



FINANCIAL  
SERVICES  
ROUNDTABLE

March 15, 2018

Via Electronic Submission

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, D.C. 20551

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

To Whom It May Concern:

The Financial Services Roundtable (“FSR”)<sup>1</sup> appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System’s (the “Board”) notice of proposed guidance describing core principles of effective senior management, the management of business lines, and independent risk management and controls for large financial institutions (the “Guidance”).<sup>2</sup> The Guidance is designed to work in conjunction with the Board effectiveness proposal (the “BE Proposal”) and the proposed revised large financial institution rating system (the “LFI Rating System”).<sup>3</sup> The Guidance, the BE Proposal and the LFI Rating System are part of an initiative by the Board to clarify and differentiate the roles and responsibilities of senior management and board of directors members and to provide a framework for the corporate governance portion of supervisory reviews of large financial institutions (“LFIs”).

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<sup>1</sup> The Financial Services Roundtable represents the largest financial services companies providing banking and payment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

<sup>2</sup> Federal Reserve System, Proposed Guidance on Effective Management, 83 Fed. Reg. 1351 (Jan. 11, 2018), available at <https://www.federalregister.gov/documents/2018/01/11/2018-00294/proposed-supervisory-guidance>.

<sup>3</sup> Federal Reserve System, Proposed Guidance on Supervisory Expectation for Boards of Directors, 82 Fed. Reg. 37219 (Aug. 9, 2017). See also Federal Reserve System Large Financial Institution Rating System; Regulation K and LL, 82 Fed. Reg. 39049 (Aug. 17, 2017).

FSR supports the Board's objective of setting clear expectations for the different levels of risk management. While FSR acknowledges and supports the need to clarify the Board's differing expectations of a banking institution's board and management, FSR recommends a principles-based approach to effective management rather than prescriptive, granular organizational requirements. LFIs could then continue to operate in the manner best tailored to respond to each institution's particular structure, market environment, and risk profile. In the post-financial crisis era, banking institutions, including LFIs, have made significant improvements in corporate governance, risk management, and supervision. Given these substantial improvements, it is critical to weigh the benefits of prescriptive, standardized regulation against the inefficiencies and loss of tailored risk management such regulation necessarily imposes upon LFIs. FSR submits that the benefits of tailored risk management far outweigh those of the proposed prescriptive directives.

To that effect, we offer the following comments and recommendations. We believe that these recommendations strike an appropriate middle ground between the benefits of setting forth clear regulatory expectations with respect to governance expectations and those associated with tailored risk management. We provide our responses to the Board's specific request for comments in Appendix A.

## **I. RECOMMENDATIONS FOR A MORE TAILORED APPLICATION**

FSR and its members support the Board's objectives in issuing the Guidance. As described below in Section I.A, we believe that the Board should generally maintain the italicized governance principles in the Guidance, but also allow for appropriate tailoring to differing institutions by eliminating the granularity now found in the Board's current proposal. As further described in Section I.A, the recommended governance processes would cause unnecessary tension with a variety of tailored governance processes that are already in place and that are consistent with current regulatory guidance. In Section I.B, FSR recommends actions the Board can take to ensure that LFIs actually are able to implement this tailored approach. Finally, in Section I.C, FSR recommends a review of Board and other agency guidance on this topic to ensure that LFIs have the clear, consistent guidance necessary to achieve the desired governance objectives as efficiently and comprehensively as possible.

### **A. The Guidance Should Allow LFIs to Pursue Tailored Governance Processes Consistent with their Unique Circumstances**

FSR and its members support the Board's focus on strong governance within LFIs and clarifying the roles and responsibilities of different levels of management. However, we believe this would be best accomplished by reference to general principles, as set forth in the italicized text of the proposal, and then allowing LFIs to meet those expectations in a manner tailored to their own organizations and risk profiles. The LFIs' already strong risk governance framework makes the more detailed guidance

unnecessary, and possibly even counterproductive to the goals the Board wishes to achieve.

Strong Governance is Already Present. Since the financial crisis, LFI have been focused on reviewing and strengthening their risk management frameworks. Strong risk management is critical to building a successful and growing company and is now a key concern for investors, shareholders and other key stakeholders. Senior management officials have designed LFI risk management and governance frameworks to align not only with market expectations, but with recently adopted enhanced regulatory requirements, including the Board’s comprehensive capital analysis review (“CCAR”) process, risk committee requirements (as discussed in further detail below) and the Office of the Comptroller of the Currency’s (“OCC’s”) Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations (“OCC’s Heightened Standards”).<sup>4</sup>

The Board’s 2014 enhanced prudential regulations for LFI risk committees<sup>5</sup> (and a similar regulation for Foreign Banking Organizations (“FBOs”) with intermediate holding companies (“IHCs”)<sup>6</sup>) illustrate the substantial risk frameworks the LFI already have implemented to respond to recent Board requirements. As the Board is aware, the regulations extensively detail the need for policies and procedures establishing a risk management framework, monitoring and implementing compliance with that framework, and establishing accountability within that framework. The regulations also specify the need for, and responsibilities of, a Chief Risk Officer, who must report directly to the risk committee.

