

March 15, 2018

By electronic submission to regs.comments@federalreserve.gov

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

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

Ladies and Gentleman:

Credit Suisse Group AG and its designated U.S. intermediate holding company (“IHC”), Credit Suisse Holdings (USA), Inc. (collectively, “Credit Suisse”), thank you for the opportunity to comment on the proposed supervisory guidance issued by the Board of Governors of the Federal Reserve System (“FRB”) setting forth core principles of effective senior management, the management of business lines, and independent risk management (“IRM”) and controls for large financial institutions (hereafter referred to as “the Proposal” or “the Management Proposal”).¹ We broadly support the FRB’s broader initiative to review the existing ratings system for large financial institutions, as articulated in its Large Financial Institution Rating System Proposal (“the LFI Ratings System Proposal”), including the proposed Governance and Controls pillar of the LFI Ratings System, of which the Management Proposal is a part.

The overarching objectives of these reforms include better alignment of the ratings system with post-crisis supervisory expectations; a greater focus on safety and soundness and materiality; and the FRB’s move away from mandating time-consuming and often ineffective “check-the-box” exercises and towards what Chairman Powell has characterized as a “principles-based approach” that “recognizes that large firms have a broad range of business models, structures, and practices.”² These are all changes that we unreservedly welcome and believe will improve the quality of supervision and internal firm governance moving forward.

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

² Governor Jerome H. Powell, “The Role of Boards at Large Financial Firms,” Remarks at the Large Bank Directors Conference, Chicago, IL, August 30, 2017. Available at: <https://www.federalreserve.gov/newsevents/speech/powell20170830a.htm>.

Overview

While we generally welcome the reforms the FRB has put forward in the Management Proposal, we offer a number of suggestions for improvement in this comment letter. Specifically, we suggest the FRB take the following steps:

- Issue a separate management guidance proposal for FBOs/IHCs, including with respect to management of Bank branches located outside the IHC but within combined U.S. operations (“CUSO”)CUSO given the differences in how FBOs are structured and managed relative to domestic firms.
- Ensure consistency with future IHC-specific guidance on board effectiveness by issuing FBO-specific board effectiveness and management proposals in conjunction with one another, and then implementing both of these portions of the LFI Ratings System Governance and Controls pillar concurrently.
- Clarify the status of existing supervisory guidance relating to risk management in light of the Management Proposal.
- Narrow the definition of “senior management” to apply only to the most senior management level responsible for day-to-day U.S. operations.
- Clarify supervisory expectations around global strategy and risks, as well as responsibility for identifying and assessing risks that occur outside of combined US operations (“CUSO”).
- Narrow the definition of what constitutes a “business line” and revise the expectations around identification and measurement of risks by business lines to avoid unnecessary duplication of the functions of IRM.
- Distinguish IRM responsibilities from those of compliance and other control functions.
- Clarify the definitions of risk and expectations around risk limits in the final guidance.

1. Issue a separate management guidance proposal for FBOs/IHCs

We commend the FRB for providing several examples and clarifications on how the Proposal would relate to FBOs.³ However, we are concerned that Proposal does not go far enough in accounting for the differences in how FBOs are structured and managed relative to U.S. bank holding companies (“BHCs”). We are also concerned that as written, the Proposal could impose undue extraterritorial requirements on FBOs.

The FRB appeared to acknowledge the differences between FBOs and BHCs in its Proposed Guidance on Supervisory Expectations for Boards of Directors (“the Board”

³ See, for example, 83 Fed. Reg. 1351, 1356 n. 28 (“For an FBO, ‘senior management’ can refer to individuals located inside or outside the United States who are accountable to the IHC board, U.S. risk committee, or global board of directors with respect to the U.S. operations.”); *id.* at 1358 (“In instances where a business line of an FBO is part of a larger business conducted outside of the United States, expectations apply only to the portion of that business conducted in the United States.”).

Effectiveness Proposal). In the Board Effectiveness Proposal, the FRB stated that the guidance would not apply to IHCs and instead that it instead “anticipates proposing guidance on board effectiveness for IHCs at a later date” and requested comments on how the Board Effectiveness Proposal could be adapted for IHCs.⁴

Recommendation: We urge the FRB to follow through on its initial intent and issue a separate, FBO-specific management guidance proposal, as suggested by both the Institute of International Bankers (“IIB”) in their recent submission to the FRB⁵, and in the submission of The Clearing House Association in relation to the Management Proposal.⁶ Doing so would also be consistent with recent remarks by Vice Chairman for Supervision Quarles in which he indicated that the FRB “will consider additional tailoring and flexibility of our regulations in light of their impact on foreign banking organizations.”⁷ Any FBO- specific management proposal should be based on the same general principles of risk management, but also take into account the differences in activities, business, risk profiles, organizational structures, and home country regulation that exist between a top-tier U.S. BHC and the CUSO, including the IHC, of FBOs, including with respect to bank branches located outside of the IHC but within CUSO.

