The *Bank Holding Company Supervision Manual* has been prepared by Federal Reserve supervision personnel to provide guidance to examiners as they conduct on-site inspections of bank holding companies (BHCs) and their nonbank subsidiaries. The manual is a compilation of formalized procedures and Board supervisory policies that supervision and inspection personnel should follow. The manual includes new concepts and keeps pace with the ever-changing industry. An integral part of the Federal Reserve's overall program to supervise banking organizations operating under a holding company structure, the manual enhances the staff's ability to implement the Board's inspection and monitoring efforts.

The manual is designed to provide guidance to examination and supervision personnel. *It should not be considered a legal reference.* Questions concerning the applicability of and compliance with federal laws and regulations should be referred to appropriate legal counsel.

The Federal Reserve System conducts risk assessments and a full-scope inspection program for BHCs. At a minimum, full-scope inspections should include sufficient procedures to reach an informed judgment on the assigned ratings for the factors included in the bank holding company RFI/C(D) rating system. The procedures of a full-scope inspection focus in part on assessing the types and extent of risks to which a BHC and its subsidiaries are exposed. Some of these types of risks include credit, market, liquidity, operational, legal, and reputational risks. Inspections also focus on evaluating the organization's policies and procedures for identifying, managing, and controlling such risk exposures and on determining whether the management and directors are actively involved in the oversight of the organization's risk-management program. To determine whether the organization's policies and procedures for risk management are fully effective and being followed, inspections or reviews also generally include transaction and compliance testing

The inspection process commences with a preliminary risk assessment. The risk assessment highlights the strengths and weaknesses of the holding company and is the basis for determining the procedures to be conducted during an inspection. Risk assessments identify the organization's principal business activities and the types and quantities of risks associated with the activities (including those conducted off-balance-sheet). The quality of management and the control of risks are factored into the initial risk profile of the holding company. Sources of information for the risk assessment include prior bank and BHC inspection reports and workpapers, surveillance program reports, and regulatory reports. In addition, other relevant supervisory materials derived from within the Federal Reserve System or other federal and state banking supervisors, as well as from other responsible regulatory agencies (for example, the Securities and Exchange Commission and state insurance authorities) are used. Other sources for the risk assessment may include the banking organization's publicly available reports, such as annual and other periodic reports and informational releases; strategic plans and budgets; internal management reports; information packages for the board of directors; correspondence; the board of directors executive and audit committee minutes; internal audit workpapers and reports; and stock-analysis reports. The activities, transactions, and identified areas having the most significant risks, inadequate risk-management processes, or rudimentary internal controls will represent the banking organization's highest risks. The risk-assessment process culminates in a formalized and structured supervisory strategy, which examination staff will follow when conducting an inspection.

The banking organization's highest risks are expected to undergo the most rigorous scrutiny, analysis, and transaction testing by examiners and supervisors. Transaction testing is a reliable and essential inspection technique for assessing the banking organization's condition and verifying its adherence to internal policies, procedures, and controls. Transaction testing alone, however, is not sufficient for ensuring safe and sound operations in a highly dynamic banking environment. The changing nature of financial instruments and markets allows institutions to rapidly reposition their portfolio risk exposures. To ensure that banking organizations have systems in place to identify, measure, monitor, and control their changing risk exposures, inspections further focus on evaluating the banking organization's risk-management processes. These risk-management evaluations determine the extent to which the banking organization's management processes can be relied on.

The full-scope inspection may be conducted at a point in time or through a series of targeted or limited-scope reviews conducted on an ongoing or continuous basis for the largest and most complex banking organizations. Irrespective of the duration of the inspection, planned supervisory activities should be coordinated well in advance with other responsible bank, thrift, and functional regulators in order to avoid duplication of effort and to minimize burden on the banking organization. Supervisory findings of inspections should be communicated to the banking organization's management or boards of directors, as well as to the banking organization's other bank supervisors and functional regulators, when relevant.

An inspection also measures the financial strength of a BHC or financial holding company (FHC) and focuses on financial indices of both the consolidated entity and its component parts. In addition to the analysis of risk, the other principal indices appraised are quality of assets, earnings, capital adequacy, cash flow and liquidity, and the competency of management. An inspection or supervisory program should also assess the banking organization's program for transactions between insured subsidiaries and affiliates. The basic objective of this assessment is to determine the impact or consequences of transactions between the parent holding company or its nonbanking subsidiaries and the insured subsidiaries. Of particular importance is whether intercompany transactions result in a diversion of income (or income opportunity) away from a federally insured subsidiary to a holding company affiliate.

