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Supervising Large, Complex Financial Institutions: What Do Supervisors Do?

- The supervision of large, complex financial firms is a key component of the Federal Reserve's role in promoting financial stability.
- However, the process by which the Fed conducts supervision can be opaque to outsiders, in part because of the need to keep supervisory information confidential.
- A close look at how supervisory activities are structured, staffed, and implemented on a day-to-day basis at the New York Fed sheds light on the strategies adopted to achieve supervisory goals. The authors detail firm-specific and cross-firm monitoring activities, and identify the tools—such as ratings and enforcement actions—used by supervisors to ensure that firms correct unsafe practices.
- The authors also highlight changes introduced post-crisis, including increased specialization of firm-focused teams at individual banks and the addition of risk specialists to those teams.

1. Overview and Background

> An Act To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.
>
> *Federal Reserve Act, Official Title*

The official title of the 1913 act that established the Federal Reserve reveals that the supervision of banks has been a key responsibility of the nation's central bank from the start. Today, the Federal Reserve carries out the prudential supervision of bank holding companies (BHCs) on a consolidated basis, as well as the supervision of a number of other financial institutions operating in the United States.[1]

[1] Consolidated oversight encompasses both the parent holding company and its subsidiaries. While state member bank subsidiaries are also directly supervised by the Federal Reserve, this article focuses on supervisory activities at the holding company level.

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Prudential supervision involves the monitoring and oversight of these firms to assess whether they are in compliance with law and regulation and whether they are engaged in unsafe or unsound practices; it also entails ensuring that firms are taking appropriate steps to correct such practices. Prudential supervision is interlinked with, but distinct from, regulation of these firms, which involves the development and promulgation of the rules under which BHCs and other regulated financial intermediaries operate. The distinction between supervision and regulation is sometimes blurred in discussions of the banking industry by academics, researchers, and analysts, and the terms "supervision" and "regulation" are often used somewhat interchangeably.[2] Moreover, while prudential supervision is a central responsibility of the Federal Reserve and consequently accounts for substantial resources, the responsibilities, powers, and day-to-day activities of Federal Reserve supervision staff are often somewhat opaque to those who are not directly involved.

This article aims to bring greater transparency to System supervisory activities by describing how they are structured, staffed, and implemented on a day-to-day basis at the Federal Reserve Bank of New York (New York Fed). The discussion focuses primarily on the supervision of large, complex bank holding companies and the largest foreign banking organizations (FBOs) and nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve. The article gives particular attention to oversight of these firms because they are the most systemically important banking and financial companies—a distinction that makes prudential supervision especially consequential for financial stability. Given their size and complexity, the approach to supervising them also differs from that taken with smaller and less complex firms. We note at the outset that supervision of these large, complex firms is conducted through a comprehensive Systemwide program governing supervisory policies, activities, and outcomes.[3] However, this article considers only supervisory staff located at the Federal Reserve Bank of New York, whose activities are carried out as part of this broader program.[4]

The article is based on information from three main sources. First, it draws on a series of discussions with staff of the New York Fed's Supervision Group (SG) involved in the day-to-day supervision of the large, complex banking and financial institutions. Second, it relies on various written materials describing the structure and goals of supervision at the New York Fed and in the Federal Reserve System, selected guidelines provided to supervisory staff, and Federal Reserve Supervisory and Regulation Letters (SR Letters) describing expectations and objectives of the Federal Reserve's supervisory program for large, complex banking companies. Third, the article pairs its descriptive analysis with SG management data about supervisory inputs—SG supervisory staff headcounts and hours by departments and activities—and outputs, namely supervisory actions.

Our overview of the structure and implementation of prudential supervision at the New York Fed is intended to provide insight into what supervisors do and how they do it, rather than to document every element in complete detail or to provide an "end-to-end" description of the supervisory process. Further, while we explain the stated rationale for the approaches taken, we do not assess whether the structure and implementation outlined are efficient or meet specific objectives. It is our view that understanding how prudential supervision works is a necessary precursor to determining how to measure its impact and effectiveness.