Of particular note, Sections (a)(2)(B)-(D) of each of 252.33 and 252.155 set forth principles requiring processes and systems for “establishing managerial and employee responsibility for risk management,” “ensuring the independence of the risk management function,” and integrating “risk management and associated controls with management goals.” In complying with these principles, the LFI already have created robust systems addressing many of the more granular issues raised in the Guidance. Of at least equal significance for the purposes of this comment letter, in both of those regulations, the Board directs as an overarching foundational principle that the risk framework for each institution be “commensurate with its structure, risk profile, complexity, activities, and

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<sup>4</sup> Office of the Comptroller of the Currency, “OCC’s Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations,” 79 Fed. Reg. 74595 (Sept. 11, 2014).

<sup>5</sup> 12 CFR 252.33.

<sup>6</sup> 12 CFR 252.155.

size, while allowing LFIs to develop tailored risk management framework.”<sup>7</sup> The Board since has assisted LFIs to further hone these requirements through the examination process, providing useful insights into possible adjustments and approaches.

Granular Guidance is Not Needed and is Counterproductive. The top-level italicized governance principles set forth in the Guidance are fully consistent with the way LFIs more generally have been enhancing their risk management frameworks. Pursuant to their own desire for strong governance and the above-quoted Board-enhanced prudential regulations and to OCC’s Heightened Standards, LFIs have, through their risk committees and otherwise, already achieved higher levels of risk identification, accountability, and independent validation.

Rather than viewing compliance with the directives of the Board’s risk committee regulations as simply a “check the box” exercise, and consistent with their own desires to develop best practices aligned with Board regulation, LFIs have tailored these frameworks to their organizations, with variations among FSR’s members based on, among other things, asset size, complexity, product offerings and geographic presence. Moreover, LFIs have embedded their risk frameworks into business as usual (“BAU”) processes tailored to their enterprises. Forcing them to revise already-compliant policies, procedures, and systems just to demonstrate compliance with the granular requirements in the Guidance requires an unnecessary migration from tailored systems to standardized protocols. As a result, the granular approach proposed by the Guidance creates operational inefficiencies, unwarranted administrative demands, and almost certainly would diminish the tailoring that the Board’s enhanced prudential regulations appropriately recognized should be the foundational component of a well-functioning risk-based framework.

Additionally, granular guidance requirements pose a risk of conflicting with processes in place to achieve compliance with guidance from other agencies such as the OCC’s Heightened Standards. The value of granular requirements in the Guidance thus should be weighed against the loss of tailored risk management frameworks that are already in place and that meet the enhanced post-crisis expectations of both regulators and other key stakeholders. Amending the Board’s proposal to focus only on the core principles rather than granular requirements can help to avoid potentially conflicting standards, while acknowledging the industry’s commitment to high governance standards.

Examples of Guidance Conflicting with Robust, Tailored Practices. FSR sought specific examples from its members to identify where overly granular Guidance could conflict with tailored practices now in place. While not meant to be an exhaustive list by any means, the following examples illustrate possible areas where the implementation of

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<sup>7</sup> See id. §§ 252.33(a)(2), .155(a)(2).

the Guidance would undermine governance practices that are better suited for a particular LFI. We also note at the outset that these examples only focus on areas where a potential conflict is clear. We do not fully discuss the concern that vague mandates can result in confusion and conflict during the actual implementation of these standards. For example, the Guidance mandates that senior management provide materials to the Board that are “timely” and “useful.”<sup>8</sup> While that requirement does not necessarily create a conflict or inefficiencies with the tailored practices of LFIs in theory, it may do so in practice if LFIs constantly have to defend the timeliness or usefulness of particular materials to examiners.

To demonstrate the breadth of these concerns, the examples relate both to the management expectations in the Guidance (Sections I and II of the Guidance), and the independent risk management (“IRM”) directives in Section III of the Guidance.

1. Overly Strict Demarcation of Management Roles. FSR and its members certainly agree with the thrust of the principles in Sections I and II of the Guidance—senior and business line management play important roles in an LFI’s risk framework and should be held accountable for the roles given to them. In response to their own desire for best governance practices, and in compliance with the Board’s enhanced prudential standards discussed above, LFIs have created risk management practices best suited to their own structures and profiles.

