March 15, 2018

Via Electronic Mail

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

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 Gentlemen:

The Clearing House Association L.L.C.[1] appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System's proposed guidance setting forth core principles of effective senior management, the management of business lines, and independent risk management ("IRM") and controls for large financial institutions ("LFIs").[2]

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1 The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by launching a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

2 Federal Reserve System, *Proposed Supervisory Guidance*, 83 Fed. Reg. 1351 (Jan. 11, 2018). Referenced throughout this letter as the "proposed guidance" and, together with the supplementary information published in the Federal Register, the "proposal." For purposes of the guidance, LFIs would include domestic bank holding companies and savings and loan holding companies with total consolidated assets of $50 billion or more; the combined U.S. operations of foreign banking organizations with combined U.S. assets of $50 billion or more; any state member bank subsidiaries of the foregoing; and systemically important nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve. *Id.* at 1359.

We support the proposal's overarching focus on safety and soundness and materiality and its emphasis on a principles-based approach in articulating the Federal Reserve's expectations for senior management, the management of business lines, and IRM and controls at LFIs. This letter provides a range of specific recommendations intended to facilitate the flexible application of the guidance so that it does not undermine those core objectives.

As the proposal notes, the proposed guidance is part of a broader initiative by the Federal Reserve to develop a supervisory rating system and related supervisory guidance that would align with its consolidated supervisory framework for LFIs. As part of that initiative, the Federal Reserve previously released two related proposals (the comment periods for which expired on February 15, 2018): a new rating system for certain LFIs ("proposed LFI rating system") and guidance establishing principles on board effectiveness ("board effectiveness proposal").[3] This proposal and the board effectiveness proposal set forth supervisory expectations relevant to the assessment of the "governance and controls" component of the proposed LFI rating system.[4] We previously submitted comment letters in response to the proposed LFI rating system and the board effectiveness proposal. Because of the interrelationship of all three proposals, our comments should be read together and understood collectively. We strongly support the Federal Reserve's review of its existing rating system and supervisory guidance, its use of notice-and-comment procedures to issue guidance intended to consolidate and clarify its expectations regarding risk management, and its efforts to align the proposed guidance with the LFI rating system and the board effectiveness proposals.

Consistent with our comments on the proposed LFI rating system and the board effectiveness proposal, the proposed guidance reflects two important objectives: *first*, a focus on safety and soundness and materiality, and *second*, an emphasis on a principles-based

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3 Federal Reserve System, *Large Financial Institution Rating System; Regulations K and LL*, 82 Fed. Reg. 39049 (Aug. 17, 2017); Federal Reserve System, *Proposed Guidance on Supervisory Expectation for Boards of Directors*, 82 Fed. Reg. 37219 (Aug. 9, 2017). Unlike the board effectiveness proposal, which would apply only to U.S. institutions and which stated that it would not apply to the intermediate holding companies of foreign banking organizations, the proposed guidance would apply to the combined U.S. operations of foreign banking organizations with combined U.S. assets of $50 billion or more. The proposed guidance would also apply more broadly than the proposed LFI rating system, which covers only intermediate holding companies established by foreign banking organizations pursuant to Regulation YY.

4 The Federal Reserve notes in the preamble to the proposed guidance that the current LFI supervision framework outlined in Supervision and Regulation (SR) Letter 12-17 is "is focused on four core areas—capital planning and positions, liquidity risk management and positions, governance and controls, and resolution planning." 83 Fed. Reg. 1351, 1352. However, the proposed LFI rating system currently does not include a component for resolution planning, though the Federal Reserve notes that it may include such a component in the future. *See* 82 Fed. Reg. 39049, 39056. As noted in our comment letter on the proposed LFI rating system, we believe that the LFI rating system should not include a separate rating component to assess the sufficiency of a firm's resolution planning. *See* The Clearing House Association, *Comment Letter re: Large Financial Institution Rating System (Docket No. R-1569; RIN 7100-AE82)* (Feb. 15, 2018) ("TCH LFI Rating System Comment Letter").

approach that specifies overall goals and objectives rather than prescriptive mandates, particularly with regard to matters of internal structure and organization. The principles-based approach rightly reflects that different institutions have different businesses and therefore different risk profiles. Moreover, this approach recognizes that there is no "best" way to implement prudent risk management principles in practice, thus promoting flexibility for institutions in designing risk governance frameworks.

We also highlight the importance of the following statement by the Federal Reserve in the preamble to the proposal:

> In order to minimize unnecessary duplication for firms subject to this guidance, the Federal Reserve would, to the extent possible, evaluate a firm's governance and controls in coordination with other relevant Federal and state agencies, particularly the primary regulators of the firm's insured depository institution subsidiaries.[5]

Interagency coordination is critical to avoid unnecessary duplication and use of resources, conflicting expectations and confusion. Covered institutions frequently utilize and benefit from elements of firmwide risk management frameworks in developing subsidiary-level risk governance and risk management frameworks and meeting applicable subsidiary-level supervisory requirements and expectations. Acknowledging that an evaluation of a firm's governance and controls framework necessarily implicates structures designed to meet existing—and often different—regulatory requirements and expectations is a constructive step in facilitating compliance with the multi-layered regulatory regime to which many covered institutions are subject. For example, firms may be subject to multiple overlapping regulatory regimes within and across jurisdictions, including the OCC's heightened standards applicable to the governance and risk management practices of large national banks ("Heightened Standards"),[6] risk management guidance applicable to broker-dealers[7] and, for foreign banking organizations ("FBOs"), home country requirements.

We note that firms with national bank subsidiaries subject to the OCC's Heightened Standards previously undertook the time-intensive process of analyzing and identifying which business lines would be "front line units" for purposes of the OCC guidance. We urge

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[5] 83 Fed. Reg. 1351, 1353.

[6] *See* Office of the Comptroller of the Currency, *OCC Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations*, 79 Fed. Reg. 54518, 54524 (Sept. 11, 2014) (including a definition of "front line units" at covered institutions).