Our discussion begins in Section 2 with a description of the broad goals of prudential supervision and the primary strategies adopted to achieve those goals, as outlined in various Federal Reserve documents. The section then describes the structure of supervision in the Federal Reserve and provides an overview of the Supervision Group at the New York Fed. Section 3 discusses how the New York Fed's supervisory staff is organized into departments and teams, with particular emphasis on supervision of the largest and most complex financial institutions. Section 4 then describes the day-to-day activities of these supervisory teams, including monitoring, examinations, and broader supervisory programs, as well as the outcomes of that work. Section 5 presents a summary and conclusion.

2. Authority, Goals, and Structure of Supervision

2.1 Authority

The Federal Reserve's authority to conduct prudential supervision of BHCs is based on law and regulation, while the implementation of the Federal Reserve's prudential supervisory

[2] See Mishkin (2001) and Masciandaro and Quintyn (2013) for surveys of the academic literature on supervision and regulation. See Board of Governors of the Federal Reserve System (2005) for a fuller discussion of the distinction between supervision and regulation.

[3] The structure of this program is described in Supervision and Regulation Letter 15-7 (SR 15-7), "Governance Structure of the Large Institution Supervision Coordinating Committee (LISCC) Supervisory Program" (Board of Governors of the Federal Reserve System 2015c).

[4] The article does not cover prudential supervision of financial market utilities, although these institutions are also large, complex, and systemically important. The activities of these organizations and the supervisory issues they present are distinct from those of the more traditional BHCs that are the focus of this article.

authority—how supervisors monitor and assess BHCs' activities and take corrective action when needed—is based on a combination of law, regulation, and accepted practice.

The principal source of the Federal Reserve's authority to supervise BHCs is found in Section 5 of the Bank Holding Company Act of 1956, as amended (the BHC Act), which provides that all BHCs are to be supervised on a consolidated basis by the Federal Reserve (Board of Governors of the Federal Reserve System 2015a). The BHC Act authorizes the Federal Reserve to collect information and to issue regulations and orders as necessary to carry out the purposes of, and prevent evasions of, the BHC Act. The stated purposes of the BHC Act include supporting the safety and soundness of BHCs, the compliance of BHCs with applicable laws, and the stability of the U.S. financial system. In addition to the BHC Act, federal law gives the Federal Reserve authority to take action against a BHC "to prevent these entities [BHCs] from engaging in unsafe or unsound practices or to address violations of law in connection with their business operations" (Board of Governors of the Federal Reserve System 2015a). Federal law also specifies the kinds of steps supervisors may take to remedy violations of law, regulation, or agreements, or to intervene when a BHC is engaging (or is about to engage) in practices that the supervisor deems to be unsafe or unsound. Finally, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") further bolsters the Federal Reserve's prudential supervisory authority by adding the authority to establish enhanced prudential standards for the largest BHCs to ameliorate the risks they pose to the financial stability of the United States.

2.2 Goals and Strategy

The Federal Reserve's supervisory strategy combines a focus on the supervised firm's internal processes and governance with an independent supervisory assessment of its financial strength, especially capital and liquidity. With respect to internal processes and governance, emphasis is placed on the supervised firm's ability to identify and manage its risks, with subsequent supervisory actions intended to make the institution remediate any shortcomings. The motivation for this approach is to try to ensure that financial institutions, especially the largest and most complex, have financial and operational resiliency under a variety of potential stressful circumstances (Board of Governors of the Federal Reserve System 2012). A central theme in the supervisory strategy is that responsibility for risk identification and risk management rests with the supervised institution while the Federal Reserve's role is to ensure that the institution has strong processes for carrying out these tasks.

As various Federal Reserve System documents make clear, the broad goals of prudential supervision relate very closely to the Federal Reserve's financial stability responsibilities. For instance, the Bank Holding Company Supervision Manual states that "the Federal Reserve's consolidated supervision activities closely complement its other central bank responsibilities, including the objectives of fostering financial stability and deterring or managing crises" (Board of Governors of the Federal Reserve System 2015a), while the 2015 Dodd-Frank stress test report notes that "through its supervision, the Federal Reserve promotes a safe, sound, and stable banking system that supports the growth and stability of the U.S. economy" (Board of Governors of the Federal Reserve System 2015b). Similarly, the description of the Supervision Group on the New York Fed public website notes that "the objectives of supervision are to evaluate, and to promote, the overall safety and soundness of the supervised institutions (microprudential supervision), the stability of the financial system of the United States (macroprudential supervision), and compliance with relevant laws and regulations" (Federal Reserve Bank of New York 2016). In all these cases, the goals of supervision include the stability of the financial system in addition to the safety and soundness of individual financial institutions.