However, in pursuing granularity, the Guidance would impose specific roles on designated personnel within each LFI. The Guidance states that “senior management is responsible for implementing the firm’s strategy and risk tolerance approved by the board”<sup>9</sup> and that “business line management should establish specific business and risk objectives for each business line that aligns with firm-wide strategy and risk tolerance.”<sup>10</sup> While these prescriptions often generally align with the overall approach of the LFIs, the Guidance too strictly demarcates the roles of the various LFI personnel. For example, this language could preclude an LFI’s board from determining that a specific risk warrants more of a collaborative approach from many stakeholders, and precludes a functional allocation of roles different from a black and white “senior management” and “business line management” approach. Forcing LFIs to realign these management functions from the best personnel for their organizations to “check the box” titles appears clearly contrary to the thoughtful risk management that both the industry and the Board desire.

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<sup>8</sup> Proposed Guidance on Effective Management, 83 Fed. Reg. at 1357.

<sup>9</sup> Id. at 1357.

<sup>10</sup> Id. at 1358.

2. Overly Strict Risk Tolerance Exception Framework. The LFIs are very focused on maintaining robust risk tolerance frameworks and holding their senior management and business line leaders accountable for compliance with the limits they impose on their operations. However, recognizing that risks are of different magnitude and importance, the LFIs also have developed various processes to address allowing exceptions to the risk management framework. The LFIs tailor their respective exception policies to provide more review and oversight over material exceptions, while potentially addressing non-material exceptions in a manner that would promote an efficient risk management framework.

The Guidance would not allow for internal evaluation and prioritization of risk exceptions. Rather, the Guidance provides that “business line management should consult with senior management before allowing any exceptions to risk limits,”<sup>11</sup> and the CRO or IRM “should be involved in any proposal to waive or make exceptions to established risk limits.”<sup>12</sup> The LFIs are concerned that this absence of prioritization could impair their risk frameworks in two related but distinct ways. First, if LFIs must escalate even the most minor of exception requests, the sheer volume of escalations could strain their bandwidth to address more material items in a timely manner, thus creating operating inefficiencies with no practical benefit. Second, and even more importantly, the LFIs are concerned that forcing the CRO or IRM to consult on all exceptions will reduce their ability, as exists now under their tailored systems, to focus their attention on those exceptions that are most likely to have a significant impact. Instead of overarching requirements, we believe the guidance should be revised to require LFIs to create review and escalation frameworks for risk limit breaches that set clear guidelines based on an institution’s specific risk appetite.

3. Improper Reduction of IRM Independence Role. As its name implies, IRM serves a critical role as independent evaluator of risk within an organization, reviewing, evaluating and, when necessary, modifying management determinations. Given this function, FSR and its members strongly agree that IRM guidelines should be part of any guidance on risk frameworks in order to ensure that an LFI has a robust risk management policy for reviewing and addressing the particular risk issues of the organization. LFIs have devoted substantial effort to deploying this potent oversight tool in the manner best suited to their organizations.

However, the Guidance imposes granular and improper mandates on the roles IRM must play in an LFI, thereby potentially altering the IRM’s ability to focus on its role as an independent evaluator and upsetting the tailored system of checks and balances

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<sup>11</sup> Id. at 1358 (emphasis added).

<sup>12</sup> Id. at 1360 (emphasis added).

each institution deploys. For example, the Guidance provides that “IRM should determine whether the firm’s risk profile is consistent with the firm’s materials risks and assess whether the firm’s risk management framework has the capacity to manage the risks,”<sup>13</sup> and that the IRM should “identify and manage current and emerging risks within and across business lines and risk types, as well as any other relevant perspectives.”<sup>14</sup>

These mandates potentially can have three negative impacts on the role of an IRM in an LFI: (1) changing its character from evaluation of the efforts of senior management to performing initial assessments itself, thereby decreasing its independence in those areas; (2) decreasing the IRM’s bandwidth to serve its important role of independent evaluation; and (3) creating inefficiencies, and duplicative and possibly inconsistent efforts within the carefully structured risk management framework of an LFI, because both senior management and an IRM would perform similar tasks concurrently. None of the above granular requirements provides any benefit to the LFI’s risk management framework of an organization, and more likely they only would detract from the critical role that an efficiently functioning, tailored IRM function can serve within an LFI.

4. Improper Mandates of IRM Operation. In addition to directing with improper granularity the role that an IRM must serve, the Guidance mandates with improper granularity how an IRM must operate when serving its role. The methods by which an IRM makes determinations, as well as how it communicates its evaluations within an LFI, vary both on the risk framework of the LFI and the nature and severity of the specific issue. LFIs seek to ensure that their IRMs have access to whatever information they need for a particular situation and that the IRM communicate any results in a time sensitive manner. They tailor their risk management frameworks to allow the IRM to serve its critical role as efficiently and forcefully as possible.