2. Ensure consistency with future IHC-specific guidance on board effectiveness

As noted above, the FRB has yet to issue a proposal on board effectiveness applicable to FBOs and has solicited comments on how the Board Effectiveness Proposal for U.S. BHCs could be amended for such institutions. In response, Credit Suisse submitted comments to the FRB focusing on how a future FBO-specific Board Effectiveness Proposal could take into account their distinct governance structures. Specifically, our comments emphasize the need for clear, aligned and consistent direction between the parent board and the board of the FBO's designated IHC and recognition that there is no “one-size-fits-all” approach standard for governance as it applies to FBOs.

The Board Effectiveness Proposal and the Management Proposal would inform the Federal Reserve's supervisory ratings under the Governance and Controls pillar of the proposed LFI Ratings System⁸ and are therefore designed to work in tandem with one another. The FRB explicitly notes that the Management Proposal would “compliment the [Board Effectiveness] proposal by aligning the attributes of senior management with those of an effective board of directors. For instance, the [Board Effectiveness] provides that an effective board of directors sets the firm's strategy and risk tolerance, and this [the Management] proposal contemplates that the firm's senior management implements the strategy and risk tolerance approved by the

⁴ 82 Fed. Reg. 37219, n. 1.

⁵ See Institute for International Bankers letter to Ann E. Misbank, Secretary, Michael S. Gibson, Director, Division of Banking Supervision and Regulation, and Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System entitled “Request for an Adjustment to the Timing and Method for Proposing and Adopting Guidance on Supervisory Expectations for Boards of Directors, a Large Financial Institution Rating System and Effective Senior Management and Risk Management,” February 15, 2018.

⁶ See the Clearing House Association letter in response to the Proposal, p. 18.

⁷ Vice Chairman for Supervision Randal K. Quarles, “The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule,” March 5, 2018. Available at: <https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm>.

⁸ See Credit Suisse Holdings (USA), Inc. letter to Ann E. Misbank, Secretary, Board of Governors of the Federal Reserve System, regarding “Proposed Guidance on Supervisory Expectations for Boards of Directors (Docket No. OP-1570),” February 15, 2018 (hereafter “Credit Suisse's Board Effectiveness Proposal Comment Letter”).

board. In this way, the proposed guidance would better distinguish the supervisory expectations for boards from those of senior management.”⁹

Recommendation: Given this close linkage, it is difficult for FBOs to evaluate the impact of the Management Proposal in the absence of FBO-specific guidance on board effectiveness. As such, we strongly recommend that the FRB issue FBO-specific board effectiveness and management proposals in conjunction with one another, and then implement both of these portions of the LFI Ratings System Governance and Controls pillar concurrently. Doing so would reduce confusion about supervisory expectations that likely will arise by implementing one portion of the Governance and Controls pillar (the management portion) before understanding how it would interact with the other portion (relating to boards of directors). At the same time, we want to reiterate the desire we expressed in our prior comment letter for the FRB to move expeditiously to issue and finalize those proposals in order to provide certainty to FBOs and ensure a level-playing field with domestic institutions.

3. Clarify status of existing supervisory guidance relating to risk management

In our response to the Board Effectiveness Proposal, we welcomed the FRB’s decision to identify Supervision and Regulation letters (“SR letters”) that ought to be revised in light of that proposal.¹⁰ While the FRB states that the Management Proposal “is intended to consolidate and clarify the Federal Reserve’s existing supervisory expectations regarding risk management,”¹¹ it does not identify SR letters and other guidance that would be altered or superseded by the Proposal.

Recommendation: We respectfully ask that the FRB identify these changes, or alternatively, make clear that any requirements or expectations in SR letters, other guidance, or in supervision and examination manuals in relation to risk management will be superseded by the final Management Guidance where conflicts arise.

4. Narrow the definition of “senior management” to ensure the final guidance is appropriate in scope and reach

In the Proposal, as aforementioned, the FRB does acknowledge the global context in which FBO governance, risk management, and control elements are embedded, and does on various occasions note that aspects of the Proposal ought to apply differently to FBOs given the different structures and home country requirements that such organizations are subject to. Nonetheless, we believe there are additional steps that the FRB should take to tailor the Proposal to FBOs (ideally in a separate FBO-specific proposal).

