FINANCIAL SECTOR ASSESSMENT PROGRAM

UNITED STATES OF AMERICA

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (BCP)

REPORT ON STANDARDS AND CODES (ROSC)

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GLOSSARY

BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
CAMELS	Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CHIPS	Clearing House Interbank Payments System
CP	Core Principle
CRE	Commercial Real Estate
DAR	Detailed Assessment Report
FASB	Financial Accounting Standards Board
FATF	Financial Action Task Force
FBA	Federal Banking Agencies
FDIC	Federal Deposit Insurance Corporation
FDI Act	Federal Deposit Insurance Act
FEDWIRE	The Federal Reserve Banks' Fedwire Funds Services
FFIEC	Federal Financial Institutions Examination Council
FSSA	Financial System Stability Assessment
GSE	Government-Sponsored Enterprises
MTM	Mark to Market
OCC	Office of the Comptroller of Currency
OFAC	Office of Foreign Assets Control
OTC	Over-the-Counter
OTS	Office of the Thrift Supervision
PCA	Prompt Corrective Action
ROSC	Report on Standards and Codes
RTGS	Real Time Gross Settlement System
SCAP	Supervisory Capital Assessment Program
SLHCs	Savings and Loan Holding Companies
U.S. GAAP	U.S. Generally Accepted Accounting Principles

I. Summary, Introduction, and Methodology

1. **This ROSC summarizes the Detailed Assessment Report (DAR) on current state of the U.S. implementation of the Basel Core Principles for Effective Banking Supervision that was published in May 2010.**[1] The DAR was completed during October/November 2009 as part of a Financial Sector Assessment Program undertaken by the International Monetary Fund[2] during October–November 2009, and reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. This assessment was undertaken in the immediate aftermath of a period of extreme market stress and continued general economic downturn**.** The causes of the financial crisis were many and cannot be identified simply through the lens of the BCPs, but they do identify shortcomings that were material in the run-up to the crisis. Importantly, this assessment is not intended to assess the merits of the wide-ranging program of reforms currently being proposed and adopted within the United States.

2. **The assessment identifies key weaknesses in the regulatory and supervisory framework that need to be dealt with effectively.** The causes of the financial crisis were many and cannot be identified simply through the lens of the BCPs, but they do identify shortcomings that were material in the run-up to the crisis, many of which were not unique to the United States. In this assessment, three key weaknesses have been identified: (i) a complicated regulatory structure that necessitates a heavy burden of cooperation and coordination between agencies; (ii) legislative provisions that have hindered and discouraged strong consolidated supervision; and (iii) certain material weaknesses in the oversight of banks' risk monitoring and risk management practices.

3. **The assessment team**[3] **held extensive discussions with staff from the main supervisory agencies and industry representatives.** The team had the benefit of working with a comprehensive self-assessment completed by the U.S. agencies, enjoyed excellent cooperation with its counterparts, and received the information it required.

4. **The approach taken by the assessors in assessing BCP compliance has been to examine whether the four Federal banking agencies (FBAs)—the Federal Reserve, the OCC, the OTS, and the FDIC—by themselves provide sufficiently effective supervision**

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[1] The underlying Detailed Assessment Report was published in May 2010 and is available at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23863.0.

[2] For further discussion see the accompanying Financial System Stability Assessment (FSSA), (www.imf.org).

[3] The BCP assessment was conducted by Wayne Byres (Executive General Manager, Australian Prudential Regulation Authority), Nicholas Le Pan (IMF Consultant; ex-Head of the Office of the Superintendent of Financial Institutions, Canada and ex-Vice Chairman of the Basel Committee for Banking Supervision), and Goran Lind (Adviser to the Swedish Riksbank and longtime member of the Basel Committee).

to meet the requirements of the BCPs. Since almost all banks[4] in the U.S. have a primary FBA to oversee them, the assessors did not seek, nor have the capacity, to test the strength and capability of each and every state banking supervisor. Where the assessors have concluded there may be gaps or shortcomings in the operations of the FBAs relative to the BCPs, the assessors have considered whether the work of the state banking agencies would be sufficient to compensate.

II. Institutional and Market Structure—Overview

5. **The U.S. financial system is large and highly diversified. At end-2007, total U.S. financial assets amounted to almost four and a half times the size of GDP.** Of this, however, less than a quarter of total financial assets were accounted for by traditional depository institutions. The crisis has radically changed the shape of the U.S. financial system in a short timeframe. The top investment banks recently have been reconfigured as bank holding companies, nonbanks severely weakened, the housing GSEs are now in government conservatorship, and private securitization remains dormant.