The competency of BHC management in overseeing the banking organization's business activities, risk management, and financial condition is also evaluated. The FHC and BHC inspection process provides a vehicle for a comprehensive assessment of the effectiveness of management, resulting in a more open and informed dialogue between management and representatives of the Federal Reserve.

In summary, the inspection process is intended to increase the flow of information to the Federal Reserve System concerning the soundness of FHCs and BHCs. This information will permit the Federal Reserve to encourage sound banking practices and to take appropriate supervisory action when warranted.

This manual is updated periodically to reflect current supervisory policy and procedures and changing practices within the industry. The manual is also available on the Board's public web site at www.federalreserve.gov/boarddocs/supmanual/. We solicit the input and contribution of all supervisory staff and others in refining and modifying its contents. Please address all correspondence to the Director of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Washington, DC 20551.

This general table of contents lists the major section heads for each part of the manual:

A detailed table of contents, which lists the subheads within each major section, precedes parts 2000 through 5000.

1020.0.1 INTRODUCTION

This manual is designed to aid personnel of the Federal Reserve System in supervising bank holding companies. As such, it will review in considerable detail current policies and procedures for supervising the financial affairs of these banking organizations and will also discuss statutes, regulations, interpretations and orders that pertain to bank holding company supervision. Before proceeding, however, it is desirable to step back and view bank holding companies and their supervision in a broader perspective. This preface is designed to provide that perspective.

While the holding company form of organization exists in many industries, it is particularly prevalent in the regulated industries—telephone, electric and gas utility, railroad, savings and loan, and banking. Regulated industries have learned that a holding company structure allows certain entities to avoid some of the constraints of regulation. For example, regulation often limits the geographic area that a regulated firm can serve. By forming a holding company, many regulated organizations can serve a broader area, thereby potentially benefiting from economies of scale and risk reduction through geographic diversification.

A second purpose for the use of a holding company structure by regulated firms is to expand into other product markets, often ones that are not subject to regulation.

A third purpose for the use of a holding company structure is to increase the organization's financial flexibility, thereby avoiding some of the financing constraints imposed by regulation. These constraints can include limitations on leverage, the types of assets that the firm can acquire and the types of liabilities that it can issue. Another possible financial advantage of the holding company is to obtain tax benefits.

Bank holding companies were created for essentially the same reasons that holding companies were created in other industries; to expand geographically, to move into other product markets, and to obtain greater financial flexibility and tax benefits. The primary use of the bank holding company device prior to the late 1960's was to expand banking operations geographically. The holding company form was needed because many States either prohibited or sharply curtailed branching within the State. Moreover, banks generally did not have the authority to branch beyond the geographic limits of the State in which the bank was chartered. By employing the holding company form of organization, several banking organizations had succeeded by the 1950's in expanding over an entire region of the country, operating banks in several States.

During the 1960's many banks, especially the largest ones, desired to expand into new lines of activity. In most cases, these new activities were financial in nature and were closely related to traditional banking operations. While some banks were successful in obtaining supervisory approval to enter certain of these new activities, the courts subsequently voided many of these approvals. Unable to enter these activities as a bank, many of these organizations converted into the holding company form and entered these activities through the holding company.

In recent years banking organizations also have used the holding company device to increase their financial flexibility. For example, in order to avoid the reserve requirements and interest rate ceilings applicable to deposits of their bank subsidiaries, many banking organizations have utilized the parent company as a vehicle to fund the organization. Moreover, the holding company structure has allowed organizations to attain higher leverage levels than otherwise might have been permitted.

Historically, the Bank Holding Company Act sought to provide for the separation of banking from commerce. In order to avoid any detrimental effects on the public interest, the activities of bank holding companies have been limited by law and regulation and transactions with banking subsidiaries are virtually prohibited. This basic rationale is the cornerstone for regulating the financial affairs of bank holding companies.