[7] *See, e.g.*, Financial Industry Regulatory Authority, Regulatory Notice 15-33, *Guidance on Liquidity Risk Management Practices* (Sept. 2015), *available at* https://www.finra.org/sites/default/files/Regulatory-Notice_15-33.pdf; Securities and Exchange Commission, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792 (Nov. 15, 2010).

the Federal Reserve to recognize in the final guidance that firms have the flexibility (but, importantly, are not required) to designate business lines consistently for purposes of complying with OCC and Federal Reserve risk management expectations, if that is the risk management framework that is most appropriate for the individual firm. We expect that Federal Reserve supervisors would coordinate with the OCC and other regulators as appropriate and would interpret the proposed guidance in a manner such that LFIs can satisfy multiple regulatory regimes (including home-country regimes in the case of FBOs) with a single enterprise-wide risk management framework.

In order to promote the objectives set forth in the proposal, we offer recommendations in this comment letter to further clarify the proposal's delineation of risk management roles and responsibilities and to allow institutions to better align those roles and responsibilities with their organizational structures and operations. Each of these recommendations reflects the core idea that flexibility in risk management is not just appropriate but, indeed, *necessary* in light of the diversity of activities, businesses, risk profiles and organizational structures at domestic and foreign LFIs. This perspective is fully consistent with the Federal Reserve's presentation of a principles-based approach to risk management and with statements made by the Federal Reserve in the proposal.

Our comments and recommendations focus on five key aspects of the proposed guidance. First, we recommend that the final guidance be revised to provide that firms have the flexibility to define and identify business lines subject to the guidance, so long as the scope of operations and units subject to the guidance is appropriate for the risk profile and organizational structure of the firm. Second, we describe our understanding of one of the key objectives of the proposal—encouraging business lines to take responsibility for and thoroughly understand the risks that they assume and strengthening IRM's role in independently reviewing and challenging the business line—and explain why aspects of the guidance indicating that firms should implement duplicative risk management frameworks inside both the business line and IRM would be inconsistent with that objective. Third, we make a number of recommendations regarding certain risk identification, risk measurement and risk limit expectations presented in the proposed guidance with the goal of enhancing efficiency and avoiding unduly prescriptive requirements that would interfere with sound risk management practices. Fourth, we recommend that the final guidance revise or clarify repeated references to individuals and functions "ensuring" outcomes and instead provide that individuals are expected to develop processes or take steps "reasonably designed to ensure" particular outcomes, including compliance with laws and regulations. Finally, we discuss that the application of the proposed guidance to FBOs does not adequately account for differences between top-tier U.S. institutions and the U.S. operations of FBOs and raises concerns about the potential reach of the guidance to non-U.S. operations, and we make recommendations designed to address these issues, including that the Federal Reserve should remove the references to FBOs in the LFI guidance and instead issue a risk management proposal specific to FBOs.

In addition to these five core recommendations regarding the substance of the proposal, we also emphasize here four points regarding the timing and implementation of the proposed guidance. First, we stress that the benefit of a principles-based approach will be merely theoretical unless it is implemented in such a manner in practice. Accordingly, it is critical that examiners recognize and implement the flexible, principles-based approach articulated in the proposed guidance. Examiners should *not* view the expectations set forth in the guidance as a "checklist" or "check-the-box" requirements against which to test or measure individuals or functions, as such an approach could result in "one-size-fits-all" supervisory expectations for risk management.[8] Activities and reporting and organization structures vary significantly among the firms that would be subject to the guidance, and so diversity in firms' risk management frameworks is wholly appropriate. Accordingly, a risk management approach that achieves the overall objective against which the Federal Reserve is evaluating the firm—effective governance and risk management structures, policies, procedures and controls that support the operational and financial strength and resilience of the institution—should be determinative from an examination standpoint. Examiners should not measure all institutions against the same set of expectations, but should instead assess how each institution's particular approach achieves the proposal's overall objectives in light of the institution's particular circumstances, including its risk profile, business model and other relevant characteristics. This point is of particular importance given the frequent use of, and increasingly greater emphasis placed on, horizontal supervisory assessments, which, if not conducted properly, can lead to a one-size-fits all approach to supervision.

Second, we note that the proposal states that it "is intended to consolidate and clarify the Federal Reserve's existing supervisory expectations regarding risk management" and that it "is designed to delineate the roles and responsibilities for individuals and functions related to risk management."[9] Accordingly, we understand this to mean, and recommend that the Federal Reserve confirm, that any requirements or expectations (including those contained in Federal Reserve supervision and examination manuals and those specifically applicable to FBOs) that conflict with the final guidance would be superseded by the guidance.

Third, with regard to timing of implementation of the proposed guidance and the proposed LFI rating system, the proposal notes that the Federal Reserve expects to finalize the guidance for use in the proposed LFI rating system beginning in 2018. The proposal also states that "[i]f the proposed LFI rating system were finalized before this proposed guidance, the Federal Reserve would use existing supervisory guidance to help inform its evaluation of each firm's governance and controls for purposes of the proposed LFI rating system, until such time that this proposed guidance is finalized."[10] We believe such a course of action would be unwise. As is evident in the Federal Reserve's overall approach, the LFI rating

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8 *See also* The Clearing House Association, *Comment Letter re: Proposed Guidance on Supervisory Expectations for Boards of Directors (Docket No. OP-1570)* (Feb. 15, 2018), regarding the need to reflect that there is "no 'one-size-fits-all' standard" for corporate governance and to avoid the imposition of "check-the-box" requirements in connection with examiner reviews of boards of directors.

9 83 Fed. Reg. 1351, 1353.

10 *Id.* at 1352 n. 9.

system and the proposed guidance are inherently interrelated, and piecemeal implementation of various aspects of this framework is likely to result in confusion as to supervisory standards and expectations during the transition period and unnecessarily complicate firms' efforts to align their internal processes and controls with those standards.[11]

Fourth, as we stated in our comment letter addressing the proposed LFI rating system, that system should not be implemented—even on an interim basis—for a minimum of one year after the proposed system (including the board effectiveness proposal and this proposed guidance) is finalized. It is critical that firms be given time, *after* the guidance is final, to conform to the Federal Reserve's expectations before they are evaluated against those expectations. Further, providing a reasonable timeframe for implementation will allow the Federal Reserve sufficient time to revise its supervisory processes and to undertake the necessary examiner education. This extended implementation timeframe would also allow firms time to consider and appropriately respond to the expectations outlined in the LFI rating system, including the board effectiveness proposal and this proposed guidance.