One of those steps ought to involve a clarification of the definition of “senior management” in the Proposal. For the purposes of FBOs, the Proposal states that “‘senior management’ can refer to individuals located inside or outside of the United States who are accountable to the IHC board, U.S. risk committee, or global board of directors with respect to the U.S. operations.”¹² Although we believe unintended, this definition could be interpreted

⁹ 83 Fed. Reg. 1353.

¹⁰ See Credit Suisse’s Board Effectiveness Proposal Comment Letter, p. 2.

¹¹ 83 Fed. Reg. 1351.

¹² 83 Fed. Reg. 1356-1357.

as applying to global senior management and their responsibilities to the global board of directors, which is not what we believe the FRB intended.

Of course, senior managers at the level of the parent are already subject to regulation and supervisory oversight of from home country authorities (in our case by the Swiss Financial Market Supervisory Authority - "FINMA"). It is clearly up to those home country authorities to determine effective management expectations for those senior managers, and it would be inappropriate and ultimately counterproductive for U.S. regulators to attempt to extend their expectations extraterritorially to senior managers operating in other jurisdictions. This is particularly true in those instances in which U.S. regulators have established strong working relationships with their foreign counterparts (as is the case with FINMA). The global adoption of standards and principles for effective bank regulation and management,¹³ as well as common principles for banks¹⁴ further attenuates the rationale for applying supervisory expectations to non-U.S. management.

Recommendation: The definition of "senior management" in the Proposal should be amended to apply to the most senior management level responsible for day-to-day U.S. operations. One workable formulation is offered by The Clearing House Association in its response: that is, "management overseen by and accountable to the IHC board with respect to U.S. operations conducted through the IHC and /or the U.S. risk committee for branch and any other non-IHC operations."¹⁵ In the case of dual-hatted senior managers with both U.S. and global responsibilities, we recommend that the FRB further clarify that the Proposal applies only to their responsibilities in relation to the U.S. operations.

5. Clarify supervisory expectations around: global strategy and risks, responsibility for identifying and assessing risks that occur outside of CUSO and IHC senior management and IRM with respect to bank branches located outside of the IHC but within CUSO

The FRB should recognize that its evaluations of senior management and IRM ought to differ between FBOs and BHCs. Senior managers at a top-tier BHC should be held accountable for a full range of enterprise-wide strategic, risk, and operational decisions (and global IRM for risk issues). By contrast, senior and business-line U.S. managers and IRM within an FBO ought to be evaluated based on those decisions for which they have discretion, U.S. implementation of decisions, and their willingness, when appropriate, to challenge global management with respect to decisions affecting the safety and soundness of U.S. operations. They should not and cannot be accountable for risks or other strategic or operational decisions over which they do not have authority.

¹³ See Basel Committee on Banking Supervision, "Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion" (September 2016). Available at: <https://www.bis.org/bcbs/publ/d383.pdf>; Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision (September 2012). Available at: <https://www.bis.org/publ/bcbs230.pdf>.

¹⁴ See Basel Committee on Banking Supervision, "Guidelines on Corporate Governance Principles for Banks" (July 2015). Available at: <https://www.bis.org/bcbs/publ/d328.pdf>.

¹⁵ The Clearing House Association letter, p. 20.

Likewise, they should not be responsible for providing an assessment of Group-wide risks or risks elsewhere in the global firm. The Proposal's expectations in the area of risk identification, measurement, and assessment are of particular concern in this regard. For example, the Proposal states that “[b]usiness line management of the U.S. operations should ensure that business line risks are captured comprehensively with consideration given to risks outside the United States that may impact the FBO's combined U.S. operations.”¹⁶ The Proposal also states that “IRM should identify and measure the firm's risks” and “should aggregate risks and provide an independent assessment of the firm's risk profile.”¹⁷

The IRM framework for FBOs is typically implemented on a Group-wide basis. Specifically, risk measurement, assessment and aggregation may rely on the methodologies developed and owned by at the Group level e.g., the methodologies used for IHC market risk measurements. U.S. IRM typically has limited influence on the underlying methodology, as there is no matrix reporting between the Group methodology organization and U.S. IRM. The language in the Proposal could be read to require a duplication of the work being done elsewhere in the Group. This would not only lead to a significant increase in operational costs, but would also undermine global enterprise-wide risk management by balkanizing risk measurement along jurisdictional lines.

In addition, the role of IHC senior management and IRM with respect to bank branches located outside of the IHC but within CUSO should be addressed in any final guidance applicable to FBOs. There ought to be recognition that while IHC senior management and IRM have responsibilities regarding risk management in CUSO, these branches are also part of distinct legal entities that have their own management teams, IRM, and boards of directors, and are subject to regulation and supervision by home country authorities.