III. Preconditions for Effective Banking Supervision

6. **Overall, the public infrastructure supporting effective banking supervision in the U.S. is well-developed.** Business laws in the United States, including contract, bankruptcy, and property law, are well-developed and reliable. Contract law is established by the combination of common law and state statute. Property rights are protected under the Bill of Rights of the United States Constitution and under state laws. Business law disputes are typically resolved in state trial courts of general jurisdiction. The U.S. possesses an independent judiciary and well-regulated accounting, auditing, and legal professions. U.S. Accounting Principles (U.S. GAAP) are established by the Financial Accounting Standards Board (FASB) and have been widely accepted internationally for many decades. Financial statement audit requirements are robust, having been considerably strengthened in 2002 with the passage of the *Public Company Accounting Reform and Investor Protection Act* (also known as the Sarbanes-Oxley Act).

7. **There is a considerable infrastructure in the U.S. that promotes and supports market discipline.** This includes a well-developed system of continuous disclosure obligations by public companies, extensive disclosure obligations for certain other investments, active rating agencies and an analyst community which disseminates its views through multiple media. As a result, major banks disclose considerable quantitative and qualitative information quarterly and annually. FBAs regularly publish bank performance reports, which show in detail how individual institutions compare with their peers. Formal enforcement actions brought by the FBAs are routinely made public.

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[4] "Banks" includes Federal Reserve members—all FDIC-insured national banks (supervised by the OCC) and FDIC-insured state-chartered banks (supervised by the Federal Reserve)—and nonmembers (supervised by the FDIC); and FDIC-insured savings associations (supervised by the OTS) unless the context indicates otherwise.

8. **The wholesale payment infrastructure in the United States comprises two systems, which are of systemic importance and settle in central bank money.** The Federal Reserve Banks' Fedwire Funds Services (Fedwire) is a real time gross settlement system (RTGS) operated by the central bank, and the Clearing House Interbank Payments System (CHIPS) is a private sector system combining net and gross real time settlement. The retail payment infrastructure employs a number of public and private sector Automated Clearing Houses, regional and interregional check exchanges and card payment schemes.

9. **U.S. banking laws provide the FBAs with a broad range of remedial powers.** These range from requiring an institution to adopt a resolution of its board of directors formally committing the bank to implement specified corrective actions through issuance by the supervisor of a formal cease and desist order that is enforceable through injunctions entered by a Federal Court. A deposit insurance scheme, sponsored by the FDIC, insures all deposits at insured banks up to US$250,000 per depositor.[5] The Deposit Insurance Fund may be used, on a least-cost basis, either to compensate depositors or to facilitate the resolution of the failed bank, typically through a purchase-and-assumption transaction.

10. The **Federal Reserve Bank's emergency lending assistance capability includes authority to provide liquidity assistance to** (i) solvent but illiquid banks, (ii) undercapitalized banks certified by their primary supervisor to be viable, and (iii) any individual, partnership, or corporation "in unusual and exigent circumstances" when the borrower is unable to obtain financing from banks. The Fed has used this authority in the current financial crisis to provide support to financial institutions and even to non-financial entities through its support of the commercial paper market and through other means.

11. **The FDI Act provides a comprehensive scheme for the resolution of an insolvent bank.** All state and federally chartered banks that conduct retail deposit taking operations in the United States have their deposits insured by the FDIC. The FDI Act provides a comprehensive definition of insolvency that includes a balance sheet test, a liquidity test, and various tests of viability. This authority, and the "prompt corrective action" provisions, authorizes a bank to be placed in receivership or be otherwise resolved before its capital has been exhausted. As Receiver, the FDIC has available to it a broad array of tools to facilitate the process of resolving the insolvent bank.

IV. MAIN FINDINGS

Objectives, independence, powers, transparency, and cooperation (CP 1)

12. **The multiplicity of agencies, which can potentially impede effective supervision, is a striking feature of the U.S. supervisory system.** A system with multiple supervisory/regulatory agencies (particularly if mandates are unclear or very broad in scope) can lead to overlap that dilutes accountability, unproductive rivalry, lessened focus on important safety and soundness matters, material coordination costs in setting regulatory

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[5] The amount of insurance was temporarily increased from US$100,000 to US$250,000 until year-end 2013.

policy and supervision, and undue compliance costs for banks. While the assessors have not taken a view on the desirable number of regulators or the optimal regulatory structure for the United States, it is clear that the system carries a heavy burden of ensuring cooperation and coordination between the agencies to avoid overlap and gaps. Another striking feature of the U.S. system is the general absence of detailed, clearly stated objectives and mandates for each agency in the agency's original governing statutes, which are common features of laws in some other countries.