Once again, the Guidance’s italicized principles recognize and promote this objective, but its granular requirements could detract from the ability of an IRM to operate in a manner best suited for its LFI. For example, when discussing the need for IRMs to have access to comprehensive information (a principle with which the LFIs wholeheartedly agree), the Guidance does not then allow an IRM to determine what information is, in fact, appropriate for a particular situation. Rather, the Guidance mandates that “IRM staff should also draw upon external information, such as peer data or market information, to supplement their assessments.”<sup>15</sup> Similarly, if the information is needed from a business line, rather than permitting the IRM to obtain that information

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<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Id. at 1361.

in the most efficient way possible, the Guidance mandates that the IRM should provide a “measured implementation plan to obtain the necessary information.”<sup>16</sup>

An IRM may find either of the above approaches, or the myriad of other operational directives presented in the Guidance, appropriate for any particular circumstance, and an LFI’s risk management framework should support an IRM’s exercise of discretion to proceed in whatever manner the IRM believes appropriate. The Guidance should not dictate the approach that the IRM should use to address every issue it may encounter (or, as discussed in Example 2 above, force it to address every risk exception request). At best, such an untailored approach creates operating inefficiencies without any corresponding benefit; at worst it forces IRM into a “check the box” exercise that diminishes its ability to focus on those risk issues that truly are material to the LFI.

For all of the above reasons, FSR and its members strongly suggest that the Board eliminate the granular prescriptions within the Guidance. In the preamble, the Board recognizes the desire for a tailored risk management program, stating that the “proposed guidance does not include specific organizational structures at firms.”<sup>17</sup> Unfortunately, for the reasons discussed above, the Guidance itself is inconsistent with this approach. The simplification of the Guidance suggested herein is also consistent with the views of the Board’s Vice Chair for Supervision, Randal Quarles, who said in his recent speech to the American Bar Association that “simplicity of regulation...promotes meaningful compliance by the industry with regulation and reduces unexpected negative synergies among regulations.”<sup>18</sup>

We also submit that it is not sufficient for the Board to add a general disclaimer at the outset of the Guidance that institutions should tailor the Guidance to their own risk management systems because examiners could assume that an LFI’s tailoring nonetheless must include all the prescriptive guidance. (We discuss in subsection B below the need for affirmative Board steps in the final Guidance to allow LFIs to continue to tailor risk management systems in light of even the more general principles recommended herein, let alone a final Guidance that includes the level of detail it does currently.) Revisiting the proposed Guidance and returning to a principles-based approach (generally, the italicized portion of the Guidance) will demonstrate that the Board is truly committed to the robust, tailored risk management approaches espoused in its 2014 enhanced

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<sup>16</sup> Id.

<sup>17</sup> 83 Fed. Reg. 1351, 1354.

<sup>18</sup> Randal K. Quarles, Vice Chairman for Supervision, Fed. Reserve Bd., Remarks at the American Bar Association Banking Law Committee Annual Meeting: Early Observations on Improving the Effectiveness of Post-Crisis Regulation (Jan. 19, 2018), available at <http://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm> [hereinafter Quarles ABA Remarks].



prudential rules, other precedents, and the recent comments by the Vice Chairman for Supervision.

**B. The Board Should Take Affirmative Steps to Allow LFIs to Continue to Deploy Tailored Standards**

Pursuing the changes in the Guidance discussed above certainly will assist in permitting LFIs to continue to pursue a tailored risk management framework. However, changing the granularity of the regulation itself is not sufficient. As Vice Chairman Quarles recognized in a Q&A discussion last fall, “a significant part of the Fed’s engagement of the firms is through supervision rather than regulation.”<sup>19</sup>

To a greater degree than other more data-based rules like the Volcker Rule, liquidity coverage ratios, and CCAR, which at least permit LFIs to show data and computations to demonstrate compliance, the perceived level of compliance with the Guidance will be subject to significant examiner discretion. A strong governance program certainly incorporates data, but also relies upon the thoughtful, dynamic decisions by an LFI’s board of directors and senior management as to the best risk management processes and decisions for its organization.

As discussed in Section I, LFIs have embedded these practices in their BAU processes and procedures. As a result, if examiners demand rigid, clearly demonstrable adherence to each line in the Guidance, LFIs could be forced to pursue “check the box” structures that drive LFIs toward standardization rather than the systems best suited for their unique risk profiles. Moreover, examiners could use “20/20 hindsight” to evaluate well-founded decisions made within that framework, potentially leading to unwarranted regulatory criticisms of LFIs and less willingness of LFIs to closely tailor a framework to their own risks.