1020.0.2 POSSIBLE CONSEQUENCES OF HOLDING COMPANY FORMATION

There are two primary ways that a holding company can have an adverse effect on the financial condition of a regulated subsidiary. The first is for the holding company (or its unregulated-regulated subsidiaries) to take excessive risks and fail. This failure could have a "ripple effect" on the regulated firm, impairing its access to financial markets. The classic case is the Insull empire in the electric utility industry, which involved the pyramiding of numerous highly leveraged holding companies. The collapse of this pyramid during the Depression of the 1930's severely impacted the regulated electric utility operating companies and impaired their ability to service the public.

A second major way that a holding company can have a harmful effect on the financial condition of a regulated subsidiary is through adverse intercompany transactions and excessive dividends. Adverse intercompany transactions typically involve either the purchase and sale of goods and services or financial transactions that are on nonmarket terms. Concern over the use of the holding company device to transfer financial resources from the regulated firm has been particularly prevalent. In this case, there has been a conflict of views between the government, and the firms which want to diversify in order to increase their return on investment.

In the mid 1970's, concern over holding companies forcing regulated firms into adverse transactions surfaced in the banking industry. In this instance, the objective was not to divert resources from the bank to more profitable areas, but rather to use bank resources to save a nonbank affiliate from failure.

1020.0.3 REGULATORY RESPONSE TO THE HOLDING COMPANY

Historically, public policymakers have recognized that holding companies can have both positive and negative effects on regulated subsidiaries. The fact that policymakers have permitted holding companies to exist in all of the major regulated industries indicates that the effects, on balance, have not been decidedly negative. However, there have been enough problems over the years that holding companies in most regulated industries are subject to at least some form of regulation. This regulation varies substantially from one regulated industry to another.

Until the mid-1970's, Congressional concerns with bank holding companies were primarily oriented to competition, concentration of financial resources and the proper range of banking activities. However, there was also some limited recognition of the possible impact of holding companies on the financial condition of banks. The earliest evidence was the Banking Act of 1935, in which Congress gave the Federal Reserve Board authority to issue permits to holding companies to vote the stock of their banks. In acting on permit applications, the Board was required to consider the holding company's financial condition, the character of its management, and the effect of granting the permit on the bank. Congress also gave the Federal Reserve the right to inspect bank holding companies.

About two decades later, Congress passed the Bank Holding Company Act of 1956. This legislation required the Federal Reserve, in passing on proposed bank acquisitions by holding companies, to consider the competitive, financial and managerial implications of the proposal. More recently, the Bank Holding Company Act Amendments of 1970 required the Federal Reserve to make a similar determination in applications by holding companies to acquire nonbanking companies. The amendments also brought one-bank holding companies into the Federal Reserve's jurisdiction.

Subsequently, Congress and the public became seriously concerned over the possible adverse impact of holding companies on the financial condition of subsidiary banks. These adverse developments led to two results; additional legislation and stepped-up holding company supervision. The major Congressional action was to give the Federal Reserve much needed cease and desist powers over bank holding companies. This authority now supplements certain statutes, such as dividend restrictions and limitations on bank transactions with affiliates, that tend to protect banks in a holding company organization.

In the mid-1970's, the Federal Reserve stepped up its supervision and monitoring of bank holding companies in a variety of ways. First, the Federal Reserve increased the scope and frequency of holding company inspections, and later introduced a bank holding company rating system designed to focus attention on those organizations having the most serious problems. Second, the Federal Reserve began to monitor transactions between bank subsidiaries and the rest of the holding company organization through quarterly intercompany transactions reports. Third, the Federal Reserve implemented a computer-based surveillance program designed to identify emerging financial problems. Finally, the Federal Reserve began to employ its new holding company cease and desist powers in an effort to curtail unsafe and unsound practices.

The period prior to 1980 marked a gradual decline in the ratio of equity capital to total assets within the United States Commercial banking system, particularly for the nation's largest banking organizations. In an effort to reverse that trend, the Federal Reserve System and the Comptroller adopted guidelines for national and state member banks and bank holding companies in December 1981. The guidelines established minimum capital levels and capital zones. The guidelines provided state member banks and bank holding companies with targets or objectives to be reached over time. As a result, many of the banks and bank holding companies improved their capital positions. However, other developments, including deregulation of interest rates on bank liabilities, weakening of loan portfolios (asset quality) of some banking institutions occasioned by economic shocks in certain industries or geographical areas, and increased competition in the financial services areas, combined to place additional pressures on the profitability of banking institutions and accentuate the potential demands on the capital positions of those institutions.