13. **The FBAs have a strong tradition of authority and accountability for supervisory matters being vested in those in charge of the supervision of individual banks and holding companies.** This system has considerable strengths, but the crisis has revealed the need for agencies to better integrate institution-specific information and judgments about emerging risks with experience from broader (system-wide) perspectives. Improvement plans need to be inter-agency not just within each agency, which will require strong governance.

Licensing and structure (CPs 2–5)

14. **Banks have an unusual degree of choice over their regulator. This is largely due to the existence of a dual banking structure—involving state and Federal charters—and multiple federal regulators.** While the actual number of conversions in each year is small, but there remains an "implicit threat" of conversion from banks to their supervisors. The stated minimum capital of US$2 million for new banks is also relatively low, compared to many other countries; however, in practice much higher capital levels can be required for de-novo banks.

Prudential regulation and requirements (CPs 6–18)

15. **The U.S. system is still on the Basel I risk-based capital framework, though the advanced approaches of Basel II have been enacted and will apply to the major banks over the next 2–3 years.** Some additional features have been incorporated in the U.S. Basel I framework, e.g., an approach to securitization that is not present in Basel I. In addition, the U.S. capital regulations include minimum leverage ratio requirements. The BCPs require supervisors to set prudent and appropriate minimum capital adequacy requirements for banks. This is generally true in the United States and the U.S. system contains features such as the leverage requirements and Prompt Corrective Action requirements that lead banks to hold capital well above the minimum. However, some important shortcomings relative to CP 6 exist in the definition of Tier 1 capital for holding companies with regard to innovative instruments, in the absence of capital rules for SLHCs, and in allowing intangibles to count for a very high portion of a bank or thrift's Tier 1 capital.

16. **Severe shortcomings in bank risk management have been revealed in the recent crisis and supervisory oversight was not effective in identifying those weaknesses and having them remedied.** These shortcomings have been sufficiently large to create serious problems for both individual banks and for the financial system. As has been noted in reports issued by global senior supervisors, many of these were not unique to the United States. These weaknesses resulted partly from the confluence of credit (including counterparty

credit), market, and liquidity risk under extreme conditions. There is broad, shared understanding of the improvements needed and the strategy to achieve them, and the processes to monitor progress are already in place.

17. **The FBAs have well-developed policies and processes to regulate and supervise traditional credit risk.** However, there is clear evidence that in the recent turmoil and the events leading up to it, these processes were not fully effective for certain markets and products. The crisis has also revealed material weaknesses in **market risk** monitoring and management by financial institutions. The major issues are in the areas of suitability of certain market risk measurement and monitoring processes and models at certain major firms, lack of reliable and prudent valuation of mark-to-market (MTM) positions, and completeness and use of market stress testing. FBA guidance on **liquidity risk management** and supervision is consistent with existing international standards and is likely to evolve in the near term due to pending interagency liquidity guidance and Basel liquidity standards. Supervision of **operational risk** appears to be effective overall, although some greater focus and specialization might be beneficial, perhaps learning from Basel II experience. Supervision of **interest rate risk**—an issue which is of increasing importance in the current environment—is broadly consistent across the FBAs in most material respects.

18. **Banks maintain comprehensive programs, policies and procedures to reduce the risk of endangering the safety and soundness of the bank through abuse of its operations and services, including physical safety.** However, the FATF assessment conducted in 2006 identified a number of deficiencies relevant to banks that need to be remedied.

Methods of ongoing banking supervision (CPs 19–21)

19. The FBAs collectively have broad, but not unlimited, legal authority to regulate and supervise banks and holding companies subject to their jurisdiction. The FBAs use their authority to conduct on-site reviews and off-site analyses to develop a thorough understanding of the risk profile of banks and holding companies. The primary tool of supervision is the on-site examination, and the FBAs conduct full-scope on-site examinations of banks at least once every year or 18 months. There is a substantial continuous supervision program at major banks. All of these mechanisms are constrained to some extent when the individual agency is not the supervisor of the entire group, or part of the group is subject to the primary oversight of another functional regulator.

