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March 15, 2018

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
OMB control number: 7100-NEW

Re: Proposed Supervisory Guidance on Effective Senior Management, Management of Business Lines and Independent Risk Management and Controls for Large Financial Institutions (Docket No. OP-1594)

Dear Ms. Misback:

UBS appreciates the opportunity to comment on the proposed supervisory guidance, which sets forth principles for effective senior management, management of business lines, and independent risk management and controls for large financial institutions (the "Proposal").¹ This comment letter is intended to be considered in concert with our previously submitted comments on two related proposals: a new rating system for certain LFIs ("proposed LFI rating system")² and guidance establishing principles on board effectiveness ("board effectiveness proposal")³. As with these earlier comment letters, this letter highlights important considerations for the application of such guidance to the US operations of foreign banking organizations ("FBOs"). UBS has also participated in the preparation of comment letters submitted by The Clearing House Association and the Institute for International Bankers and strongly supports their comments and recommendations.

We strongly support the Proposal's principles-based approach; however, we believe that further tailoring is warranted given the diversity of FBOs' organizational structures and management frameworks operating in the US relative to those established at the head office level. In addition, we consider the following elements to be critical factors that warrant attention in the Federal Reserve's finalization of the Proposal:

- Applied definitions and expectations for management within the Proposal should be sufficiently clear that they apply solely to those positions within the US and promote greater collaboration with and reliance on home country regulators' oversight of the global management framework and thereby facilitate the US supervisors' ability to assess the adequacy of governance and controls for the FBO's Combined US Operations (CUSO);
- Final guidance to examiners should emphasize reliance upon a firm's demonstrated alignment with the Proposal's principles in assigning a supervisory rating for the Governance and Controls component of the proposed LFI Rating framework and minimize the potential for illustrative lists of expectations and examples evolving into a prescriptive series of requirements; and
- The Federal Reserve should consider additional opportunities to leverage supervisory oversight afforded by the home country supervisor relative to the FBO's governance and control framework.

Finally, since the Proposal is a critical element along with the board effectiveness proposal of the Governance and Controls pillar of the new proposed LFI rating system, we highly recommend that the guidance for both elements be issued together. Further, given the tailoring requirements for FBOs for both this Proposal and the board effectiveness proposal, it is important that finalized guidance not be issued until these features are fully reflected.

¹ Federal Reserve System, *Proposed Supervisory Guidance*, 83 Fed. Reg. 1351 (published January 11, 2018)

² Federal Reserve System, *Large Financial Institution Rating System; Regulations K and LL*, 82 Fed. Reg. 39049 (issued Aug. 17, 2017)

³ Federal Reserve System, *Proposed Guidance on Supervisory Expectation for Boards of Directors*, 82 Fed. Reg. 37219 (issued Aug. 9, 2017).

In the following paragraphs, we offer several suggestions for enhancement of the principles and expectations expressed in the Proposal.

Roles and responsibilities of "senior management" and "business line management"

Within the Proposal, the term "senior management" can refer to individuals located outside of the US who are accountable to the global board of directors and thus become covered individuals under the Proposal. Specifically, this could "ring-fence" positions such as the global chief risk officer ("CRO"), who oversees the activities of the US CRO, in conjunction with the US risk committee, and reports to the global board. A similar impediment may be faced relative to the global chief audit executive ("CAE") that has a reporting line to the firm's global audit committee and oversees the efforts of a US-based CAE who may report to a US-based audit committee. Given the responsibilities of CUSO senior management for ensuring the safety and soundness of US operations while executing on business strategy, final guidance should clearly specify that expectations related to "senior management" refer to CUSO senior management.

With respect to "business line management," the Proposal attempts to specify expectations relative to the generally-held concept that the first line of defense should "own" risk. Granular expectations such as "business line management should provide a business line with sufficient resources and infrastructure to meet strategic objectives while maintaining financial and operational strength and resilience over a range of operating conditions, including stressful ones" do not appropriately contemplate that such duties are assumed by other accountable functions at the local or global level within the firm. Further, certain additional "business line management" expectations delineated within the Proposal such as those related to risk identification and measurement and controls testing may unduly create certain redundancies relative to the Regulation YY-related responsibilities of the US CRO, namely, "(a) the measurement, aggregation, and monitoring of risks undertaken by the combined US operations; and (b) the implementation of and ongoing compliance with the policies and procedures for the foreign banking organization's combined US operations and the development and implementation of processes and systems ⁴."

The Federal Reserve should consider developing separate or more tailored guidance for FBOs focused on responsibilities for US-based senior and business line managers that avoids the extension of requirements to managers operating in home country jurisdictions. In doing so, the Federal Reserve should consider employing the approach that led to the tailored guidance in the Federal Reserve's SR Letter 08-9⁵. Through this tailoring effort, the guidance should also be clarified to reinforce the principle that "business line management" through its ownership of risk should regularly evaluate the efficacy of support and controlling functions and related processes and their capacity to support ongoing and planned business activities in a well-controlled manner.

