divided by the total number of institutions in the peer group. It does not include time to national program administration, travel time, time off, or support and overhead time. All time is for safety and soundness; it does not include consumer compliance time.

Additionally, in July 2018, the Federal Reserve implemented changes to its supervisory portfolio designations that raised the total asset threshold between large and regional banking organizations from $50 billion to $100 billion. The portfolio designation in figure 8 reflects this threshold change. However, supervision hours that occurred prior to July 2018 would not reflect the changes in supervisory exam plans related to this threshold change.

High-Quality Liquid Assets (HQLA)

HQLA are estimated by adding excess reserves to an estimate of securities that qualify for HQLA. Excess reserves are estimated using balance data from internal Federal Reserve accounting records and reserve balance requirements computed based on confidential fillings of the FR 2900 Report of Transaction Accounts, Other Deposits, and Vault Cash. Securities are estimated from Form FR Y-9C. Haircuts and Level 2 asset limitations are incorporated into the estimate (Level 2 assets can represent only a limited share of the HQLA stock).

Because of data availability constraints, HQLA amounts displayed in figure 10 are not based on 2052a reporting data.

Percent of Time Spent Off-site

The percent of time spent off-site measures the percentage of examination and inspection time that occurs off-site for SMB, BHC, and SLHC safety-and-soundness events. Small shell holding companies, with assets less than $1 billion, are excluded from these data.[8]

Median Exam Hours

The median value of total hours spent on each exam. Data displayed in figure 12 are for routine, full-scope, safety-and-soundness exams conducted independently by the Federal Reserve Banks in 2018 on SMBs under $10 billion in total assets.

[8] For more information regarding off-site examinations, see SR letters 16-8 and 95-13 at https://www.federalreserve.gov/supervisionreg/srletters/srletters.htm.

Appendix B: Abbreviations

AML	anti-money laundering
BETR	Bank Exams Tailored to Risk
BSA	Bank Secrecy Act
C&I	commercial and industrial
CBO	community banking organization
CCAR	Comprehensive Capital Analysis and Review
CDS	credit default swap
CET1	common equity tier 1
CLAR	Comprehensive Liquidity Analysis and Review
CRE	commercial real estate
DFAST	Dodd-Frank Act Stress Test
EGRRCPA	Economic Growth, Regulatory Relief, and Consumer Protection Act
FBO	foreign banking organization
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FR	*Federal Register*
G&C	governance and controls
G-SIB	global systemically important bank
HCR	horizontal capital review
HLR	horizontal liquidity review
HQLA	high-quality liquid asset
IHC	intermediate holding company
LBO	large banking organization
LCR	liquidity coverage ratio
LFBO	large and foreign banking organization
LISCC	Large Institution Supervision Coordinating Committee
NIM	net interest margin
OCC	Office of the Comptroller of the Currency
OIG	Office of the Inspector General
RBO	regional banking organization
ROAA	return on average assets
ROE	return on equity
RRP	recovery and resolution preparedness
SLHC	savings and loan holding company

SMB	state member bank
SNC	Shared National Credit
SR	supervision and regulation

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