20. **Individually, each of the FBAs employs standard supervisory techniques in a broadly consistent manner.** Each agency supplies its supervisory staff with extensive manuals, guidance, and other assessment mechanisms which supervisors can use to develop their assessments and judgments. These appear well embedded in each agency's practices. There are, however, areas where the agencies could improve consistency between their operating processes, and seek to develop a "best of breed" model for supervision. The CAMELS-based rating system used by U.S. supervisors is somewhat outdated compared to those now used by overseas peers.

Accounting and disclosure (CP 22)

21. **The U.S. agencies provide for extensive disclosure of financial information by regulated banks and holding companies.** This disclosure is founded on U.S. GAAP. In discussions with supervisory staff, the decision to align regulatory reporting with U.S. GAAP, particularly with respect to the allowance for loan losses, was repeatedly criticized as it does not permit consideration of future events when estimating loan losses. The current framework also undermines the efficacy of the PCA regime (see below), as the thresholds for regulatory intervention are aligned to U.S. GAAP reporting.

Corrective and remedial powers of supervisors (CP 23)

22. **The FBAs have a range of supervisory options when a bank or holding company is not complying with laws, regulations or supervisory decisions, or is engaging in unsafe and unsound practices.** The agencies may take prompt remedial action and impose penalties. Remedial penalties and sanctions may be applied to banks and holding companies and, when appropriate, to management, board members, employees, controlling shareholders, other persons who participate in a bank's or holding company's affairs, and independent contractors, such as attorneys, appraisers, and accountants.

23. **A PCA regime applies to those instances in which a bank's capital falls below the prescribed minimum ratios/levels.** The regime provides a backstop against regulatory forbearance. The agencies also have powers to intervene even before the minimum capital ratio is breached. As an indicator of timely actions by the authorities, the rapid resolution of some major banks (and non-banks) during the present crisis can be noted. However, in many cases, while adhering to regulations and supervisory guidelines, supervisors will assess banks as being capital deficient and will require an infusion of capital, while at the same time the bank could be defined as "well capitalized" under the definitions of the PCA. This dichotomy arising from the relative inconsistency between the U.S. GAAP-based PCA regime and supervisory risk assessment systems could weaken the credibility of enforcement actions.

Consolidated and cross-border banking supervision (CPs 24–25)

24. **The existing legislation for consolidated supervision needs to be strengthened.** Restrictions, both statutory and practical, on access to information on various parts of a group make it difficult to assess risks from a group-wide perspective. Some steps have been taken to overcome this drawback as a result of the crisis; specifically FBAs have ramped up their consolidated supervision efforts including for the former investment banks that are now BHCs. However, clear, ready, and direct access, legally supported, for whichever agency is responsible for consolidated supervision is desirable. The ability in the existing legislation for supervisors to get around these restrictions when there is "a material risk to the bank" is not workable. The legislative restrictions need to be repealed.

25. **The FBAs have clear authority to share confidential supervisory information with foreign banking and other sector supervisors.** This facilitates global consolidated supervision and implementation of the underlying home-host relationship framework, but it is subject to the limitation of not impinging on "U.S. interests". The information must be

used for lawful supervisory purposes, and the recipients must keep the information confidential. FBAs provide adequate data and information to host country supervisors about U.S. banks and holding companies, to enable the host country to supervise the overseas operations of the U.S. banks. The FBAs have ongoing contact with supervisors in other countries in which U.S. banks or holding companies have material operations, including periodic visits to discuss supervisory issues.

