SPEECH

Supervisory Reform for Global Banks

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Sarah Dahlgren, Executive Vice President

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Thank you for the invitation to speak today. Please note that the opinions I express today are my own and do not necessarily reflect those of the Federal Reserve Bank of New York or the Federal Reserve System.

Although the topic of the seminar is "regulatory reform," I will focus my comments on "supervisory reform." Regulation and supervision work together to ensure a strong global financial system. While rules and regulations set out the standards that must be met, supervision provides the necessary oversight and enforcement to ensure firms are following the rules.

It's a challenge to supervise a large internationally active firm. Many businesses are truly global and often include complex booking models that may involve trades being originated in one domicile with various sub components being booked in one or more other jurisdictions.

As Governor Tarullo noted in a recent speech, there are unique challenges in regulating and supervising the U.S. operations of a global institution. Although we have full authority over the local operations, we see only a piece of your global operations and regular access to information can be limited. It's one thing when we have a view into all of the operations and access to decision makers at the top of the house—both senior management and boards of directors—as is the case when we are the home country supervisor. It's another thing when we see but one piece of the organization. I can't help but think of the fable about the blind men and the elephant—each of whom feels a different part of the elephant and each thinks he is right about what the elephant really is. I could continue the analogy, but I think my point is clear—without the context of the global organization, we can't be sure whether we are seeing the head or the tail of the elephant, or the organization.

If done well, host country supervisors can be the eyes and ears for the home country supervisor. We have context for the activities of the banks doing business in our markets and can provide that to the home country supervisor. In addition, host county supervisors can be helpful in ferreting out where practices aren't consistent across a firm; identifying where certain practices (like stress testing) aren't occurring as necessary; providing insights into key business lines that are primarily conducted in the U.S., such as municipal finance and certain products within sales and trading; and helping to assess the risk culture in the U.S. operations, which can be a key input into the overall view of the home country supervisor.

As you discussed this morning, there are a range of new rules and regulations being considered to enhance the regulation of the U.S. operations of foreign banks. Beyond these new rules, though, we are continuing to press ahead to make substantive enhancements to how we carry out supervision of the largest global firms doing business in the U.S. These enhancements largely follow along the work that we are doing to enhance overall supervision of all the firms that we supervise, so they shouldn't be a surprise to you.

These enhancements, many of which reflect lessons we learned through the financial crisis, include deepening our engagement with senior managers, including business line owners and directors of firms; developing a better understanding of firm strategy, revenue and business drivers and vulnerabilities; enhancing our focus on resilience and ensuring that buffers are strong —including stronger capital, liquidity, collateral management and contingency planning, to name a few; and increasing our attention on risk culture and risk appetite within the firms we supervise.

What I offer today is two-fold. First, I will identify three things that you—as global firms with a U.S. presence—can do to help remove impediments to our understanding the operations we are supervising and to make it easier to get our jobs done. This should also make it easier for you to understand and follow the rules that are set out for global firms. And, second, I will share three things that I think we— as supervisors—need to do to strengthen supervision of global firms and, at the same time, make it easier to get our jobs done.

Three Things Global Firms With U.S. Presence Can Do

- First, improve communication and transparency with supervisors. Communication between supervisors and supervised institutions has to start with a "no surprises" philosophy, which serves as the basis for building the right channels of communication and confidence between firm and supervisor. This means identifying and discussing issues that could grow into significant risk events—even before all of the facts may be known or collected. "No surprises" also means more timely information sharing with key supervisors. Supervisors talk regularly and pass along key information; we are fine doing so, but firms could position themselves better if they communicate significant items to core supervisors on similar timetables. Given the global management structures of many business lines and risk functions, a risk event in one jurisdiction may have an immediate impact in other jurisdictions.

Another element of improving communication is sharing more global information with host supervisors. In order for us to better understand your operations and to put the U.S. operations into the global context, we need to have a better understanding of the global operations. Many, if not most, firms assert that they manage businesses and risk on a global basis. With this approach, firms have an obligation to share relevant and significant issues around the globe with key host country supervisors on a timely basis. As well, firms need to share more global data—including key risk management reports—that allow host supervisors to better understand important vulnerabilities, as well as the overall condition of the firm. While information sharing among supervisors can address some of this, it's insufficient to assume that key host country jurisdictions don't need to have a view of the overall health of the company.

And, finally, clarity—or transparency—of communication with supervisors needs to be a focus going forward. There are times when firms attempt to respond to questions or concerns with very narrow answers or with an overwhelming amount of paper. This generally leads to additional follow up—on both sides—and a lot of time and energy expended to resolve the outstanding questions. I encourage you to ask for clarity when we aren't being clear and to try to understand better what we are looking for by asking more questions. One way that you can facilitate better information flows is to provide us with what you provide to senior management and board members, rather than producing something just for us.

- Second, invest in MIS. One of the key weaknesses identified during the last crisis was that information systems within firms weren't robust enough to provide timely and accurate risk management information as events unfolded. While some progress has been made to address some of these weaknesses, there is still quite a bit more work needed in firms to achieve a robust risk reporting infrastructure. From a host supervisor's point of view, significant improvements in MIS are necessary to demonstrate that firms have clarity about their businesses and risks and have the tools necessary to manage the risks both here and abroad.

  At the same time, the challenges in implementing effective MIS across a global firm are made more daunting by the complex legal and organizational structures of most firms today. As the financial crisis highlighted, risk reporting by business line alone isn't sufficient to effectively manage a global firm. Firms need to be able to segment data not just by business line, but also by legal entity. Firms with simpler legal entity structures tend to be able to do this more readily on both an as-needed basis, but also on a more routine basis. Simplifying your organizational structure in the U.S.—and globally—would facilitate enhancements in MIS and risk reporting, while at the same time facilitating our understanding of your organization.