I. Firms should have flexibility in defining and identifying business lines subject to the guidance so long as the scope of operations and units subject to the guidance is appropriate for the risk profile and organizational structure of the firm.

A. The final guidance should expressly permit firms to determine the organizational units that are "business lines" for purposes of the expectations set forth in the guidance.

A "business line" is defined in the proposal 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."[12] The expectations for business line management set forth in the proposed guidance would apply to both business lines and "critical operations," defined to include those operations which, if they were to fail or discontinue, would pose a threat, in the view of the firm or the Federal Reserve, to the financial stability of the United States.[13] Because the definition is broadly worded, it is not clear which standalone units and functions within a firm's vertical *or* horizontal organizational structure would be subject to the guidance, and which would not

[11] *See also* TCH LFI Rating System Comment Letter (recommending that the Federal Reserve not issue the final LFI rating system in a bifurcated fashion given the importance and implications of a firm's examination ratings).

[12] 83 Fed. Reg. 1351, 1357 n. 34.

[13] *Id.* We note that, for a number of firms subject to the proposed guidance, the failure of any individual firm would not pose a threat to the financial stability of the United States. As a result, such firms could not be said to have any "critical operations." Given the limited applicability of the term, we recommend that the final guidance explicitly recognize that many covered firms will have no "critical operations." We discuss "critical operations" further in Section I.B below.

be.[14] As a result, depending on how the term "business line" is ultimately interpreted by examiners, LFIs (and particularly firms subject to oversight by the Large Institution Supervision Coordinating Committee ("LISCC"), for which the proposed guidance would apply to all business lines) could be required to adjust their organizational and / or reporting structures solely to meet the expectations set forth in the guidance in a manner that does not further sound risk management for the organization. In addition to causing disruption, duplication of existing processes and unnecessary expenditure of resources, this result would be contrary to the Federal Reserve's statement in the proposal that "the proposed guidance does not include specific expectations regarding organizational structure at firms."[15]

To address these concerns, the final guidance should be revised to provide explicitly that firms, including LISCC firms, may identify which units are business lines subject to the guidance, so long as the determination as to which business lines are covered is appropriate for the risk profile and organizational structure of the firm. This standard would apply the principles set forth in the proposed guidance to the business line structure by which a banking organization is ***actually*** managed, without creating diffusion of risk management by requiring new and duplicative processes and without creating undue burdens on firms by subjecting units which do not generate material risk exposures to all of the supervisory expectations set forth in the guidance. This would be consistent with the Federal Reserve's presentation of a principles-based, and appropriately tailored, approach to risk management. It would also avoid the creation of a "one-size-fits-all" risk management regime, which is ill-suited for the management of risks by institutions with diverse structures, activities, businesses and risk profiles. This flexibility would also prevent conflicts between units that are defined as "business lines" in the Federal Reserve's guidance and units that are identified for similar purposes in connection with other applicable regulatory regimes, including the OCC's Heightened Standards.

B. Critical operations should not separately and independently be subject to the guidance as "business lines" in their own right in cases in which

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14 Indeed, the Federal Reserve notes in the preamble that the definition would include units such as corporate treasury and IT support, but it does not discuss examples of units or functions that would not be captured by the definition. Although the definition of "business line" refers to those operations and support functions that are "associated" with another defined unit or function that provides related products or services, the definition could be read to also cover those standalone operations and support units that are not "associated" with another business line because they sit at the enterprise level of the firm and provide related services to multiple business lines, and the firm as a whole, on a centralized basis. We recognize that these standalone operations and support units, which could include legal, financial reporting and human resources, generate certain risks, such as reputational risk or operational risk, and firms should account for and manage these risks through appropriate policies and procedures subject to review and challenge by IRM. However, for some firms that would be subject to the guidance, those processes are established and conducted outside of the "business line" risk management framework contemplated by the proposal.

15 *Id.* at 1354.

oversight and management of those operations is embedded in other business lines.

For the reasons stated in Section I.A above, the final guidance should clarify that, to the extent a firm's "critical operations" are embedded within its defined business lines such that the people who oversee the critical operations report to business line management, rather than directly to senior management, those critical operations would not be required to separately implement processes, procedures and reporting lines to comply with the expectations set forth in the guidance. If a firm's critical operations are already incorporated into the risk management framework applicable to a covered business line, risks associated with those critical operations will be captured by the framework and appropriately escalated to business line management, senior management and IRM.

II. Certain of the expectations presented in the proposed guidance, including those related to risk identification, risk measurement and risk limits, should be revised or clarified to (i) promote the business lines' monitoring and management of risks and IRM's reviewing and challenging the business lines' management thereof, (ii) enhance efficiency and (iii) avoid unduly prescriptive requirements that would interfere with sound risk management practices.

One of the broad principles we understand the proposed guidance to promote is that business lines should thoroughly understand and "own" the risk exposures they generate—that is, business lines should monitor and manage their associated risks and be accountable to senior management with respect to those risks. IRM's role is to independently review and challenge the frameworks the business line implements and the decisions the business line makes with respect to risk management. We support and agree with this construct. However, the proposal includes a number of expectations applicable to business lines, on the one hand, and IRM or control functions, on the other, that appear duplicative and inconsistent with the relationship between IRM and the business line. We are concerned that these expectations could be read and applied by examiners in a manner that requires firms to implement parallel risk management functions, one inside the business line and one within IRM. In addition, in some cases, these expectations are overly granular and prescriptive, allocating responsibilities to the business line or IRM without providing appropriate flexibility for firms.

For example, the proposed guidance provides that business line management should "consult with senior management before allowing any exceptions to risk limits"[16] and that the chief risk officer ("CRO") or IRM should "be involved in any proposal to waive or make exceptions to established risk limits… provide an assessment of any such proposal, and… escalate the proposal to the board of directors as appropriate."[17] In certain firms, business

16 *Id.* at 1358.