Table 1. Summary of Compliance with the Basel Core Principles—ROSC

Core Principle	Assessment
1. Objectives, independence, powers, transparency, and cooperation	
1.1 Responsibilities and objectives	The authorities comply with this subcomponent of CP 1. Agency mandates are derived from, but are not always expressly stated in, legislation as in some other countries. Greater clarity is needed on the expectations of the bank supervisor and the holding company supervisor where these are different agencies to ensure strong coordination and clear accountability for the supervision of banking groups. Further clarity in mandates and expectations would be desirable as FBAs are expected in future to enhance their contribution to financial stability more broadly.
1.2 Independence, accountability and transparency	The authorities comply with this subcomponent of CP 1. Opportunities exist to better link strategic resource planning to more-forward-looking measures of risk and future resource demands. Improved collaboration will be needed for FBAs to make improvements such as better linking on-site, surveillance and macro staff, within and across agencies. Federal Reserve District Bank governance may not fully protect from the potential of influence from industry (or the perception thereof); it should be clearly noted that, there was no evidence of this in practice.
1.3 Legal framework	The authorities comply with this subcomponent of CP 1.
1.4 Legal powers	The authorities comply with this subcomponent of CP 1.
1.5 Legal protection	The authorities comply with this subcomponent of CP 1.
1.6 Cooperation	The authorities comply with this subcomponent of CP 1. There are channels for cooperation, coordination, and leveraging off best practices—within and between FBAs and functional supervisors that could be further enhanced as assessors saw many examples of opportunities for better inter-agency coordination.
2. Permissible activities	The authorities comply with this CP.

Core Principle	Assessment
3. Licensing criteria	The authorities comply with this CP. The scope of the interagency agreement to prevent inappropriate charter conversions should be strengthened. The (absolute) minimum capital requirement for new banks is relatively low, although practice has required higher levels of capital.
4. Transfer of significant ownership	The authorities comply with this CP.
5. Major acquisitions	The authorities comply with this CP.
6. Capital adequacy	CP 6 requires supervisors to set prudent and appropriate minimum capital adequacy requirements for banks. This is generally true and features such as Prompt Corrective Action and leverage requirements lead banks to hold capital well above the minimums. However, important shortcomings exist in the definition of Tier 1 capital for holding companies with regard to innovative instruments, in the absence of capital rules for SLHCs, and in allowing intangibles (especially mortgage servicing rights) to count for a very high portion of a bank or thrift's Tier 1 capital.
7. Risk management process	Despite the existence of formal rules, severe shortcomings in enterprise-wide risk monitoring and management at banks, were revealed in the recent crisis. Supervisory oversight was not effective in identifying those weaknesses and having them remediated. They created serious problems for banks and for the financial system. Although many of these weaknesses were present in other firms in other jurisdictions, because the U.S. system will likely remain at the forefront of financial innovation, it is imperative that risk monitoring and management systems be compliant with the requirements of this principle, which are high for the U.S., considering (as the CP mandates) the size and complexity of the financial sector. Although weaknesses have been partially remedied the robustness of needed improvements—in both banks and supervisors—will take some time to implement and test.

Core Principle	Assessment
8. Credit risk	There are well-developed rules and guidance, but processes have not been fully effective for some markets, particularly residential mortgages and CRE exposures at smaller and mid-size banks. Weaknesses in understanding risks of complex credit products were not adequately remediated by the supervisory process. Additional monitoring, supervisory focus and credit risk measurement tools being developed by certain FBAs are all desirable enhancements, but need to be placed in a more comprehensive, coordinated strategy designed to deal with identified weaknesses (including timliness of guidance, intervention and will to act) and position the U.S. to better deal with future credit cycle issues well in advance of them becoming serious problems.
9. Problem assets, provisions, and reserves	The authorities comply with this CP. The FBAs process is well developed and effective. Its effectiveness would be increased if accounting rules were changed to allow more-forward-looking provisioning.
10. Large exposure limits	The authorities comply with this CP. although the aggregate regulatory limits for total large exposures (loans plus other exposures) are high, in comparison with international practices. Reporting requirements on large exposures lack some detail (e.g., not showing total indebtedness) .
11. Exposure to related parties	The authorities comply with this CP. However, there is inadequate specificity in the supervisory regulations on board oversight and involvement, and the reporting requirements to boards and to the supervisors lack in scope and detail. These weaknesses are compensated for to a high degree by supervisory policies and reviews, which expect active board oversight and monitoring of related lending, and require remedial action in case deficiencies are observed. The limit for aggregate lending to a single related party or to a conntected group of related parties is set at 15 percent of the bank's own fund plus surplus funds (i.e., excess provisions for loan losses) which is in accordance with international best practices. The overall limit for lending to all related parties in aggregate is set at 100 percent of own funds plus surplus funds, which is higher than international practice, although the supervisory policy includes the possibility to comment on exposures even within the limit, if deemed unsafe or unsound