These goals are quite broad and could be implemented using a variety of supervisory strategies, but some implementation detail can be found in the documents just cited as well as other System documents. For instance, the Federal Reserve's policy statement about supervision of large financial institutions (SR 12-17) states,

> the consolidated supervision framework has two primary objectives: (1) Enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary. . . . This requires financial resilience by maintaining sufficient capital and liquidity, and operational resilience by maintaining effective corporate governance, risk management, and recovery planning. (2) Reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness. . . . This requires, among other things, effective resolution planning that addresses the complexity and the interconnectivity of the firm's operations.[5] (Board of Governors of the Federal Reserve System 2012)

[5] In this context, resolution refers to steps taken in the event of "material financial distress or failure" of a banking company to foster a rapid and orderly outcome in which the critical operations of the firm can continue. Critical operations "are those operations (including associated services, functions, and support) that if they were to fail or be discontinued could pose a threat to the financial stability of the United States" (Board of Governors of the Federal Reserve System 2012).

The Board of Governors' public website sheds additional light on implementation procedures, indicating that the Federal Reserve's approach to the supervision of systemically important financial institutions involves

> an interdisciplinary and cross-firm perspective. . . . This approach . . . fosters rigorous supervision of individual firms while formalizing the use of horizontal reviews and analyses of activities and risks across the portfolio. Further, the approach promotes the evaluation of systemic risks posed by firms . . . through the evaluation of macroeconomic and financial risks, and how those risks could affect individual firms and the financial system collectively. (Board of Governors of the Federal Reserve System 2016)

New York Fed documents also provide detail on the System's strategic approach to supervision:

> [In overseeing individual financial institutions,] the Supervision Group takes a risk-focused approach based on a supervisory plan that is customized to a firm's risk profile and organizational structure. Examiners look at key aspects of a supervised firm's businesses and risk management functions to assess the adequacy of the firm's systems and processes for identifying, measuring, monitoring, and controlling the risks the firm is taking. . . . In addition, the Supervision Group evaluates the adequacy of a firm's capital and liquidity. (Federal Reserve Bank of New York 2016)

The Board's *Purposes and Functions* document describes the Federal Reserve's approach to supervision in similar terms: "The goal of the risk-focused supervision process is to identify the greatest risks to a banking organization and assess the ability of the organization's management to identify, measure, monitor, and control those risks" (Board of Governors of the Federal Reserve System 2005).

Many of the passages quoted present an explicitly microprudential perspective in the sense that the focus is on individual firms, even if the standards for what constitutes sound practices are based, in part, on practices observed across the range of supervised institutions. However, the supervisory documents also suggest that macroprudential considerations are important. These macroprudential concerns could affect seemingly microprudential supervisory strategies by, for instance, focusing on common risk exposures across firms or risk management strategies that would protect an individual institution but potentially cause harm to others (fire-sale risk, for example).

The Federal Reserve's prudential supervisory activities are closely related to its role as a regulator of these firms. As noted above, prudential supervision is interlinked with, but distinct from, regulation of these firms, which involves the development and promulgation of the rules under which BHCs and other regulated financial intermediaries operate. The two activities are linked because an important part of prudential supervision is verifying compliance with regulation, although as much of the preceding discussion suggests, the scope of supervision is much broader than compliance alone. Beyond the link through compliance, the Federal Reserve's prudential supervisory activities are related to its regulatory role through the influence that supervision has on the regulatory agenda. In particular, information about industry practice and institutional activities that is gained through prudential supervision can be used in developing regulations governing those activities. Regulation based on in-depth knowledge of industry practice can better achieve desired policy outcomes while reducing unintended consequences. In addition, insights into emerging risks and new products and activities gained through supervision can help identify areas meriting new or amended regulation. In other words, regulation guides supervisory activities, and supervision in turn provides information that allows the Federal Reserve to develop and maintain regulations that more effectively address its public policy objectives.