Recommendation: The FRB should clarify that U.S. senior and business line management, and U.S. IRM, are not responsible for Group-level risk management decisions (as opposed to U.S. implementation of those decisions) over which they have no authority. In addition, there ought to be explicit recognition that U.S. IRM can utilize common methodologies developed at the Group level in the assessment of risk at the level of the IHC/CUSO, so long as they are implemented in a manner that is appropriate for its size, risk profile, organizational structure and other relevant characteristics. Special guidance should also be given with regard to expectations of senior management and IRM regarding branch management, recognizing these branches are a part of distinct non-U.S. legal entities.

6. The broad definition of a “business line” ought to be narrowed. In addition, the expectations around identification and measurement of risks by business lines ought to be revised to avoid unnecessary duplication of the functions of IRM.

Looking beyond FBO-specific issues, we also share many of the substantive concerns raised by other commenters in relation to the Proposal. In particular, we note that the definition of “business line” appears overly broad and could result in LFIs (particularly those subject to supervision by the Large Institution Supervision Coordinating Committee – “LISCC”) having many distinct “business lines” subject to the guidance. The Proposal defines a “business line” as “a

¹⁶ 83 Fed. Reg. 1351, 1358.

¹⁷ 83 Fed. Reg. 1361.

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."¹⁸ This means it could include both revenue-generating front-line business lines as well as "critical operations" i.e. back-office functions such as corporate treasury and information technology support.

If this definition is interpreted by the FRB to mean every "business line" or "critical operation" within the firm, then it could lead to the creation of needlessly duplicative processes and reporting structures that may not align with how the institution is actually structured and may impose operational and cost burdens on a wide number of immaterial units. Moreover, it would create a "one-size-fits-all" approach to supervisory expectations that would apply business-line management principles articulated in the Proposal to non-business functions where it may not be appropriate. It would also run counter to the FRB's stated desire in the Proposal to "not include specific expectations regarding organizational structure at firms."¹⁹

In addition, the Proposal states that "Business line management should identify and measure current and emerging risks that stem from the business line's current activities and changes to external conditions."²⁰ At the same time, it states that "IRM should identify and measure current and emerging risks within and across business lines and jurisdiction."²¹ The Proposal also states that IRM is not permitted to exclusively rely on information collected or used from business lines.²² Taken together, these provisions imply that both business lines and IRM will be required to identify and measure business line risks to a large degree on a separate basis. This could lead to a needless duplication of functions, requiring the creation of costly shadow risk management function within business units that could produce conflicting measurements of risk. These business line risk functions will also inevitably lack the holistic view of risk available to IRM.

Recommendation: The FRB should allow firms to identify which units qualify as a "business line," providing they are aligned to the risk profile and structure of the firm and subject to challenge by the Federal Reserve's supervisory staff. It should also permit firms to have the flexibility to determine when business-line specific risk identification, measurement or management functions should be performed by the business lines (subject to IRM challenge and review), and when those functions should be performed by IRM.

7. The final Guidance should distinguish IRM responsibilities from those of compliance and other control functions

The Proposal broadly defines IRM as "comprised of a range of risk management functions" including "an independent compliance risk management function that establishes a firm-wide compliance risk management program and delineates responsibilities for managing compliance risk," while acknowledging that the "structure and reporting lines for such an independent compliance risk management function may vary across firms."²³ However, the compliance function at most firms is distinct from the IRM function: IRM covers business line risk,

¹⁸ 83 Fed. Reg. 1351, 1357 n. 34.

¹⁹ 83 Fed. Reg. 1351, 1354.

²⁰ 83 Fed. Reg. 1351, 1358.

²¹ 83 Fed. Reg. 1351, 1361.

²² *Id.*

²³ 83 Fed. Reg. 1360, n. 49.

market risk, credit risk, liquidity and non-financial risk, but not other control functions such as compliance and internal audit.