Core Principle	Assessment
12. Country and transfer risks	The authorities comply with this CP.
13. Market risks	Material weaknesses have been revealed at banks in market risk monitoring, use of models, valuation and risk management. Substantial improvements are in progress, but will take time to put in place and assess, because they entail complex IT and risk architecture changes as well as changes in governance, oversight and compensation incentives.
14. Liquidity risk	Guidance on liquidity risk management and supervision is consistent with existing international standards (although likely will evolve in the near term in accord with international efforts). Needed improvements to effectiveness are in progress at banks and supervisors, but cannot be fully assessed currently. Crisis-induced focus on liquidity at banks and supervisors is being formalized into an enhanced, regular, in-depth supervisory program.
15. Operational risk	The authorities comply with this CP. The agencies should continue to build more holistic and structured approaches to operational risk assessment, utilizing enhanced cross-agency mechanisms.
16. Interest rate risk in the banking book	The authorities comply with this CP. Supervisors could consider introducing a consistent measurement approach to improve risk assessment across FBAs.
17. Internal control and audit	The authorities comply with this CP.
18. Abuse of financial services	The authorities comply with this CP. It is noted that a number of CP 18-relevant issues as identified by the FATF remain to be addressed.
19. Supervisory approach	Authorities need to improve their approach to the group-wide oversight of financial groups, including unregulated entities. Introducing domestic "supervisory colleges" involving all material U.S. regulators for a group may assist, although broader reform is necessary. A review of risk rating systems, with a view to improving their capacity to distinguish between banks, is needed.
20. Supervisory techniques	The authorities comply with this CP. It is suggested that the authorities could review, perhaps under the auspices of the FFIEC, existing supervisory manuals and processes to remove unnecessary differences and develop a "best of breed" approach.

Core Principle	Assessment
21. Supervisory reporting	The authorities comply with this CP. It is suggested that the authorities review solo reporting requirements and consider the implications of U.S. GAAP for the effectiveness of supervision and the PCA regime.
22. Accounting and disclosure	The authorities comply with this CP, but could consider the introduction of statutory reporting ("whistleblower") obligations for external auditors reporting to bank supervisors, along with associated protections.
23. Corrective and remedial powers of supervisors	The authorities comply with this CP.
24. Consolidated supervision	Present legislation and practices hinder effective conduct of consolidated supervision of financial groups although supervisors work around this by changing their interpretation of the GLB Act. There are gaps in regulatory limits and reporting of large exposures, related lending, and capital on a consolidated basis at the holding company level. De facto practices of applying and monitoring large exposure and related lending limits should be expressly mandated. Lacking a fixed rule, SLHC capital is supervised on a case-by-case basis.
25. Home-host relationships	The authorities comply with this CP.

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
1. Objectives, independence, powers, transparency, and cooperation	
1.1 Responsibilities and objectives	Consider formally setting out the mandate and objectives of the FBAs in legislation. Ensure core safety and soundness mandates and individual accountability for each FBA are clear. Clarify expectations and accountability for the primary federal bank regulator and the holding company regulator as they are inextricably linked in the case of large complex banking groups. Strengthen inter-agency coordination of supervisory processes, pursue opportunities for: more integrated supervision planning; more commonality of forward-looking risk rating systems, more sharing of off-site surveillance methodology and results, and more joint reviews.
1.2 Independence, accountability and transparency	Develop a more forward-looking detailed resource plan that takes account of risk assessments, lessons learned, and new and existing priorities. Focus senior governance within and between agencies on improvements in supervisory process. Improve public performance reporting. Alter the governance rules at Reserve Banks to remove appearance of industry influence. Raise threshold for triggering material loss reviews and consider the themes from those reviews (e.g., timeliness and forcefulness of intervention) to improve performance.
1.6 Cooperation	Strengthen channels for cooperation, coordination, and learning from best practices—within and between FBAs and functional supervisors.
3. Licensing criteria	Strengthen interagency agreement to prevent inappropriate charter conversions. Monitor developments to see if said agreement needs further strengthening. Deepen assessment and presentation to chartering decision-makers on the operational plan for the applicant bank. Increase the (absolute) minimum capital requirement for new banks