To reduce the likelihood of this result, FSR and its members believe that even with the reduction of granularity described in the previous section (and believe even more forcefully if any of that granularity should remain in the final Guidance), the final Guidance should have a clear, declarative, overarching statement that while the Guidance sets forth high-level principles that it expects LFI risk frameworks to achieve, each LFI is entitled to deference in developing its own tailored risk management framework to satisfy those objectives. This type of express declaration in the final Guidance is consistent with Vice Chairman Quarles’ statement at that fall Q&A that “changing the tenor of

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<sup>19</sup> Randal K. Quarles, Vice Chairman for Supervision, Fed. Reserve Bd., Q&A Session at the Clearing House Association Annual Conference (Nov. 7, 2017) (reported in John Heltman, Quarles says Fed taking ‘fresh look’ at regulation, fintech, AM. BANKER (Nov. 7, 2017, 3:35 PM)).

supervision will be the biggest part of what it is that I do,”<sup>20</sup> and his 2018 speech that the Board has the responsibility to “do further tailoring for the institutions that remain subject to [Board] rules to ensure that regulation matches the risk of the firm.”<sup>21</sup>

### C. The Board Should Map the Guidance to Related Regulatory Standards

FSR also recommends that the Board identify and reconcile any ways in which the Guidance varies from existing guidance and precedent. Language in the Guidance notes that it is intended to “consolidate and clarify the Federal Reserve’s existing supervisory expectations regarding risk management,”<sup>22</sup> but does not mention the specific rules and guidance that are consolidated and clarified. To ensure LFIs meet the expectations contained in the Guidance and other Board precedents, the Board should explain which of the already existing regulatory standards are subsumed within the Guidance. The final Guidance should also state what, if any, precedents<sup>23</sup> are superseded by the Guidance.

Moreover, beyond the Board’s own precedents, LFIs would find it helpful for the final Guidance to specifically discuss the Guidance’s relationship to the standards of other regulatory agencies, such as the OCC’s Heightened Standards. The Board long has shown, and indeed promoted,<sup>24</sup> deference to the primary regulator of a bank within a bank holding company structure. FSR and its members seek confirmation that the Board will defer to the risk management guidance of the OCC as to a national bank’s activities. Even if the Board provides that deference, however, imposing granular requirements through the Guidance potentially subjects LFIs to multiple, perhaps inconsistent, directives from the different banking agencies as to their risk management frameworks.

The desire to avoid this inconsistency, and promote LFIs maintaining risk management frameworks tailored to their particular circumstances, highlights once again the desirability of removing the granular prescriptions from the final Guidance (as

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<sup>20</sup> Id.

<sup>21</sup> Quarles ABA Remarks, supra note **Error! Bookmark not defined.**

<sup>22</sup> 83 Fed. Reg. at 1353.

<sup>23</sup> E.g., Supervision and Regulation (“SR”) Letter 95-51, “Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies,” is mentioned as being superseded by the Guidance. SR Letter 03-5, “Amended Interagency Guidance on the Internal Audit Function and its Outsourcing,” as supplemented by SR Letter 13-1/CA Letter 13-1 is not superseded by the Guidance. See 83 Fed. Reg. 1351, 1353 n.11; 83 Fed. Reg. 1351, 1362.

<sup>24</sup> See, e.g., *Indep. Ins. Agents of America, Inc. vs. Board of Governors of the Federal Reserve System*, 890 F.2d 1275 (Nov. 29, 1989).

discussed in Section I.A above), and affirmatively declaring that examiners should defer to LFIs in implementing the Guidance in the manner best suited to the LFI (as discussed in Section I.B above). Particularly for the many regional LFIs for which substantially all of the assets reside in a subsidiary national bank, the LFI's enterprise-wide risk management framework would likely (and appropriately) be influenced substantially by the OCC's Heightened Standards.

## **II. RECOMMENDED MODIFICATIONS TO THE GUIDANCE**

As detailed in Section I above, FSR and its members most fundamentally recommend that the Board significantly reduce the granularity of the proposed Guidance and generally rely on the italicized principles contained therein. By following that recommendation, the Board also conceivably could resolve (by elimination of the granularity) some of the more specific comments in this Section II, such as the recommendation in Section II.B below. Nonetheless, because we cannot be certain of the exact nature of the Board's simplification of the final Guidance, and because of the importance of the issues in this Section II, FSR also wishes to touch upon other areas of the proposed Guidance where we believe reform is needed.

### **A. The Guidance Should Apply Only to FBOs with IHCs**

The Guidance would apply to the U.S. operations of FBOs with combined U.S. assets (branch and non-branch) of \$50 billion or more. This would apply the Guidance to FBOs that are not currently subject to the IHC requirement of the Board's Regulation YY, which applies only to FBOs with \$50 billion or more of non-branch assets. Applying the Guidance to FBOs that are not subject to the IHC requirement similarly is inconsistent with the scope of the proposed LFI Rating System, which applies only to FBOs that are subject to Regulation YY's IHC requirement. Properly applying the Guidance only to FBOs with IHCs thus would make it consistent with principles contained in both existing and pending Board directives.

