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16 December 2019

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Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket ID OP-1679

UBS Response to Proposed Interagency Guidance on Credit Risk Review Systems

Thank you for your recent outreach undertaken to inform your response on the *Proposed Interagency Guidance on Credit Risk Review Systems*. The centralization of the various U.S. regulatory guidelines pertaining to credit risk review into one document will greatly enhance the understanding of the proper role of the function. We appreciate the opportunity to offer our views and share our experiences. This letter is intended to offer further perspective based on our experiences having recently established the Credit Risk Review (CRR) department of UBS' Combined U.S. Operations (CUSO). We look forward to continued dialogue on these and related issues.

The CRR department of CUSO was established in March, 2018 to provide a fully independent assessment of credit risk management (1st line) and control (2nd line) in UBS's CUSO operations, in satisfaction of U.S. regulatory requirements. This includes, but is not limited to, assessing overall quality of the CUSO credit portfolio, management's ability to provide accurate and timely credit quality information for financial and regulatory reporting purposes, ability to appropriately grade and classify credit exposure, and the adequacy of, and adherence to, internal policies and all relevant laws and regulations. CRR is currently comprised of 15 credit risk professionals who provide continuous monitoring of a portfolio totaling nearly \$110B of credit exposures.

We have chosen to share our views in the form of responses to the three specific questions put forth by the U.S. regulatory agencies in the proposed guidance document. We have aimed to make our comments as specific as possible to so as to render them more actionable.

Question 1: To what extent does the proposed credit review guidance reflect current sound practices for an institution's credit risk review activities? What elements should be added or removed, and why?

- 1) Credit risk review (CRR) activities encompass all credit risk activities, including those exposures resulting from non-lending activities. We recommend that this fact should be demonstrated by the replacing all general references to "loans" in the guidance with specific references to "credit exposure" or an equivalent, more comprehensive term.
- 2) The guidance requires that CRR be sufficiently independent so as to permit a firm's internal audit function to review CRR. As CRR routinely engages in review of risk ratings, however, it is of paramount importance that audits of CRR be conducted by fully qualified persons with sufficient credit risk expertise. To ensure this, the regulatory agencies have always permitted audits of CRR to

be conducted by independent qualified third-party auditors. In addition, guidance on the timing of such audits should be included. We therefore recommend the following addition to the end of Footnote 4 (p. 11):

The audit team must demonstrate sufficient expertise and qualifications in credit risk. Audit of the credit risk review function may also be performed by a qualified, independent third-party auditor. Audits of the credit risk review function may be conducted on a multi-year cycle based upon audit results, risk trends and regulatory feedback.

- 3) Credit risk review does not provide information for regulatory reporting purposes but rather, provides an effective challenge of that information. We recommend this be clarified by revising the final bullet point under Overview of Credit Risk Review Systems (p. 12) as follows:

Provides an independent, timely and credible challenge of the credit quality information provided to management for financial and regulatory reporting purposes, including the information used in the determination of ACL, ALLL and CECL, as applicable.

- 4) A significant number of large, complex financial institutions have already formally designated the credit risk review (CRR) function as the final arbiter of all regulatory classifications and risk ratings. The proposed guidance wording may be incorrectly interpreted to indicate that all institutions must employ an arbitration process. To avoid any confusion, we recommend the following revision to the start of the 2nd paragraph of Review of Findings and Follow-Up (p. 19):

Institutions may address risk rating differences between loan officers and credit risk review personnel by either a) designating the credit risk review function as the final arbiter of all risk classifications and ratings, b) defaulting to the classification or grade that indicates lower credit quality, or c) according to a pre-arranged process that includes formal appeals procedures and arbitration by a qualified party independent of both functions.

Question 2: To what extent is the proposed credit review guidance appropriate for institutions of all asset sizes? What elements should be added or removed for institutions of differing asset sizes, and why?

The guidance makes it clear that the size and structure of the credit risk review function should mirror the size and complexity of the institution it serves. We would, however, recommend that the Overview of Credit Risk Review Systems section (p. 10-11) be revised to provide a) a general, asset size based definition of a "large" institution (e.g. >\$5B in assets, etc.), b) some general examples for complex institution (i.e. FBOs, IHCs, etc.), and/or c) specify that the agencies will make such determinations based upon their ongoing supervisory activities.

Question 3: What if any additional factors should the agencies consider incorporating into the guidance to help achieve a sufficient degree of independence and why? To what extent does the approach described for small and rural institutions with fewer resources and employees provide for an appropriate degree of independence in the credit risk review function? What if any modifications should the agencies consider and why?

The responses noted above would also address these matters.



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We appreciate the opportunity to provide our views on the proposed guidance. We look forward to working with you to continue to identify ways in which regulatory guidance may be enhanced to ensure the safety of our financial system.

Yours Sincerely,

A handwritten signature in black ink, appearing to read "R. Flaum".

Robert Flaum
Chairman, Board Risk Committee
Board of Directors of UBS Americas
Holding LLC

A handwritten signature in black ink, appearing to read "Paul A. Szczepanski".

Paul Szczepanski
Head of Credit Risk Review

cc: Board of Directors of UBS Americas Holding LLC
Manfred Plank, COO Group Risk Control
Jeff Samuel, Head of Americas Government and Regulatory Affairs