17 *Id.* at 1360.

lines are responsible for monitoring and managing their associated risks, but IRM has responsibility for reviewing and, where appropriate, escalating exceptions to risk limits. Mandating that business lines escalate matters relating to risk limits to senior management is inconsistent with the risk management framework at certain firms and, where IRM has primary responsibility for escalating risk limit exceptions, unduly duplicative. The final guidance should reflect that firms have flexibility in determining whether business lines or IRM determine whether to allow or propose exceptions to risk limits and, where the responsibility is allocated to either the business line or IRM, the other may participate in—but is not expected to duplicate—practices and procedures regarding risk limit exceptions.

In addition, the proposed guidance states that "[b]usiness line management should regularly test to ensure the controls within its business line are functioning as expected and are effective in managing risks" and that "[m]ore frequent testing is appropriate for key controls."[18] Requiring that *all* controls be regularly tested and deficiencies remediated by each business line, regardless of the underlying risk, would result in an undue expenditure of resources from a prudent risk management perspective. Moreover, requiring each business line to test its controls is unnecessarily duplicative to the extent that those controls are also being tested by a second-line or support function that is not embedded in any specific business line. The proposal properly includes the general expectation that firms test and monitor their internal controls using a risk-based approach, with the scope, frequency and depth of testing informed by the complexity of the firm, the results of the firm's risk assessments and any deficiencies identified during prior testing.[19] There should not be an additional expectation that each business line "regularly" test its controls, with "more frequent" testing for "key controls," and so the final guidance should be revised to remove this business line-specific expectation.[20]

The proposed guidance also provides that "IRM should determine whether there are sufficient resources and infrastructure in the relevant areas of the firm to properly identify, manage, and report the risks associated with the business strategies outlined in the risk tolerance, including during stressful or unanticipated conditions."[21] However, consistent with the Federal Reserve's expectation that business lines understand, manage and own both the activities and the risks associated with that business line's activities, it is appropriate for the business lines to manage their staffing and resources. In order to avoid undue duplication

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18 *Id.* at 1359.

19 *See id.* at 1362.

20 Similar clarification—that there should be no duplication of processes and all processes implemented should be appropriately risk-based—should be provided with respect to other requirements included in the proposal, including the requirement that business line management develop "processes with indicators and early warning mechanisms to facilitate timely detections of existent and potential issues." *Id.* at 1359.

21 *Id.* at 1360.

of efforts by business lines and IRM, we recommend that the Federal Reserve confirm in the final guidance that IRM is not expected to conduct an independent staffing adequacy review of the business line, but instead should review and challenge the business lines' staffing and resource decisions as they relate to the business lines' being able to properly identify, manage and report associated risks.

Taken together, these examples and the additional examples we discuss in Section II.A below create real risk that the guidance will be interpreted in practice to require dual risk management frameworks at the business line and IRM levels. Such a result could have unintended consequences, including the loss of a robust and independent IRM function if IRM is required to expend additional resources to perform initial risk assessments in parallel with the business line. This interpretation also could muddle the framework that we understand the Federal Reserve to be promoting—that business lines understand and "own" the risk exposures they generate by monitoring and managing their associated risks. In addition, this result would be counterproductive to the Federal Reserve's stated goal of "delineat[ing] the roles and responsibilities for individuals and functions related to risk management."[22] Instead, each firm should have a risk management framework that provides appropriate mapping and coverage of *that* firm's particular risks in a manner that is best suited to the reporting structures and allocation of resources at *that* individual firm. We therefore urge the Federal Reserve to clarify in the final guidance that firms need not have parallel or duplicative risk management processes in order to comply with the guidance's expectations.

A. The expectation that both business lines and IRM identify, measure and aggregate risks that are business line-specific would result in significant and unwarranted duplication of effort and should be eliminated.

The proposed guidance creates overlapping and potentially confusing risk identification, measurement and aggregation expectations for both business line management and IRM. Specifically, the proposed guidance provides that "[b]usiness line management should *identify, measure,* and manage *current and emerging risks* that stem from the business line's activities and changes to external conditions,"[23] while at the same time providing that "IRM should *identify and measure current and emerging risks within* and across business lines and risk types, as well as any other relevant perspectives, such as by legal entity or jurisdiction."[24] In addition, the proposed guidance acknowledges that IRM "may utilize information collected or used from business lines," though IRM may not rely on such information exclusively,[25] while also providing that IRM is responsible for conducting an

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[22] *Id.* at 1353.

[23] *Id.* at 1358 (emphasis added).

[24] *Id.* at 1361 (emphasis added).

[25] *Id.*

assessment of risks across the entire firm that is "separate from the business line's risk management activities."[26] The proposed guidance also provides that "[b]usiness line management should aggregate risks, including by business activities or products,"[27] while also providing that IRM should "aggregate risks across the entire firm" and should assess risk information "at a more granular level than firmwide, such as by business line."[28]

Taken together, these expectations create uncertainty regarding the extent to which IRM is permitted to use the output from the risk identification, measurement and aggregation activities of the business lines. Moreover, the expectation that both business lines *and* IRM identify, measure and aggregate risks that are business line-specific could result in significant and unwarranted duplication of effort. One specific area of overlap is data and metrics. In some cases, it may be appropriate for the business line to produce data and metrics necessary to assess risks, while in other cases, it may be appropriate for IRM to produce such data and metrics. The data produced by either the business line or IRM should be available for use by the other for risk assessment or review purposes. In any case, the data production methodologies utilized by both business lines and IRM would be subject to review by internal audit, thereby providing a layer of independent review that obviates the need for duplication of data production.

Firms should have the flexibility to determine when business line-specific risk identification, measurement or management functions should be performed by the business lines—with IRM reviewing the data collected by the business lines, performing a separate risk assessment and challenging the business lines on risk assessments where necessary or appropriate—and when those functions should be performed by IRM in the first instance. In certain cases, the systems used to measure risk are complex and expensive, and therefore use of only one such system by either the business line or IRM would result in both consistent risk measurement and avoidance of undue costs. In other cases, IRM, and not the business line, may have the expertise necessary to properly identify and measure risks, making it more efficient for IRM to perform the tasks in the first instance. There may also be occasions in which IRM's performance of the risk identification, measurement or management role provides IRM with a holistic view of the risk that would be lost if performed by the business line. In cases where IRM identifies and measures business line risks in the first instance, the business line will nevertheless have access to the risk information provided by IRM, and the business line will remain responsible and accountable for the risk exposure.