2.3 Structure: Institutions and Portfolios

The Federal Reserve is responsible for prudential supervision of a large range of bank and nonbank financial institutions, including relatively small and noncomplex commercial banks and BHCs, the U.S. operations of foreign banks, and savings and loan holding companies, as well as the large, complex institutions that are the focus of this article. These institutions differ significantly in size, complexity, geographic reach, and business focus. Given this diversity, Federal Reserve supervision of these firms is organized by "portfolio," where portfolios are defined as groups of broadly similar financial institutions from across the Federal Reserve System. The portfolio approach helps ensure that the supervisory program is tailored to the size and complexity of individual firms, that oversight of similar firms is conducted in a consistent manner, and that supervision within each portfolio benefits from a cross-firm

perspective (Board of Governors of the Federal Reserve System 2015a).[6]

The Board of Governors has the authority and responsibility to carry out supervision of financial institutions, while the supervisory activities of the Reserve Banks are conducted under delegated authority from the Board. Within the Federal Reserve, each Reserve Bank supervises financial institutions that are located within its District; in the case of the New York Fed, this includes institutions located within the Second Federal Reserve District, which covers New York, northern New Jersey, southwestern Connecticut, Puerto Rico, and the U.S. Virgin Islands (Federal Reserve Bank of New York 2016). Interaction between staff at the Board of Governors and at the Reserve Banks is typically substantial, both on an ongoing basis and when concerns arise about a particular institution or group of institutions.

At the System level, the Large Institution Supervision Coordinating Committee (LISCC) coordinates supervision of the largest and most complex, systemically important BHCs, U.S. operations of foreign banks, and nonbank firms designated by the Financial Stability Oversight Council. As of February 2016, the LISCC portfolio comprised sixteen large, complex organizations, twelve of which were in the Second Federal Reserve District and thus subject to supervision by the New York Fed (Table 1).

Table 1
LISCC Portfolio Firms
February 2016

Firm	Federal Reserve District
American International Group, Inc.	New York
Bank of America Corporation	Richmond
The Bank of New York Mellon Corporation	New York
Barclays PLC	New York
Citigroup Inc.	New York
Credit Suisse Group AG	New York
Deutsche Bank AG	New York
General Electric Capital Corporation	New York
The Goldman Sachs Group, Inc.	New York
JP Morgan Chase and Co.	New York
MetLife, Inc.	New York
Morgan Stanley	New York
Prudential Financial, Inc.	Boston
State Street Corporation	Boston
UBS AG	New York
Wells Fargo and Company	San Francisco

Source: Board of Governors of the Federal Reserve System 2016.

Note: LISCC is Large Institution Supervision Coordinating Committee.

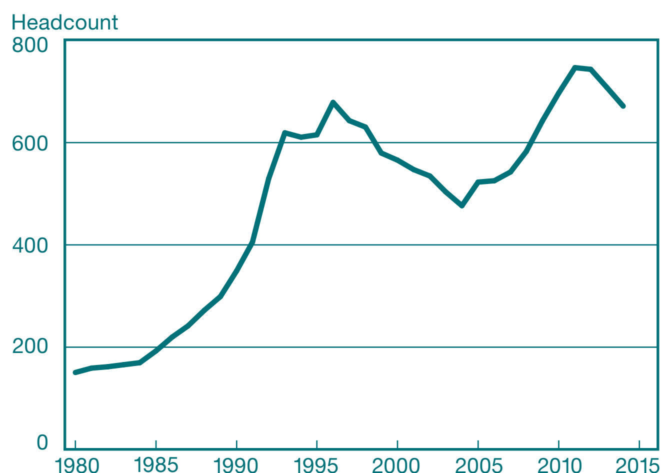
Reflecting the systemic importance of the firms in its portfolio, the LISCC has a governance structure that is distinct from that in place for the supervision of smaller and less complex firms. The LISCC is chaired by the director of the Board of Governors' Division of Banking Supervision and Regulation and is composed of senior officials from across the Federal Reserve System. The membership is multidisciplinary, including representatives from the research, markets, credit risk management, and payments, clearing, and settlement areas of the Federal Reserve (Board of Governors of the Federal Reserve System 2010, 2015c; Yellen 2015). The goals of the LISCC are to provide strategic and policy direction for supervisory activities involving firms in the LISCC portfolio, to enhance the consistency and quality of supervision of these firms, and to incorporate systemic risk considerations in the supervisory program (Board of Governors of the Federal Reserve System 2015c, 2016).