The Federal Reserve System continued to stress the importance of the capital guidelines in setting standards of capital adequacy. The Board thus amended its guidelines in June 1983, to set explicit minimum capital levels for multinational organizations.

In November 1983, congressional concern over existing conditions, prompted the enactment of the International Lending Supervision Act of 1983 (''ILSA''). The Act directed that the federal banking agencies cause banking institutions to establish minimum capital levels for banking organizations. In December 1983, the Board, therefore, published the guidelines as Appendix A to the totally revised Regulation Y (12 C.F.R. section 225). Then in April 1985, the Board adopted new capital adequacy guidelines to increase the required minimum primary and total capital levels for the larger regional and multinational bank holding companies and state member banks. This action, when considered in conjunction with the capital maintenance regulations of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, established uniform minimum capital levels for all federally supervised bank holding companies, regardless of size, type of charter, primary supervisor or membership in the Federal Reserve System.

The strengthening of supervision over banks and bank holding companies is an equally imposing supervisory concern. The Federal Reserve System adopted a number of supervisory policies in 1985 that directly affected the supervision of bank holding companies, such as the increased frequency and scope of inspections and the communicating of the results of inspections (refer to Manual section 5000). In addition, the scope of the inspection was expanded to provide for a comprehensive analysis of management's ability to direct and control the organization utilizing the basic assumption that the bank holding company is responsible for the direction and vitality of the organization. Overseeing the supervision of banking organizations entails evaluating management's policies and procedures, wherever they are established within the corporate structure, as part of the examination/inspection process. Such policy areas include the consolidated planning process, risk management, funding, liquidity, lending, management information systems, loan review, and audit and internal controls.

The Board, concerned with strengthening the supervision over member banks and bank holding companies, adopted a policy statement regarding cash dividends not fully covered by earnings on November 14, 1985. The policy statement addressed the situation when cash dividends are not fully covered by earnings, which represents a return of a portion of an organization's capital (refer to Manual section 2020.0 for a discussion regarding the policy statement).

The Board adopted a policy statement on April 24, 1987, also related to the strengthening of the supervision over subsidiary banks of bank holding companies. The Board reaffirmed its long-standing policy that a bank holding company should act as a source of financial and managerial strength to its subsidiary financial institutions. The policy statement provides that a bank holding company should not withhold financial support from a subsidiary bank in a weakened or failing condition when the holding company is in a position to provide the support. The Board emphasized that a bank holding company's failure to provide assistance to a troubled or failing subsidiary bank under these circumstances would generally be viewed as an unsafe and unsound banking practice or a violation of the Boards Regulation Y (refer to section 225.4 (a)(1)) or both.

Congress limited the expansion of nonbank banks with the passage of the Competitive Equality Banking Act of 1987. The legislation redefined the definition of ''bank'' in the Bank Holding Company Act so that an FDIC-insured institution is a bank. Existing nonbank banks were grandfathered but certain limitations were imposed on their operations.

In an effort to further strengthen the capital position in banks and bank holding companies, the Board of Governors of the Federal Reserve System, on January 19, 1989, issued final guidelines to implement risk-based capital requirements for state member banks and bank holding companies. The guidelines are based on the framework adopted July 11, 1988, by the Basle Committee on Banking Regulations and Supervisory Practices, which includes supervisory authorities from 12 major industrial countries. The guidelines are designed to achieve certain important goals:

- Establishment of a uniform capital framework, applicable to all federally supervised banking organizations (the guidelines were also adopted by the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation);
- Encouragement of international banking organizations to strengthen their capital positions; and,
- Reduction of a source of competitive inequality arising from differences in supervisory requirements among nations.

The guidelines establish a systematic analytical framework that: (1) makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations; (2) factors off-balance sheet exposures into explicit account in assessing capital adequacy, minimizes disincentives to holding liquid, low-risk assets; and achieves greater consistency in the evaluation of the capital adequacy of major banking organizations throughout the world.

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted risk assets by assigning assets and off-balance sheet items to broad risk categories. An institution's risk-based capital is calculated by dividing its qualifying total capital (the numerator of the ratio) by its weighted risk assets (the denominator).

The guidelines provide for phasing in of risk-based capital standards through the end of 1992, at which time the standards become fully effective. At that time, banking organizations will be required to have capital equivalent to 8 percent of assets, weighted by risk.