Importantly, the processes for risk identification and measurement vary across the firms that will be subject to the guidance, with some firms providing for business lines to perform these assessments in the first instance, some providing for IRM to do so, and some using a mixed approach depending upon the nature of the risk(s) being assessed and the relative resources and expertise at the business line and IRM levels. Mandating that these

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26 *Id.* at 1358 n. 37.

27 *Id.* at 1358.

28 *Id.* at 1361.

identification and measurement functions be duplicated by business lines and IRM creates an unnecessary burden, and, accordingly, the guidance should permit firms to make the appropriate determination regarding these functions based on the firms' allocation of resources and the particular risks they face.

B. The guidance should explicitly recognize that all risk assessments, whether at a firmwide or more granular level, should be informed by the materiality of relevant risks.

The proposed guidance provides that "IRM should identify material or critical concentrations of risks and assess the likelihood and potential impact of those risks on the firm" and that "IRM should assess risk information along different meaningful dimensions at a more granular level than firmwide, such as by business line, geographic regions, obligors, counterparties, and products, to determine how those impact the firm's risk profile."[29] Although we generally agree with these statements, we believe that the second should, like the first, be qualified by materiality, so that IRM is expected only to assess *material* risk information. IRM could sufficiently evaluate a firm's risk exposures relative to its risk tolerance through an assessment of material risk information. Omitting a materiality qualifier could result in IRM expending disproportionate time and resources to assess immaterial risk information.

C. The Federal Reserve should revise certain prescriptive risk limit expectations to align them with the proposal's overall principles-based approach and focus on safety and soundness and materiality.

As noted above, we strongly support the proposal's principles-based approach and general focus on safety and soundness and materiality of risks. However, certain of the proposed risk limit expectations are overly prescriptive. These should be revised to be consistent with that focus and with the Federal Reserve's proposed overall flexible, principles-based approach to risk management. Specifically, the core principles of both management of business lines and IRM contain prescriptive and granular guidance related to waivers, exceptions and breaches of risk limits. For example, according to the proposed guidance:

- "Business line management should consult with senior management before allowing *any* exceptions to risk limits."[30]
- "Business line management should evaluate breaches of risk limits to determine whether a breach was caused by a weakness in the business line's monitoring or limits framework for the business lines, and *take appropriate remedial action*."[31]

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[29] *Id.*

[30] *Id.* at 1358 (emphasis added).

- "Risk limits should include explicit thresholds that, if crossed, *strictly prohibit* the activity generating the risk."[32]

The Federal Reserve should revise these aspects of the guidance to make them consistent with the overall principles-based approach and focus on safety and soundness and materiality reflected elsewhere in the proposal.[33] Although waivers, exceptions and breaches of risk limits deserve scrutiny, it should not be the case that every waiver, exception or breach of any risk limit requires business line management or senior management-level attention, much less automatic consequences such as an absolute prohibition of the activity generating the risk. Firms have numerous individual risk limits across many dimensions, including limits that are enterprise-wide and those that are established at more granular levels, such as by risk types, business lines, legal entities, products or activities. Requiring senior management-level attention to each and every waiver, exception or breach of any risk limit—irrespective of the materiality of the limit generally or the specific waiver, exception or breach—would be impracticable and result in undue allocation of management time and resources to immaterial matters.

Moreover, the concept of "strictly prohibiting" activities following a breach of a risk limit may not be applicable to various types of limits. One purpose of a risk limit may be to trigger escalation and discussion. Risk acceptance above a limit after such discussion is wholly appropriate. Firms set certain limits with the understanding that they will be sometimes be breached, at which time business line personnel and risk personnel (and, where appropriate, senior management) will engage in a dialogue of the reasons and determine next steps. Such a discussion could appropriately lead to temporarily or permanently increasing the limit, ceasing the relevant activity and / or reducing the risk exposure. Firms should be permitted to maintain flexibility to determine when notification to the board or senior management is appropriate, in particular for more granular and lower-level limits within a cascade structure. These types of processes are wholly consistent with the goal of a risk management framework, which is to identify, manage and mitigate risks, not prohibit activities.

The final guidance should be revised to expressly recognize that, in some cases, risk "limits" are used as a notification and escalation threshold, rather than a hard limit reflecting maximum risk tolerance, the breach of which requires the institution to immediately cease the activity in question or take other remedial action. In addition, the final guidance should recognize that exogenous events that cause risk limit breaches cannot always be anticipated and do not universally present a basis for taking remedial action. The guidance as proposed could result in unintended consequences where, as a result of the prescriptive expectations

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31 *Id.* at 1358 n. 40 (emphasis added).

32 *Id.* at 1361 (emphasis added).

33 We also recommend that the Federal Reserve clarify and revise the final guidance to provide that risk limits can be qualitative *or* quantitative, and not that they "should be" both qualitative *and* quantitative. *See id.*

for the application of risk limits (including reporting any breach to senior management and "strictly prohibiting" activities following a limit breach), firms re-structure their risk limit frameworks so there are fewer limits, with the remaining limits calibrated to reflect a firm's risk appetite.[34] Such restructuring would result in the removal of lower-level risk limits that are useful for risk monitoring purposes. Thus, the guidance, as proposed, could have the perverse effect of incentivizing firms to calibrate limits so they would only be breached if a firm were exceeding its risk appetite or, alternatively, to reduce the risks they assume solely in order to avoid breaching any limits.[35] Effectively, this could weaken risk management practices by removing useful early warning indicators. Moreover, the potentially increased volume of reporting as a result of the proposed guidance could lead to an information overload for senior management, which could have the counter-productive effect of impeding senior management's ability to identify and assess material risks.

D. The final guidance should recognize that different firms use different terminology to refer to various components of their risk management frameworks and should clarify how the Federal Reserve expects the terms used in the guidance to relate to each other and how they should be interpreted.