FSR also believes that there is no policy reason for extending the Guidance beyond FBOs that have an IHC. Regulation YY carefully balances deference to an FBO's home office regulatory framework with the desire to protect the stability of the U.S. economy. In that regard, Regulation YY requires FBOs with a large branch presence in the United States to form a U.S.-focused risk committee, though the ultimate management of the branch is left to the home office. Only institutions with more than \$50 billion U.S. non-branch assets, which generally include a large U.S. bank or broker-dealer, are regulated under Regulation YY's IHC requirements.

FSR believes that applying the Guidance to FBOs outside of the scope of the IHC requirement contravenes the careful balance developed in Regulation YY, and imposes additional burden and complexity to certain institutions unnecessarily. We further believe that, in light of Regulation YY's significant expectations of the U.S.-focused risk

committee (as discussed in Section I.A above), the Guidance is not necessary for FBOs without an IHC. We thus submit that FBOs with IHCs, which are the only foreign banks with U.S. structures similar to the U.S. bank holding companies, are the only FBOs for which application of the Guidance is even potentially appropriate.

Furthermore, the Guidance also suggests that it could apply to the home office management of an FBO. Regulation YY imposes significant risk management and other requirements on an IHC, resulting in their having governance and risk management frameworks very similar to a similarly sized U.S.-headquartered bank holding company. FSR thus believes that the Board extending the Guidance to home office management is not necessary, and such extension of the Guidance would disrupt the “compromise between the interest of home and host regulators” that Regulation YY imposed after Board consultation with foreign regulatory authorities.<sup>25</sup>

Additionally, extending the Guidance to home office management would contravene a core objective of Regulation YY, particularly with respect to IHCs—empowering the IHC’s U.S. leadership. The Board mandated the IHC structure to address its concern after the financial crisis that an FBO with significant U.S. non-branch operations (e.g., a large broker-dealer), but less U.S.-based oversight, governance and accountability could take actions in the next downturn that could threaten the U.S. economy.<sup>26</sup> By holding home office management accountable for its mandates, the Guidance also may reduce in practice the willingness of home office management to defer to the business judgment of U.S. management. The Guidance thereby could impair a protection (U.S.-based governance and accountability) that the Board developed Regulation YY to impose.

#### **B. The Guidance Should Eliminate the Requirements that LFIs “Ensure” Specific Outcomes**

The Guidance should not establish as a standard or expectation that groups within the firm must “ensure” certain outcomes. The use of the word “ensure” could be interpreted to create something akin to a strict liability standard that would require management to guarantee a particular outcome, which is unrealistic in any ongoing business.

Many LFIs already have BAU processes and procedures in place that are designed to provide strong governance. In situations where LFIs are expected to “ensure”

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<sup>25</sup> Total Loss- Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holdings Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8,266, 8,297 (Jan. 24, 2017).

<sup>26</sup> 79 Fed. Reg. 17240, 17271-17272.

outcomes, the Guidance could instead focus on the LFI demonstrating that the appropriate BAU governance processes and procedures are in place. For example, the Guidance requires senior management to “ensure effective communication and information sharing across the entire firm.”<sup>27</sup> Senior management cannot guarantee this outcome, but it can put appropriate communication channels in place, which IRM would then evaluate as part of an LFI’s tailored program.

Thus, in each instance where the Guidance requires senior management, business line management, IRM, and controls to “ensure” an outcome, we believe the language should be changed to include a reasonableness qualifier (e.g., take reasonable or appropriate steps reasonably designed to ensure). Focusing on the BAU processes and their ability to address the specific needs of an LFI over time, rather than whether any individual result is “ensured”, will allow the Guidance to promote the most durable, dynamic, and tailored risk framework for each LFI.

We note that when initially proposed, the OCC’s Heightened Standards similarly used the term “ensure,” and that the preamble to the final rule addresses how the OCC changed approach after industry comment in a manner consistent with our recommendation above. Such a change also would be appropriate here if the Guidance retains the granular “ensure” provision. Nonetheless, as stated in the introduction to this Section II, we recommend that the Board resolve this issue by revising the final Guidelines to focus on general principles so as to avoid the concerns arising from granular directives such as this one and others discussed in this Section II.