Banking organizations must have at least 4 percent Tier 1 capital, which consists of core capital elements, including common stockholder's equity, retained earnings, and noncumulative and limited amounts of cumulative perpetual preferred stock, to weighted risk assets. The other half of required capital (Tier 2), can include, among other supplementary capital elements, the non-Tier 1 portion of cumulative perpetual preferred stock, limited-life preferred stock and subordinated debt, and loan loss reserves up to certain limits.

The risk weights assigned to assets and credit equivalent amounts of off-balance sheet items are based primarily on credit risk. Other types of exposure, such as interest rate, liquidity, and funding risk, as well as asset quality problems, are not factored into the risk-based measure. Such risks will be taken into account in determining a final assessment of an organization's, capital adequacy, however.

Congress addressed the recent thrift crisis with the passage of thrift legislation, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which was signed into law on August 9, 1989. The legislation brought forth a number of important developments affecting bank holding companies. The legislation addressed:

1. acquisition of thrifts, in addition to failing ones;
2. conversion of thrifts to banks;
3. merger of thrifts with banks; and the
4. enhancement of enforcement authority.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) was signed into law on December 19, 1992. It was enacted to require the least-cost resolution of insured depository institutions, to improve supervision and examinations, to provide additional resources to the Bank Insurance Fund, and for other purposes. It required the federal banking agencies and their holding companies to prescribe standards for credit underwriting, loan documentation, as well as numerous other standards that are intended to preserve the safety and soundness of banking organizations.

FIDICIA further amended the International Banking Act of 1978. The Federal Reserve's authority over foreign bank operations (including representative offices in the U.S.) was significantly increased.

FIDICIA required the federal banking agencies to adopt standards for undercapitalized financial institutions. The Board, on September 18, 1992, issued Prompt Corrective Action Measures for state member banks.

During 1992, the Federal Reserve issued guidance on such issues as the monitoring and controlling of risk from asset concentrations, the disclosure, accounting, and reporting of past due (nonaccrual) loans, and the need for consistent methods in determining the amount of the allowance for loan and lease losses.

With the FIRREA and FIDICIA legislation, Congress re-emphasized the need for continued strengthening of the supervision over financial institutions. The strengthening of supervision over banks and bank holding companies will continue to be a primary objective of the Federal Reserve. As it is now, it will be continuously emphasized during the examination/inspection of member banks and bank holding companies during the 1990's and beyond.

The Manual is presented in ‘‘sections’’ which have been grouped together into ‘‘parts’’ that have in common a central theme pertaining to BHC supervision. For example, Part II is composed of sections which discuss topics of special interest for supervisory review. Part III is composed of sections which discuss the various exemptive provisions to the nonbank prohibitions of the BHC Act. Part IV presents sections on the preparation of a financial analysis while Part V discusses the methods used to prepare the inspection report forms.

In preparing to conduct an inspection and complete the inspection report forms, the examiner should review the information requirements presented in Part V which include a ‘‘section’’ for each page within the inspection report. Many of these sections contain cross-references to other sections within Parts II–IV of the Manual that present in greater detail the issues to be considered during the inspection process. The examiner assigned to complete a particular inspection report page should review the sections cross-referenced in Part V.

Given that the overall objective of the Manual is to standardize and formalize inspection objectives and procedures that provide guidance to the examiner and enhance the supervisory process, the content of the sections within Parts II–IV are grouped into broad categories. They are:

1030.0.1 INSPECTION OBJECTIVES; INSPECTION PROCEDURES; LAWS, REGULATIONS, INTERPRETATIONS, AND ORDERS

Not all of the categories are presented in each section. Where a particular topic is exclusively financially related and does not involve legal considerations, the subsection on ‘‘Laws, Regulations, . . .’’ may be omitted.

These procedures were designed for a full-scope, comprehensive inspection. It is recognized that in some instances the procedures may not apply in their entirety to all bank holding companies.

Examiners may exercise a measure of discretion depending upon the characteristics of the organization under inspection.

References to the ‘‘Examiner’s Comments’’ inspection report page throughout this Manual are synonymous with Core Page 1 of the inspection report—‘‘Examiner’s Comments and Matters Requiring Special Board Attention’’—as discussed in Part V of the Manual.

Part V of the Manual concerns the inspection program and report forms.