One of the issues upon which the Federal Reserve seeks comment in the proposal is the use of the terms "risk appetite" and "risk tolerance" by the industry.[36] Some firms that would be subject to the guidance use the term "risk appetite" to refer to the level and types of risks the firm is willing to assume, while using the term "risk tolerance" to refer to the measures of risk that the firm *can* take on and the term "risk capacity" to refer to the total amount of risk the firm can accept based on its capital levels. In this example, the firm's "risk appetite" would be an amount less than the firm's "risk tolerance" or "risk capacity" under various scenarios. However, these usages are not universal in the industry and have different meanings under different regulatory regimes, and so we recommend that each term used in the final guidance be clearly defined for purposes of *this* guidance, including with references as to how the various terms relate to each other.

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34 We have used the term "risk appetite" to be consistent with the terminology a number of firms use to refer to the aggregate level and types of risks the firm is willing to assume. We discuss firms' use of the terms "risk appetite" versus "risk tolerance" in Section II.D below.

35 We note that unnecessary risk reduction could have the negative consequence of reducing firms' provision of credit to the economy and liquidity to the capital markets.

36 *See id.* at 1355. We note that the Federal Reserve's definition of "risk tolerance" in the proposal aligns with the OCC"s definition of "risk appetite" in the Heightened Standards. *See id.* at 1357 n. 29 ("'Risk tolerance' is defined as the aggregate level and types of risk the board and senior management are willing to assume to achieve the firm's strategic business objectives, consistent with applicable capital, liquidity, and other requirements and constraints."); 79 Fed. Reg. 54518, 54547 ("Risk appetite means the aggregate level and types of risk the board of directors and management are willing to assume to achieve a covered bank's strategic objectives and business plan, consistent with applicable capital, liquidity, and other regulatory requirements.").

It is also not clear from the proposal how a firm's risk tolerance and risk objectives[37] 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"—for example, whether there is an expectation that risk objectives generally should be set at a lower threshold than risk limits. As used in the proposed guidance, "risk objectives" seem to serve the same or similar purpose as business line risk limits, which could result in confusion and potentially duplicative or overlapping requirements. We recommend that the final guidance define each of these terms for purposes of this guidance and clarify how these terms should be interpreted relative to each other.

III. The final guidance should eliminate or clarify repeated references to individuals and functions "ensuring" outcomes and should instead provide that individuals are expected to develop processes or take steps "reasonably designed to ensure" particular outcomes, including compliance with laws and regulations.

The word "ensure" is used throughout the proposed guidance, particularly in connection with the discussion of senior management and business line management responsibilities. Although we agree with a limited number of these formulations where appropriately qualified, characterizing management's responsibility as "ensuring" various outcomes is not achievable as a standard.[38]

For example, we recommend that the Federal Reserve revise the following description of senior management: "senior management is responsible for… ensuring safety and soundness and compliance with internal policies and procedures, laws, and regulations, including those related to consumer protection,"[39] by deleting "ensuring." Likewise, although we generally agree with the expectation set forth in the proposed guidance that "[s]enior management is responsible for developing and maintaining the firm's policies and procedures and system of internal control, commensurate with the firm's size, scope of operations, activities, and risk profile, to ensure compliance with laws and regulations, including those related to consumer protection, and consistency with supervisory expectations,"[40] we recommend the Federal Reserve clarify the expectation by adding "reasonably designed" before "to ensure."

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[37] "Risk objectives" 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 firmwide risk tolerance." 83 Fed. Reg. 1351, 1357 n. 30.

[38] The word "ensure" is defined synonymously with "guarantee" or "make certain." *See, e.g.,* THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (5th ed. 2011) (defining "ensure" to mean "to make sure or certain; insure"); MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (10th ed. 2001) (defining "ensure" to mean "to make sure, certain, or safe: guarantee").

[39] 83 Fed. Reg. 1351, 1356.

[40] *Id.* at 1357.

The two expectations referenced above are distinguishable in an important way. The former requires the individuals who make up a firm's senior management to, themselves, ensure that the firm complies with laws and regulations. This creates an unrealistic standard against which to measure senior management effectiveness, particularly in light of the highly complex and multiple sources of compliance requirements, and the subjective judgments that are often involved. Indeed, the former expectation presents senior management as the guarantor of a certain outcome and fails to recognize the role of delegation in the management of an LFI. Although senior management has the authority to direct others to act and manage activities in a manner to achieve various outcomes (such as compliance with laws and regulations), this authority to direct others does not translate to absolute control over their actions or guarantee the desired result.

The latter expectation, in contrast, addresses senior management's role in developing and maintaining policies, procedures and systems, which in turn must be reasonably designed to achieve various outcomes. Notably, the definition of "internal controls" specifically refers to "the policies, procedures, systems and processes designed to provide *reasonable assurance*" that various outcomes would be achieved.[41] The second expectation is consistent with the notion that an LFI is responsible and accountable for compliance with laws and regulations, while members of senior management or business line management are responsible for taking reasonable steps, including through the design and implementation of policies and procedures, to achieve the LFI's compliance.[42]

As another example, the proposed guidance states that "senior management should ensure the firm's infrastructure, staffing and resources are sufficient to carry out the firm's strategy and manage the firm's activities in a safe and sound manner"[43] and that "[b]usiness 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."[44] Beyond the inability to guarantee an outcome, these expectations do not account for the fact that (i)

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[41] The proposed guidance provides that the term ''internal controls'' refers to "the policies, procedures, systems and processes *designed to provide reasonable assurance regarding*: The effectiveness and efficiency of operations; reliability of financial reporting (including risk reporting); compliance with laws and regulations (including those related to consumer protection); and safeguarding of assets and information." *Id.* at 1357 n. 32 (emphasis added).

[42] Other expectations set forth in the proposed guidance that appear to charge management with ensuring outcomes, as opposed to taking reasonable steps or implementing processes or systems of internal control, include (i) "[s]enior management should ensure effective communication and information sharing across the entire firm" and (ii) "[b]usiness line management should ensure that deficiencies in control design and operating effectiveness are remediated." *Id.* at 1357, 1359.

[43] *Id.* at 1357.