**C. The Guidance Should Apply Only to the Material Business Lines of Large Institution Supervision Coordinating Committee (“LISCC”) Firms**

The Guidance defines a “business line” broadly as a “defined unit or function of a financial institution, including associated operations and support that provides related products or services to meet the firm’s business needs and those of its customers.” This definition would include units such as Corporate Treasury and IT support. For an FBO, a business line similarly could include all business lines that are present in the United States.<sup>28</sup>

As a result, the mandate in the Guidance that a LISCC firm apply the Guidance to all of its business lines<sup>29</sup> is overly broad, untailored and unnecessary. This definition would force LISCC firms to inappropriately expand their already extensive risk

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<sup>27</sup> Proposed Guidance on Effective Management, 83 Fed. Reg. at 1357.

<sup>28</sup> 83 Fed. Reg. 1351, 1354, n. 15.

<sup>29</sup> Id. at 1356, FN. n. 26.

management framework and divert resources from areas of actual risk. More fundamentally, like all LFIs, the LISCC firms have devoted substantial resources to develop a risk management framework that is tailored specifically to their risks, and this arbitrary directive in the Guidance to include anything that could be deemed a “business line” under the broad definition above would serve no purpose other than to increase costs and create inefficiencies within a well-functioning program.

#### **D. The Guidance Should Defer to LFIs as to which Business Lines are Material**

FSR believes that the final Guidance should make it clear that the Board will defer to good faith determinations by LFIs (including LISCC firms) as to what constitutes a business line subject to the Guidance. The proposed Guidance on senior management would apply to “business lines where a significant control disruption, failure or loss event would result in a material loss of revenue, profit or franchise value, or result in significant consumer harm.”<sup>30</sup>

FSR recognizes the difficulty the Board faces in trying to define, in the abstract and divorced from the circumstances of a particular LFI, the criteria to subject an LFI business line to the Guidance. We believe this difficulty further reinforces our Section I.A recommendation that the final Guidance should focus solely on general principles. However, to the extent the final Guidance retains some criteria for business line inclusion, we believe it is critical for the Board to provide an express statement in the Guidance that would afford substantial flexibility for LFIs to determine in good faith which business lines its risk management framework should cover.

This issue also further highlights the need (as discussed in Section I.B above) for the Board and the Guidance to expressly provide for flexibility when examiners are evaluating compliance with its directives. As highlighted throughout this comment letter, LFIs have devoted substantial time and resources to developing risk management frameworks tailored in scope to their specific organizations—a process that necessarily includes consideration of which business lines should be covered as part of the risk management program. The above recommendations would help to avoid the Guidance compelling an LFI to divert time and resources to add a business line to its already well-tailored framework simply to avoid the risk of regulatory criticism during an examination.

Finally, as discussed in Section I.C. above, to avoid duplication, and likely confusion as to the approach an LFI should take in confronting overlapping Guidance, when considering a depository institution subsidiary the Guidance should clearly provide that Board examiners will rely on the work of the primary regulator of the depository

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<sup>30</sup> Id.

institution and give deference to the determinations made by that regulator. For many LFIs, there are a significant number of material business lines located entirely, or almost entirely, in the subsidiary depository institution. These depository institutions are heavily regulated by either state or federal regulators, including the OCC. Subjecting subsidiary depository institutions to duplicative document production and other efforts to meet regulatory requests resulting from the Guidance would not only be unnecessary, but likely confusing and counterproductive.

### **III. RECOMMENDATION ON CALIBRATING THE GUIDANCE AND THE TIMING OF IMPLEMENTATION**

Finally, FSR recommends that the Board change the timing and applicability of the Guidance, in recognition of both (A) pending federal legislation and (B) the Board's own set of governance proposals.

#### **A. The Applicability of the Guidance Should Vary with the Dodd-Frank Act's Enhanced Prudential Standards**

The \$50 billion threshold used in the Guidance appears to be based on the asset threshold for enhanced prudential standards used in sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").<sup>31</sup> FSR has long believed that a simple asset threshold does not represent an effective mechanism for determining which financial institutions should face heightened regulatory scrutiny.<sup>32</sup> Reliance on asset thresholds acts as a barrier to effective regulatory tailoring as they can force institutions to become subject to new regulations despite no material change in the size or risk profile of their operations. As a result, many institutions make concerted efforts to avoid passing the applicable asset threshold.

Notably, Congress is currently considering multiple legislative proposals to revise the Dodd-Frank enhanced prudential standards threshold, a reform that has already been endorsed by leaders of the Board, including Chairman Powell<sup>33</sup> and by other regulatory

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<sup>31</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>32</sup> See "Size Alone is Not Sufficient to Identify Systemically Important Banks," Office of Financial Research, 17-4, October 26, 2017.