The primary operational arm of the LISCC is the Operating Committee (OC), which like the LISCC has a multidisciplinary membership from across the Federal Reserve System (Board of Governors of the Federal Reserve System 2010, 2015c). The OC, in consultation with the LISCC, establishes the most important areas for supervisory focus at individual firms and groups of firms, oversees supervisory activities for firms in the LISCC portfolio, identifies common risks facing firms in the portfolio, fosters deeper understanding of business strategies among the firms, and makes decisions about certain supervisory actions to address safety and soundness concerns at these institutions (Dudley 2014). The OC has various subcommittees that focus on current and emerging risks, operating performance, capital, and supervisory planning. Membership of the subcommittees consists of OC members as well as other staff from the Board of Governors and the Reserve Banks (Board of Governors of the Federal Reserve System 2015c).

The structure of the New York Fed's Supervision Group mirrors the portfolio structure discussed above to a large degree. As Chart 1 indicates, there were about 675 staff members in the SG at year-end 2014 (when our data end), about 75 below the peak reached at the end of 2011.

[6] Aside from the large, complex financial companies that are the primary focus of this article, the portfolios include the following: the large banking organization (LBO) portfolio, which includes BHCs with assets greater than $50 billion, other than the largest and most complex; the foreign banking organization (FBO) portfolio; the regional banking organization (RBO) portfolio, which includes regional banking companies; and the community banking organization (CBO) portfolio, which includes the smallest and least complex BHCs and banks. LISCC is Large Institution Supervision Coordinating Committee.

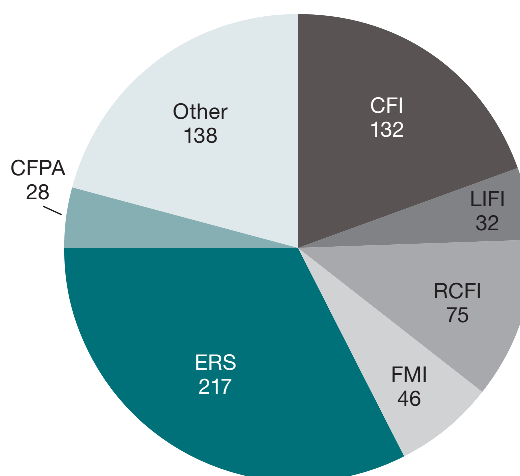
Chart 1
New York Fed Supervision Group Headcount



Source: Federal Reserve Bank of New York internal supervisory headcount data.

Note: The chart reflects the number of full-time-equivalent employees each year.

Chart 2
Department Allocation of FRBNY Supervision Group Staff in 2014, Based on Headcount



Source: Federal Reserve Bank of New York internal supervisory headcount data.

Notes: The firm-focused staff (represented by the gray areas) is divided into CFI (Complex Financial Institutions), LIFI (Large International Financial Institutions), RCFI (Regional, Community, and Foreign Institutions), and FMI (Financial Market Infrastructure). ERS is Enterprise Risk Supervision; CFPA is Cross-Firm Perspectives and Analytics. "Other" includes Executive Function (11 members), Group Operations (119 members), and Supervisory Policy (8 members).

The staff has grown since the 1980s, with a large increase during the early 1990s following the passage of legislation giving the Federal Reserve additional supervisory responsibility for foreign banking activities. This increase was followed by a gradual decline in the later 1990s reflecting staffing efficiencies from technological improvements (such as greater automation and advances in information processing that led to reductions in administrative staff), changes in the structure of firms in the District during the consolidation wave of the late 1990s, and the advent of risk-focused supervision. The SG staff is organized into departments that are responsible for different aspects of the supervision of large, complex financial institutions.