[44] *Id.* at 1358.

strategy formulation and resource budgets are interdependent and should inform each other and (ii) senior management operates under the umbrella of an approved firmwide strategic plan. Thus, the proposal should be amended to provide that (i) senior management should develop a budget for infrastructure, staffing and resources that appropriately allows the firm to execute its strategy and operate in a safe and sound manner and (ii) business line management, under the oversight of senior management, should develop a budget for the resource and infrastructure of the business line to allow it to meet its strategic objectives while maintaining financial and operational strength and resilience over a range of operating conditions, including stressful ones.

We recommend that the Federal Reserve clarify in the final guidance that use of the word "ensure", wherever used, is not intended to create an absolute standard by which effective risk management is measured. This clarification could be accomplished by qualifying the word "ensure" with the phrase "reasonably designed to", as we recommend above. This would set a standard consistent with the definition of "internal controls"—i.e., that the applicable individual or function should take reasonable steps to achieve the desired outcome.

IV. The application of the proposed guidance to FBOs does not adequately account for differences between top-tier U.S. institutions and the U.S. operations of FBOs and raises concerns about the potential reach of the guidance to non-U.S. operations; the Federal Reserve should issue separate, FBO-specific guidance that more appropriately addresses these issues.

The proposed guidance would apply to the combined U.S. operations of FBOs with combined U.S. assets of $50 billion or more. It therefore applies more broadly than the Federal Reserve's related proposed LFI rating system, as the proposed guidance covers the combined U.S. operations (both subsidiaries and branches) of FBOs, and the proposed LFI rating system covers only intermediate holding companies ("IHCs") established pursuant to Regulation YY. The Federal Reserve's earlier summary of risk management expectations (previously provided in the preamble to the proposed LFI rating system) noted that the expectations would apply only to domestic LFIs, but that adjustments may be made to apply the guidance to the U.S. operations of FBOs before issuance for comment.

We support the Federal Reserve's recognition throughout the proposal of the global context in which FBO governance, risk management and control elements are embedded. The acknowledgement of various aspects of the proposed guidance that would necessarily apply differently in the FBO context is welcome and recognizes that there is no "one-size-fits-all" standard to corporate governance, risk management and controls, particularly in relation to the structures through which FBOs conduct their operations in the United States.

However, as proposed, the application of the guidance to the combined U.S. operations of large FBOs may lead to tension in a number of areas, which we discuss further in the sections that follow. We also do not believe that the proposal adequately reflects differences for FBOs that have IHC structures and those that do not.

A. The Federal Reserve should issue a proposal specific to FBOs that is based on the same general principles of risk management, but also takes into account the differences between U.S.-top-tier bank holding companies and the combined U.S. operations of FBOs that operate as part of global enterprises.

The approach to effective risk management of FBOs' operations in the United States is so inherently different from domestic LFIs that the Federal Reserve should either issue proposed guidance specific to FBOs or include principles applicable to FBOs in a separate section of the final LFI guidance, rather than as a series of exceptions to, or commentaries on, the expectations applicable to domestic LFIs.[45] Either of these approaches would have two distinct advantages. First, it would avoid the proverbial "fitting square pegs into round holes" approach. Attempting to establish principles of risk management for the combined U.S. operations of covered FBOs through use of footnotes to the guidance, which was written to be applicable to U.S.-based entities, is insufficient to deal with the many differences in structures and operations and instead creates uncertainty and ambiguity. No matter how much modification of the expectations for domestic LFIs is done, the results will almost certainly be distorted in a number of respects. Second, such an approach would more definitively recognize that the differences are fundamental rather than marginal.

A proposal specific to FBOs that is based on the same general principles of risk management, but also takes into account the differences between top-tier U.S. institutions and FBOs would allow the Federal Reserve to better tailor its risk management principles to the FBO context. In proposing such guidance, as with the current proposal for U.S.-based institutions, the Federal Reserve should recognize that flexibility in risk management is necessary in light of the diversity of activities, businesses, risk profiles and organizational structures of FBOs. Indeed, Vice Chairman Randal K. Quarles recently recognized this very point when he explained that "circumstances may require application of the [enhanced prudential standards'] requirements to be adjusted in light of an individual [FBO's] structure or risk profile," and further stated that the Federal Reserve "will continue to provide flexibility where appropriate to accommodate these differences."[46] These statements apply equally in the context of the proposed guidance. If the starting point is FBO-specific guidance that takes into account "the uniqueness of FBOs,"[47] as we recommend, the Federal

[45] Consistent with our comment letter on the proposed LFI rating system, we strongly recommend that the Federal Reserve not apply the new rating system to IHCs until the guidance—including any FBO-specific risk management guidance—that would inform the "governance and controls" component rating for IHCs is finalized.

[46] 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*, Speech at the Institute of International Bankers Annual Washington Conference (Mar. 5, 2018). A transcript of the speech is available at https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm.

[47] *Id.*

Reserve will not be left with the task of adjusting expectations applicable to U.S. entities to FBO circumstances, and FBOs will not be faced with the uncertainty of trying to determine which of the expectations set forth in the proposed guidance will apply to them and which may ultimately be adjusted by the Federal Reserve in the future.

B. The definitions of "senior management," "business lines" and "business line management" as they apply to FBOs should be revised to give due recognition to the manner in which FBOs manage risk in the United States.

Although the proposal offers examples and clarifications regarding the application of various definitions and related expectations to FBOs,[48] we are concerned that the broad definitions employed in the proposed guidance are inconsistent with the way that FBOs are actually managed and could have undue extraterritorial implications.

An analysis of this issue must begin with a basic understanding of the role of senior management of the U.S. operations of FBOs. Although there are substantial variations among FBOs in implementation and structure, the basic roles of U.S. senior management are: (i) to provide significant input, in conjunction with FBO home country senior management, on strategy, risk tolerances, policies, procedures, and employment and compensation arrangements for the U.S. operations; and (ii) to implement each as is ultimately determined by FBO senior management in accordance with the FBOs' enterprise-wide policies, procedures and governance and risk management frameworks. In implementing these decisions, the U.S. senior management is directed and overseen by, and responsible to, both the U.S. oversight body(ies) and FBO senior management.