Reference Principle	Recommended Action
6. Capital adequacy	Work with the BCBS and domestically to strengthen the definition of what counts as Tier 1/core capital especially for holding companies. Revisit ability for banks and thrifts to have a large part of their Tier 1 capital composed of intangibles by capping the percentage allowed at a lower level. Put in place formal capital rules for SLHCs.
7. Risk management process	Conduct regular inter-agency horizontal detailed assessment of all risk monitoring, management and risk governance improvements at major complex banking groups. Include detailed testing of the robustness of improvements. Include all large complex banking organizations in these regular assessments. Publish regular reports and guidance to reinforce supervisory expectations. Ensure adequate ongoing resources for these reviews.
8. Credit risk	Develop a clear comprehensive strategy to reduce the extent and severity of credit risk problems resulting from a future credit cycle and building on (and extending across agencies) improvements in credit risk monitoring and surveillance already started. This strategy should address: timeliness and forcefulness of supervisory interventions, timeliness of guidance, revisiting whether guidance needs to occasionally contain specific limits to be effective, consistency of follow-up on new guidance; ability of the FBAs to intervene to make their views known about systemic weaknesses in credit risk management practices or in contributing polices that they do not control but that may need to be addressed by authorities more broadly; strengthen inter-agency processes to enhance collective assessment of emerging problems; and, ensure that sufficient specialist resources are available to assess complex credit risk matters in smaller and mid-size, as well as larger banks.
10. Large exposure limits	Include all exposures within the limits and reporting of large exposures. Strengthen reporting requirements on large exposures. Advance supervisory guidance further on sectoral and geographical concentration risk identification and management.
11. Exposure to related parties	Strengthen regulations on board oversight and involvement. Enhance reporting requirements to board and to the supervisors. Lower the current limit on the aggregate amount of loans to all insiders. (It now equals a bank's own funds plus "surplus" funds.) Incorporate all exposures to insiders (and affiliates) in the definition of insider transactions and in the limits.

Reference Principle	Recommended Action
13. Market risks	Complete the current horizontal assessment of the Market Risk Amendment and determine how much further in-depth horizontal review of market risk and valuation improvements at major banks is required. Conduct regular, horizontal, in-depth assessments of banks' progress in market risk enhancements.
14. Liquidity risk	Make sure the crisis-driven improvements in banks and supervisors liquidity risk processes are transitioned into organized, sustainable, improved liquidity risk management and supervisory monitoring and assessment. Update the supervisory program, and conduct regular supervisory assessments of risk management and crisis and contingency plans at banks.
15. Operational risk	Consider a more holistic and structured approach to operational risk assessment, utilizing enhanced cross-agency mechanisms.
16. Interest rate risk in the banking book	Consider the capacity to improve the assessment of interest rate risk by introducing a more consistent measurement approach.
18. Abuse of financial services	Rectify certain CP 18-relevant deficiencies as identified by the FATF.
19. Supervisory approach	Improve the capacity for group-wide oversight of financial groups, including unregulated entities. Introducing domestic "supervisory colleges" involving all main regulators (not just the FBAs) of major banking groups may assist, although broader reform is necessary. An overhaul of risk rating systems, with a view to improve their capacity to distinguish between banks, is also recommended.
20. Supervisory techniques	Review, perhaps under the auspices of the FFIEC, existing supervisory manuals and processes to remove unnecessary differences and develop a "best of breed" approach.
21. Supervisory reporting	Review the solo reporting requirements to ensure prudential requirements can be monitored relative to an individual bank's balance sheet. Also consider the implications of U.S. GAAP for the effectiveness of supervision and the PCA regime.
22. Accounting and disclosure	Consider the introduction of statutory reporting ("whistleblower") obligations for external auditors, along with associated protections.
24. Consolidated supervision	Make changes in legislation and practices to ensure effective conduct of consolidated supervision of financial groups. Also, regulatory limits and reporting of adherence to those should be introduced on the consolidated group level, including at the holding company level, for large exposures, and related lending.

V. Authorities' Response to the Assessment

26. The U.S. authorities wish to express their appreciation to the IMF and its assessment teams for the dedication, time and resources committed to this assessment. The authorities strongly support the Financial Sector Assessment Program, which promotes the soundness of financial systems in member countries and contributes to improving supervisory practices around the world. The U.S. assessment has presented a challenging and complex task, and the IMF has worked professionally and in a spirit of collaboration to produce the assessment. The U.S. authorities appreciate the opportunity to provide the following comments.

27. As recognized by the Report, it is important to consider the U.S. assessment in context. The assessment follows in the wake of a severe financial crisis and economic downturn, and these severe stresses have tested the resilience of the U.S. financial sector and its supervisory framework. The assessment properly holds the United States to a higher standard, given the maturity, complexity, and significance of our financial sector. Additionally, it is important to recognize that the United States is the first highly complex economy to have been evaluated under the Core Principles as updated in 2006. The revised Core Principles place a greater emphasis on risk management, and the methodology requires assessors to consider the practices of banks as well as the policies and practices of banking agencies. The authorities are pleased that, even under these more stringent Core Principles, and when applying a higher standard to the complex U.S. financial system, the IMF's assessment of the U.S. system is that it is broadly in compliance with the Core Principles. The few areas that are identified for improvement are acknowledged and are recognized; much is underway to address these known concerns.