1030.0.2 NUMBERING SYSTEM

The Manual is arranged using a numerical coding system based on the Manual’s parts, sections and subsections. Parts are differentiated using ‘‘thousands’’ notations, sections using ‘‘digits’’ notations, and subsections using ‘‘tenths’’ placed after a decimal point as follows:

Part II—Topics for Supervisory Review	2000.0
Section 6—Management Information System	60.0
Subsection l—Audit	.1
	2060.1

1030.0.3 ABBREVIATION

The Bank Holding Company Act of 1956, as amended, is abbreviated as ‘‘the Act’’ throughout the Manual.

1030.0.4 AMENDMENTS TO THE MANUAL

Amendments will be published periodically as needed.

WHAT'S NEW IN THIS REVISED SECTION

Effective July 2008, this section has been revised to discuss further the authority for the Federal Reserve to conduct BHC inspections under section 5 of the Bank Holding Company Act of 1956.

1040.0.1 BHC INSPECTIONS

The Gramm-Leach-Bliley Act (GLB Act) amended section 5(c) of the Bank Holding Company Act (BHC Act) pertaining to BHC reports and examinations (or inspections, in the case of BHCs). The GLB Act provides specific supervisory guidance to the Board of Governors of the Federal Reserve System (and the Federal Reserve Banks via delegated authority) with respect to the breadth of BHC inspections. It also emphasized the focus and scope of BHC inspections and the inspections of BHC subsidiaries. An inspection is to be conducted to—

1. inform the board of the nature of the operations and financial condition of each BHC and its subsidiaries, including—
   a. the financial and operational risks within the holding company system that may pose a threat to the safety and soundness of any depository institution (DI) subsidiary of such bank holding company, and
   b. the systems for monitoring and controlling such financial and operational risks; and
2. monitor compliance by any entity with the provisions of the BHC Act or any other federal law that the Board has specific jurisdiction to enforce against the entity, and to monitor compliance with any provisions of federal law governing transactions and relationships between any DI subsidiary of a BHC and its affiliates.

1040.0.1.1 Authority for Bank Holding Company Inspections

Section 5 of the BHC Act of 1956 authorizes the Board to require reports and to conduct inspections of bank holding companies and their affiliates.[1] Subject to the limitations discussed below, Section 5 authorizes the Board to examine each bank holding company and nonbank subsidiary thereof. Within those limitations, the Federal Reserve System's supervisory staff (includes BHC inspection and examination staff) may review *all* books and records of a banking organization that is subject to Federal Reserve Supervision.[2]

1. See 12 U.S.C. 1844.

1040.0.2 FOCUS AND SCOPE OF BHC INSPECTIONS

The focus and scope of an inspection is to be limited, to the fullest extent possible, to the BHC and any subsidiary of the BHC that could have a materially adverse effect on the safety and soundness of any DI subsidiary of the holding company due to (1) the size, condition, or activities of the subsidiary, or (2) the nature or size of the transactions between the subsidiary and any DI subsidiary of the BHC.

The Board is to use, to the fullest extent possible, the bank examination reports of DIs prepared by the appropriate federal or state DI supervisory authority. The Board also is to use, to the fullest extent possible, the examination reports for non-DIs prepared by the following:

1. the Securities and Exchange Commission (SEC) for any registered broker or dealer
2. the SEC or any state for any investment adviser registered under the Investment Company Act of 1940
3. any state insurance regulatory authority for any licensed insurance company
4. any federal or state authority for any other subsidiary that the Board finds to be comprehensively supervised

1040.0.3 EXAMINATIONS OF FUNCTIONALLY REGULATED SUBSIDIARIES

The Board's ability to examine a functionally regulated subsidiary (FRS) is limited. The Board can examine an FRS only if the Board—

1. has reasonable cause to believe that the subsidiary is engaged in activities that pose a material risk to an affiliated DI;

2. Supervisory staff includes individuals that are on and/or off site.

2. has reasonably determined, after reviewing relevant reports, that an examination of the subsidiary is necessary to be adequately informed of the systems for monitoring and controlling the operational and financial risks posed to any DI; or
3. has reasonable cause to believe, based on reports and other available information, that a subsidiary is not in compliance with the BHC Act or any other federal law that the Board has specific jurisdiction to enforce against such subsidiary. This includes provisions relating to transactions with an affiliated DI, when the Board cannot make its determination by examining the affiliated DI or the BHC.