- Third, encourage and provide better access to key executives and directors. As I indicated at the outset, one of the enhancements we've made to our broader supervisory program is deepening our engagement and interactions with senior leaders and directors of the firms we supervise. This effort stems from a critical lesson from the crisis—that we need to better understand our firms and how they operate, including a greater understanding of how the governance of the firm works. We expect that by intensifying the supervisory relationship with those overseeing the health of the firm, we can improve the flow of information and dialogue. This should give us an earlier and clearer view into emerging business trends and risk strategies within the firm. It should give us a better sense of what the senior leaders and directors are thinking. And, it also creates a better dynamic where discussions are more frequent and less monumental so that dialogue flows more naturally through all means—not just in person, but also over the phone and via email.

  This effort extends not just to firms where we are the home country supervisor, but also to large global firms where we are the host supervisor. We realize the challenges in building any relationship, and the challenges in doing so across geographic boundaries, cultures and corporate entities are even more challenging. Nevertheless, where we have had success in building that dialogue and deepening the engagement with business leaders and directors of global firms, we have achieved a higher degree of understanding on both sides. As relationships develop, we have found more frequent, informal dialogue to be extremely productive for all involved. Firms are in a better position to understand what our concerns are and respond more appropriately and timely to these concerns. And, we understand better the tone at the top—even though the top is somewhere other than the U.S.—as well as the risk culture of the firm. It's simply not enough to understand tone at the top in the U.S., if the top is really somewhere else.

Three Things That Supervisors Can Do

- First, improve communication with firms. The counterpart to asking you to improve your communications with us is raising the expectation that we do the same. We need to be timelier in our communication of relevant findings in our supervisory efforts, and we need to shorten the time between the conclusion of supervisory work and our feedback to firms. More timely communication should also include sharing information in the earlier stages of our work, before all issues have been confirmed or facts sorted out, but at the point at which we suspect there's something not quite right. This is important not just in the context of formal supervisory efforts like examinations, where we may have an early read on an issue, but also in areas where we see something or something has been flagged through other means and we raise it with you for discussion and attention as needed.

  Our communication needs to be more candid and direct. Too often I hear that our communication has too much "nuance" and that firms struggle to understand exactly what we are looking for. To be clearer in our communication, though, we also need to better understand the businesses you are in and how your businesses operate. As I indicated earlier, we need more context to understand your operations—and your sharing more global information with us does provide that necessary context.

- Second, improve collaboration and communications with other supervisors—both U.S. and foreign. For true consolidated supervision to work, information has to flow freely among supervisors. We need to eliminate the legal impediments for supervisors on the ground to be able to share information in a more routine and natural way. There are many efforts underway, through such venues as the FSB and the Senior Supervisors Group, to promote enhanced information sharing and collaboration among supervisors.

  We also need to work more collaboratively together. This means sharing concerns about issues and agreeing on work necessary across the global firm to address the issues. This means jointly conducting examinations, as well as concurrently conducting work with similar scopes so that the full picture of the firm can be drawn, and we can capture all the relevant insights of these globally managed businesses. Finally, it also means leveraging the results of work from other supervisors and not undertaking duplicative work.

- Third, enhance supervisory colleges, which were designed to improve the exchange of information among supervisors with the goal of ensuring safe and sound banking practices, reducing the possibility of governmental assistance, and building confidence in the financial system. We need to make supervisory colleges more effective by going beyond basic information sharing. In addition to improving our information sharing, this should also include making sure that core colleges are appropriately constructed and reflect the key jurisdictions necessary to get a full picture of the risks of the firm; ensuring that the dialogue between supervisors and firms in college settings is robust and that the engagement among all parties is sufficiently high; and providing clear and direct feedback following supervisory colleges, both between supervisors and to the firm.

  Home supervisors should be providing host supervisors with feedback and, where necessary, direction on key risks and other issues requiring follow up in their jurisdictions. Host supervisors should be providing home supervisors with feedback on what they are seeing in their jurisdiction and how risks are evolving in their markets. And, finally, to ensure consistency of supervisory messages on group-wide issues, home and host supervisors should agree on key message to firms.

  Finally, supervisory colleges are a good way to promote more consistent supervision of globally active firms, and supervisors

- should leverage the college construct to reinforce more consistent application of global standards and risk management expectations across all firms.

Conclusion

In conclusion, my goal here today was to leave you with several things we need from you to help us achieve a stronger supervisory framework for foreign banks operating in the U.S. and also recognize that there are things that supervisors need to continue to work on to strengthen our oversight of global firms.

We want to ensure we are doing everything we can to be an effective host supervisor, including ensuring consistency and equivalence in how we approach all global firms. We also have a responsibility to facilitate, to the greatest extent possible, the job of the home country supervisor, and we expect the same from our supervisory colleagues around the world who are our eyes and ears on the ground in those other jurisdictions. While this is very important in our routine day-to-day operations, it becomes even more important in effectively dealing with crisis situations.

We have a common interest—a safe and stable global financial system. In pursuing this common interest, there are three fairly simple—yet important—things we need you to do:

- ensure robust communication with host supervisors;
- continue to build out your risk reporting and broader MIS capabilities; and
- encourage deeper and more intensive dialogue among your senior leaders and directors with key host supervisors.

And, for our part, we need to:

- improve our communications with firms, including being more timely and clearer in our feedback;
- improve collaboration with home and other host supervisors; and,
- make supervisory colleges more effective, by promoting more robust discussions and more direct feedback to firms.

Thank you for your attention today. I look forward to continuing to work with you on these issues as we seek to enhance our supervisory programs.

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