Recommendation: The FRB should explicitly state in the final guidance that it does not necessarily expect IRM to assume responsibility for or oversight of other control functions within the institution. The FRB should also clarify that the existing reporting structure should not be changed, as we understand from the FRB's statement that the Proposal "does not include specific expectations regarding organizational structure at firms."²⁴

8. The FRB should clarify the definitions of risk expectations around risk limits in the final guidance

It is not clear from the Proposal how a firm's risk tolerance and risk objectives²⁵ should relate to the firm's enterprise-wide risk limits and business line risk limits. It is also not clear how "risk objectives" relate to "risk limits" e.g., whether there is an expectation that risk objectives generally should be set at a lower threshold than risk limits. We also note that the term "risk tolerance" appears to be used instead of the term "risk appetite" in the Proposal. The latter term is used frequently in other U.S. regulatory guidance and international standards. Within Credit Suisse, we define "risk appetite" as "the aggregate level and types of risk we are willing to assume, and is contained within our risk capacity²⁶, to achieve our strategic objectives and business plan,." a definition is consistent with the definition in various existing regulatory guidance.²⁷ Risk appetite is then implemented through a set of risk metrics with risk limits applied and calibrated to these metrics. By contrast, "risk tolerance" is a term used solely in operational risk construct in the context of risk appetite, where operational risk tolerance levels are set against economic operational risk gains and losses.

We also are concerned with the use of the term "qualitative limit." The Proposal states that "risk limits should be quantitative and qualitative," and that "IRM should set qualitative limits – such as an expert assessment to constrain business in a given country – as a proxy for risks or aspects of risks that are more difficult to quantify."²⁸ The concept of "qualitative limits" is confusing and can lead to ambiguous interpretations. We agree there can be qualitative statements that identify what types of risk we are willing to take, and/or theoretic exclusions of certain exposures (i.e. business in a given country), but such exclusions can still be quantified as a quantitative limit of zero exposures. We also acknowledge the use of qualitative risk appetite statements, and qualitative elements in risk measures and risk analysis (i.e. expert judgment). But limits are, by design, quantitative, as "qualitative" should not be the substitute for a lack of specificity in risk limits.

²⁴ 83 Fed. Reg. 1351, 1354.

²⁵ "Risk objective" is defined to mean "the level and type of risks a business line plans to assume in its activities relative to the level and type specified in the firm-wide risk tolerance." 83 Fed. Reg. 1351, 1357 n. 30.

²⁶ "Risk Capacity", within Credit Suisse, is defined as "the maximum level of risk Credit Suisse can assume given our current level of resources before breaching constraints determined by regulatory capital & liquidity needs, the operational environment (e.g., technical infrastructure, risk management capabilities, expertise) and conduct obligations towards depositors, policyholders, shareholders, fixed income investors, other customers and stakeholders."

²⁷ See, for example, Basel Committee on Banking Supervision, "Guidelines on Corporate Governance Principles for Banks" (July 2015).

²⁸ 83 Fed. Reg. 1361.

Finally, we concur with The Clearing House Association that certain prescriptive risk limit expectations in the Proposal ought to be revised given the more flexible, principles-based approach — focused on safety and soundness and materiality — adopted elsewhere in the Proposal. Specifically, we are concerned about the statement that “risk limits should include explicit thresholds that, if crossed, *strictly prohibit* the activity generating the risk.”²⁹ As The Clearing House Association notes, “the concept of ‘strictly prohibiting’ activities following a breach of a risk limit may not be applicable to various types of limits.”³⁰

For example, high-volume, business-as-usual activities are subject to limits, but it would be impracticable to entirely discontinue such activities on account of any breach of a risk limit, in particular if there has been only a small, incremental breach of a limit.”³¹ Not only does this language not account for the materiality of the risk involved, it also seems to misunderstand the purpose of risk “limits” altogether: our risk limits are intended for the purpose of strictly controlling the risk profile within the risk appetite. A limit breach does not automatically require the business to immediately cease the activity that caused the breach, but rather it requires immediate mitigating action to reduce risk below the limit.

Recommendation: The FRB ought to clarify the use of the terms of risk tolerance, risk objectives, risk appetite, and risk limits in the final guidance, including how these terms should be interpreted relative to each other. The FRB should also consider the use of terms such as “qualitative statement” or “qualitative controls” in place of “qualitative limits” in the final guidance. Finally, the final guidance should be revised to remove overly prescriptive expectations with regard to risk limits. Specifically, the FRB should acknowledge that in many cases risk “limits” (particularly lower-level ones) are used as notification and escalation trigger points rather than absolute prohibitions, and that breaches of limits do not necessarily require firms to immediately cease the activity in question.

We thank the Board of Governors of the Federal Reserve System for its considerations of our comments. If you have any questions, please do not hesitate to contact the undersigned, Joseph L. Seidel (202-626-3302; joseph.seidel@credit-suisse.com), or Peter J. Ryan (202-626-3306; peter.ryan.3@credit-suisse.com).



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²⁹ 83 Fed. Reg. 1351, 1361 (emphasis added).

³⁰ The Clearing House Association letter, p. 13.

³¹ The Clearing House Association letter, pp. 12-14.