<sup>33</sup> The Semiannual Monetary Policy Report to Congress Before the Senate Committee on Banking, Housing and Urban Affairs, 115<sup>th</sup> Congress (March 1, 2018) (testimony of Jerome Powell, Chairman, Federal Reserve Board); see also Daniel K. Tarullo, *Departing Thoughts*, The Woodrow Wilson School, Princeton University, New Jersey (April 4, 2017), available at <https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm> (The "\$50 billion in assets threshold established in the Dodd Frank Act for banks to be 'systemically important' and thus subject to a range of stricter regulations was set too low").

agencies. As such, we suggest that final action on approval of the Guidance should be delayed pending Congressional action to ensure that any Board programs properly reflect the views of both Congress and the current membership of the Board. FSR supports language in the Guidance that exempts institutions that are not included within any amended statutory standard for imposing enhanced prudential standards. Beyond that, we urge the Board to tailor application of the Guidance without regard to a static asset threshold pursuant to metrics used by the Board in other contexts for determining systemic risk.

**B. Finalization of the Guidance and the Board’s Related Proposals should be Delayed until they can be Appropriately Calibrated**

LFI have in place strong governance practices, which they continue to refine based on their structure, risk profile, complexity, activities, and size. As a result, FSR strongly urges the Board to take sufficient time to examine and evaluate all aspects of the proposed Guidance, the BE Proposal and the LFI Rating System Proposal, instead of rushing to complete all or any part of the framework. Similarly, local examination teams should wait for final guidance before beginning any examination work related to any of these proposals. In the interim, the Board should carefully evaluate the Guidance and the other proposals, both individually and in the aggregate, to ensure that the final rules provide benefits greater than the burdens they impose. Delaying the finalization and effective date of the Guidance, the BE Proposal, and the LFI Rating System until 2019 or even later would be worthwhile to ensure that LFIs can continue to maintain tailored risk management frameworks best suited for their particular issues.

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Thank you for your consideration of our comments. We look forward to working with the Board to improve both the content and implementation framework of the Guidance. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact me via telephone at (202) 589-2424 or email me at [Richard.Foster@FSRoundtable.org](mailto:Richard.Foster@FSRoundtable.org).

Sincerely yours,

A handwritten signature in black ink that reads "Rich Foster". The signature is written in a cursive, slightly slanted style.

Richard Foster  
Senior Vice President and Senior Counsel  
for Regulatory and Legal Affairs  
Financial Services Roundtable

## Appendix A

### RESPONSES TO SPECIFIC BOARD QUESTIONS

**I. What considerations beyond those outlined in this proposal should be considered in the Federal Reserve’s assessment of whether an LFI has sound governance and controls such that the firm has sufficient financial and operational strength and resilience to maintain safe and sound operations?**

Please refer to Sections II.B and II.D where we recommend focusing on the processes and procedures supporting LFI governance and allowing LFIs (including LISCC firms) to determine which business lines are material to their organization.

**II. How could the roles and responsibilities between the board of directors set forth in the proposed board effectiveness guidance, and between the senior management, business line management, and IRM be clarified?**

Please refer to Section I.A where we recommend that the Guidance focus on core principles rather than prescriptive requirements, and Section I.C where we suggest alignment with other regulatory precedents.

**III. What, if any, aspects of the structure and coverage of IRM and controls should be addressed more specifically by the guidance?**

Please refer to Section I.A (specifically items 3 and 4) where we recommend that additional flexibility, rather than further granularity, is needed for the IRM function.

**IV. The proposal tailors expectations for FBOs, recognizing that the U.S. operations are part of a larger organization. How could this tailoring be improved?**

Please refer to Section II.A where we discuss the need for clarification of the application of the Guidance to FBOs and recommend restriction of the applicability of the Guidance to FBOs that are subject to Regulation YY’s IHC requirement.

**V. In what ways, if any, does the guidance diverge from industry practice? How could the guidance better reflect industry practice while facilitating effective risk management and controls? Are there any existing standards for internal control frameworks to which the guidance should follow more closely?**

Please refer to Sections I.A (specifically items 3 and 4) and Section II.D where we discuss the need for flexibility in the IRM function and the ability of LFIs to determine the materiality of their business lines.

**VI. Other supervisory communications have used the term “risk appetite” instead of risk tolerance. Are the terms “risk appetite” and “risk tolerance” used interchangeably within the industry, and what confusion, if any, is created by the terminology used in this guidance?**

No comment.

**VII. The proposal would adopt different terminology than is used in the proposed LFI rating system, and the Board expects to align the terminology so the element in the governance and controls component would change from “management of core business lines” to “management of business lines.” Does this proposal clearly explain this expected change? Do commenters anticipate any impact from this change?**

Please refer to Section III.B where we recommend the Board evaluate and align all three outstanding proposals, to evaluate their possible benefits and burdens, both individually and in the aggregate, before finalizing any of them.