Also central to the analysis is the question of whether the concept of senior management should include the home country senior management for the entire FBO. The Federal Reserve should rely on the home country regulators to establish the principles of effective management for those individuals. Any other course could result in extraterritorial over-reach by creating the potential, and, indeed, the virtual inevitability, of conflict. Furthermore, reliance on the home country's approach to senior management has become more reliable as a result of the global adoption of standards and principles for effective bank regulation and management.[49]

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[48] *See, e.g.*, 83 Fed. Reg. 1351, 1356–57 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.").

[49] *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* (Sept. 2016), *available at* https://www.bis.org/bcbs/publ/d383.pdf; Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* (Sept. 2012), *available at* https://www.bis.org/publ/bcbs230.pdf.

Accordingly, the definition of senior management should include only U.S. senior management and should be defined to refer to those members of U.S. senior management who are 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.

We appreciate the Federal Reserve's efforts to limit the application of the proposed guidance to only the portion of the FBO's business conducted in the United States. Nonetheless, it will be essential that examiners adhere to this jurisdictional dichotomy to avoid significant implications for FBOs' non-U.S. operations.

C. U.S. management should be held responsible for their appropriate roles and responsibilities, taking into account the global management structure of the FBO.

U.S. management should be evaluated with respect to: (i) decisions for which they have discretion; (ii) the safe and sound implementation of parent-level decisions with respect to U.S. operations; and (iii) their willingness to challenge the FBO's senior management with respect to decisions affecting the safety and soundness of U.S. operations. In contrast, U.S. management should not be evaluated with respect to enterprise-wide risk and other decisions, including resource allocations, that they lack the authority to make. Of particular concern is the statement in the proposal 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."[50] This suggests that U.S. business line management should be responsible for assessing the enterprise-wide risks of global FBO businesses. We do not believe that these expectations appropriately reflect the actual role of an FBO's combined U.S. operations within the broader organization. The guidance should be revised to reflect that U.S. management (at senior and business line level) cannot ***unilaterally*** determine resources for the combined U.S. operations or particular business units, assess enterprise-wide risks or make strategic decisions separate and apart from the FBO's enterprise-wide strategy. Indeed, the guidance should clarify that U.S. business line management can rely on an FBO's enterprise-wide risk management framework to identify, assess and monitor risks outside the United States, including those that may affect the combined U.S. operations.

D. The Federal Reserve should clarify that the U.S. CRO is not required to report to the global board of directors or the global risk committee.

The proposed guidance provides that the CRO must report directly to the board's risk committee and to the CEO and adds, in a clarifying footnote, that in the FBO context, the U.S. CRO must report to the U.S. risk committee and the global CRO or equivalent

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[50] *See* 83 Fed. Reg. 1351, 1358 n. 36 (emphasis added). As discussed above in Section III, the term "ensure" is inappropriate where applied.

management officials.[51] However, the proposed guidance also describes various circumstances in which the CRO should inform the board, the risk committee or senior management of certain matters. The Federal Reserve should further clarify that, for FBOs, wherever the guidance provides that the CRO should escalate matters, provide input or report concerns to the board or risk committee, "board" and "risk committee" refer to the IHC board (if applicable) and the U.S. risk committee, respectively, and not the global board of directors or the global risk committee.

E. The guidance should be revised to expressly recognize the importance and relevance of FBOs' enterprise-wide policies, procedures and governance and risk management frameworks.

FBOs should be permitted to structure the governance, risk management and controls frameworks of their combined U.S. operations in accordance with the frameworks implemented on an enterprise-wide basis. These enterprise-wide frameworks govern, among other things, the structure, composition and functions of FBO subsidiary boards and their committees and the appointment, compensation and succession planning of members of senior management at the parent and subsidiary level. The guidance should be revised to expressly allow FBOs' combined U.S. operations to use and rely on the FBOs' enterprise-wide policies, procedures and governance and risk management frameworks so long as they are implemented in a manner that is appropriate for the U.S. operations in light of their activities, risk profile, organizational structure and other relevant characteristics.

We are concerned that the proposal, if adopted as proposed, will lead to an international paradigm shift away from enterprise-wide risk management and regulation to a balkanized approach. Under the latter, each host country would seek to impose its own standards on not only the local operations of an institution headquartered in another jurisdiction but on the entire organization. This would inevitably lead to inconsistent regulatory requirements, resulting in uncertainty, unpredictability and conflict—all to the detriment of safety and soundness. The European proposal to require non-EU financial institutions to establish EU intermediate holding companies demonstrates the reality and seriousness of this concern.

We urge the Federal Reserve to avoid supervisory expectations that further a trend toward regulatory ring-fencing. Global institutions must be managed on a global basis if they are to achieve maximum safety and soundness and best serve their customers. This is central to the concept of enterprise risk management that has been strongly, and, in our view, correctly, advocated by the Federal Reserve. A wholly separate and independent management structure, with unilateral decision-making powers, in each host country is antithetical to that basic concept.

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[51] *See id.* at 1360 n. 45.

F. Certain modifications or clarifications are needed to align the expectations for the U.S. chief audit executive ("CAE") in the proposal with existing guidance.

The proposal notes that the guidance would not supersede existing guidance on the internal audit function at covered institutions.[52] However, the proposal also states generally that the CAE (1) should be appointed by the board and (2) should report findings, issues, and concerns to the board's audit committee and senior management without clarifying that such requirements would not necessarily apply in the context of an FBO.[53] Specifically, SR 13-1 provides that, for an FBO, "[w]hen there is a resident U.S. audit function, the CAE of the U.S. audit function should report directly to senior officials of the internal audit department at the head office such as the global CAE."[54] The final guidance should recognize that, depending on the FBO's organizational structure, there may be a dual reporting line from the U.S. CAE to the IHC board and global audit. In addition, the guidance should be modified to provide that, in the FBO context, the U.S. CAE can be appointed by the global CAE (and need not be appointed by the IHC board or the global board).

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The Clearing House appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at (202) 649-4619 or by email at paige.pidano@theclearinghouse.org.

Respectfully submitted,

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52 *See id.* at 1362.

53 *See id.* at 1360.

54 Federal Reserve System, Division of Banking Supervision and Regulation, *Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing*, SR letter 13–1/CA letter 13–1 (Jan. 23, 2013), at 5.