Principles versus prescriptive requirements

Although helpful in providing context relative to the defined principles, the examples laid out in the Proposal imply a prescriptive approach to evaluating a firm's Governance and Controls framework, which we feel does not take into account differences in firms' structures and operations, especially FBOs. For example, while we are generally supportive of the concepts expressed in the following principle "*Independent Risk Management (IRM) should establish enterprise-wide risk limits consistent with the firm's risk tolerance and monitor adherence to such limits,*" the specific expectations noted in the Proposal, "*To the extent possible, risk limits should consider the range of possible external conditions facing the firm over a period of time; consider the aggregation and interaction of risks across the firm; and be consistent with the firm's financial resources, such as available capital and liquidity, as well as with non-financial aspects, such as managerial, technological, and operational resources,*" may present instances where management would have to defend their selection of limits relative to the firm's risk tolerance versus those that examiners may have observed through horizontal exercises at other firms with different risk tolerances. Further, the Proposal by its detailed nature does not sufficiently contemplate the potential where

⁴ 12.CFR.252.155(b)(2) Subpart O—Enhanced Prudential Standards for Foreign Banking Organizations With Total Consolidated Assets of \$50 Billion or More and Combined U.S. Assets of \$50 Billion or More

⁵ Federal Reserve SR Letter 08-9 Attachment B1 "Guidance for the Supervision of the Combined US Operations of Foreign Banking Organizations that are Large Complex Banking Organizations (issued October 16, 2008)

examiners may prescribe the need for certain metrics, outside of those required under current banking regulations, which are isolated from or inconsistent with metrics within the global FBO's limit framework. Guidance should be directed at examiners' assessment of policy-governed controls and the effectiveness of those processes in achieving the principles-based objectives of the Proposal. Further, the Proposal should reinforce the effectiveness of internal audit and the board and its risk committee's oversight of such processes.

Consistent with the overall theme that there is no "one-size-fits-all" standard for a firm's governance and control framework, the Proposal and guidance provided to supervisory examination teams should reinforce that regardless of whether it is a BHC, IHC, or large branch-based FBO, management must have a certain level of discretion and flexibility as to its three lines of defense management structure and how the roles and responsibilities of each line is executed to align with the Proposal's principles.

Coordination with home country supervisors

While the Proposal makes certain references to how an FBO's US-based activities fit with that firm's global activities, the Proposal does not sufficiently draw an important element of the Federal Reserve's SR Letter 08-9 and cross-referenced in SR Letter 12-17 pertaining to the reliance and leverage of home country supervisors' oversight activities. Specifically that document notes the following:

"The Federal Reserve has the same supervisory goals and standards for the US operations of FBOs as for domestic organizations of similar size, scope, and complexity, including expectations for key governance and primary risk management and internal control functions. Given the added element of foreign ownership, supervision of an FBO requires consideration of the manner in which governance and control functions for US operations are integrated into the organization's global operations, as well as the home country supervisory framework under which the FBO operates. The Federal Reserve will supplement its knowledge of these factors by engaging in discussions with the home country supervisor and building upon that supervisor's insights on key governance and control functions as they impact US operations.

Key governance and control functions for the US operations of FBOs may be implemented locally or outside the United States, and the Federal Reserve will maintain an understanding and assessment of these functions regardless of where they are located. In instances where these functions are performed outside the United States, the established oversight mechanisms, governing policies and procedures, and supporting infrastructure must be sufficiently transparent for US supervisors to assess their adequacy. Further, the FBO's US management must demonstrate that it provides sufficient information flows to foreign governance and control functions, and that responsible senior management (including in the home country) maintain a thorough understanding of the risk and control environment governing US operations."

We believe that the Federal Reserve should consider adopting a more holistic approach to strengthening coordination of supervisory efforts with home country regulators, particularly as it applies to Governance and Controls activities conducted through head office. Furthermore, this approach should be a driving consideration in the Federal Reserve's tailoring of the expectations within the Proposal that are intended to inform examiners' assessment of Governance and Controls within the proposed LFI rating framework.

* * *

We appreciate the opportunity to provide our views and respectfully request that the Federal Reserve consider our suggestions on the Proposal and stand ready to participate in further dialogue and/or discussions with the Federal Reserve, as necessary. We feel strongly that the final guidance issued by the Federal Reserve should be tailored to fit the unique circumstances surrounding governance and control structures of IHCs operating in the US

Sincerely,

A handwritten signature in black ink that reads "Tom Naratil". The signature is written in a cursive style with a large, stylized initial "T".

Tom Naratil
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CEO, UBS Americas Holdings LLC
Co-President, Global Wealth Management
Group Executive Board, UBS Group AG

Cc: IHC Board of Directors
Michael Crowl, Americas General Counsel
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