28. The Report acknowledges that, while many of the identified weaknesses are being addressed by the U.S. federal banking agencies and by legislative reforms, it was not possible for the assessment to incorporate, or give credit for, these actions or reforms. For example, the Report acknowledges that a number of the firms that experienced major problems (i.e., the government sponsored enterprises and various investment banks before they became BHCs) were not subject to oversight by any of the federal banking agencies and that failures in risk management at these companies were a major contributor to the financial crisis. The U.S. federal banking agencies have, in multiple forums, expressed their desire to move forward expeditiously with legislative changes to address identified concerns.

29. Aside from supporting legislative reforms the U.S. federal banking agencies are making substantial progress in the oversight of risk management practices. Initiatives related to credit, market, and liquidity risk, and consolidated supervision are recognized in the Report. These changes, combined with proposals for legislative reforms that would enhance the ability to supervise institutions on a consolidated basis, address many of the deficiencies cited. It is equally important, however, to acknowledge that actions supervisors took as the magnitude of the crisis became clear and have continued to take since the crisis, are at least

as important in judging the supervisors' effectiveness as any assumptions made about their oversight based on risk management weaknesses of supervised institutions.

30. The authorities believe each FBA has both statutory and organizational mandates and objectives which are clear and do provide specific roles and authority for the conduct of supervision of regulated entities. In addition, each agency has very specific authority to take steps to compel organizations to make improvements in risk management and other processes and as noted in the DAR we are actively working with institutions to improve these processes as well as regulatory policy in these same areas.

31. The IMF's assessment of CP 6, the Capital Adequacy standard, does not fully reflect aspects of U.S. bank supervision, both immediately before the crisis and once the crisis emerged. U.S. banks are held to a higher capital standard than international standards because of U.S. Prompt Corrective Action law and regulation. Currently, approximately 96 percent of U.S. banks, representing approximately 99 percent of total bank assets, hold 50 percent or more capital than international minimums. In addition, the quality of capital held by U.S. banks has generally been higher than in many other jurisdictions. Prior to the crisis most U.S. banks, including the largest, had Tier 1 capital composed mostly of common equity (80–90 percent or higher). In contrast, banks in other countries had common equity levels closer to the Basel predominance standard of 50 percent common shareholders' equity with the remaining component of Tier 1 capital generally consisting of tax-deductible hybrid securities. Moreover, as a result of the Supervisory Capital Assessment Program (SCAP), the largest U.S. banks now have risk-based ratios of Tier 1 capital and Tier 1common equity that far exceed Basel minimum capital requirements.

32. Finally, the federal banking agencies have taken a number of substantive actions that are not fully reflected in the Report. These include:

- The SCAP stress assessment on the 19 largest bank holding companies, which together hold two-thirds of the assets and more than one-half of the loans in the U.S. banking system. The SCAP was notable among stress tests conducted by other countries in its scope, rigor, intensity, breadth, and transparency, and resulted in large banks raising a substantial amount of common equity capital which strengthened the level and quality of bank capital in the United States;

- Joining international efforts to initiate supervisory colleges for large, globally active U.S. banks;

- Directing large banks to improve their ability to aggregate risks across legal entities and product lines to identify potential risk concentrations and correlations, and requiring improved contingency funding plans;

- Conducting targeted, leveraged lending reviews at the largest syndication banks, focusing on syndicated pipeline management, stress testing, and limit setting

- Conducting high quality implementation of Basel II;

- Issuing and implementing interagency guidance on subprime and non-traditional mortgages; and

- Initiating new data gathering, e.g., a project that provides data on over 60 percent of residential mortgages serviced in the United States.

33. The U.S. authorities appreciate the Report's recommendations, and will review them carefully. They will take action where they have authority, including in the areas of enhancing communication and information-sharing among the agencies, ensuring more effective oversight of systemic risks, and requiring increased liquidity buffers at systemically important institutions. They look forward to a continuing dialogue as they jointly seek to improve the stability and effective supervision of the global financial services sector.