Chart 2 shows SG staff department allocations by headcount as of the end of 2014.[7] At that time, a set of these departments contained examiners assigned to specific financial institutions or groups of financial institutions. These departments were Complex Financial Institutions (CFI), Large International Financial Institutions (LIFI), Regional, Community, and Foreign Institutions (RCFI), and Financial Market Infrastructure (FMI). In addition, the Enterprise Risk Supervision (ERS) department housed analysts considering different facets of financial institution and banking industry risk and performance. Finally, the Cross-Firm Perspective and Analytics (CFPA) department pursued cross-firm analysis of performance and capital to provide industrywide insights. "Other" included the Executive Function and Group Operations, as well as Supervisory Policy, which works on the development of policy related to supervisory matters in both a domestic (U.S.) and international context. Interaction among these different areas is discussed in detail in the next section.[8]

[7] The SG has realigned its departmental structure since this analysis. The teams responsible for oversight of non-LISCC firms have been shifted from CFI (since renamed the LISCC Portfolio department) to LIFI (now named the Large and Foreign Banking Organization department). In addition, following a reorganization of the New York Fed's supervision staff at the beginning of 2015, the analysts in the CFPA function were either reassigned within the SG or became part of a unit outside of the SG.

[8] Group Operations included about forty staff members in the supervisory development programs of new hires for examiners and risk specialists.

3. How Is the New York Fed's Supervisory Staff Organized?

3.1 Overview

The structure and organization of the SG staff date from a significant reorganization that took place in 2011. Drawing on lessons learned during the financial crisis, the reorganization was designed to reshape both the internal structure of the group and the interactions among staff members in order to enhance communication and facilitate identification of emerging risks through greater emphasis on cross-firm perspectives. In addition, the reorganization was intended to foster engagement between senior supervisory staff and senior managers and members of the board of directors at supervised firms (Dahlgren 2011).

To these ends, staff members engaged in the prudential supervision of large bank and nonbank financial companies at the New York Fed are assigned to one of two types of groups: *firm-focused teams* concentrating on individual companies or portfolios of companies (the gray areas in Chart 2) or *risk departments* concentrating on a particular type of risk facing these firms (the largest blue area in the chart).[9] While the two sets appear distinct in an organization chart, in practice there is considerable interaction between the firm-focused teams and the risk departments, as when risk department members are assigned to firm-focused teams on a long-term basis. This section describes the structure of the firm teams and risk departments, the various roles that different team and department members play, and the way that staff members interact across teams and departments. The discussion also highlights how the structure varies based on the size and complexity of the bank holding company or nonbank firm being supervised.

3.2 Firm-Focused Supervisory Teams

Each of the largest and most complex bank and nonbank financial companies has its own dedicated New York Fed team whose primary responsibility is supervision of the firm (Federal Reserve Bank of New York 2016). As of February 2016, these companies included nine domestic and foreign banking companies that are part of the LISCC portfolio and three systemically important nonbank financial firms that had been designated by the FSOC for supervision by the Federal Reserve (Table 1).

Each firm-focused supervisory team is headed by a senior supervisory officer (SSO)—typically a senior vice president with experience in supervision, technical expertise relating to the firm's primary business activities, and/or experience in the banking industry—assisted by a deputy supervisory officer (DSO). The SSO oversees the supervisory program for the firm and is the point of contact for the firm's chief executive officer (CEO) and board of directors; for foreign banking companies, the SSO may interact with the global senior executive group ("C-suite") and directors, as well as those overseeing the firm's U.S. operations. The SSO also interacts regularly with other New York Fed SSOs and with those holding similar positions at other Reserve Banks (known as "central points of contact," or CPCs). The DSO is responsible for the day-to-day management of the team, including logistics and resources, and meets regularly with firm officers at the next level down from the CEO.

The SG firm-focused teams for companies in the LISCC portfolio had the equivalent of between eight and twenty-one staff members assigned directly to the team, with an average team size of twelve, based on actual hours worked in 2014 (Table 2, top panel).[10] The number of team members generally corresponds to the size and complexity of the firm. Aside from the SSO and DSO, firm-focused team members fill one of three roles: financial analyst, business line specialist, or corporate function specialist. Financial analysts specialize in assessing the firm's financial condition, including earnings, capital, and liquidity, and interact regularly with the company's chief financial officer (CFO). Business line specialists are responsible for understanding the firm's business strategy and performance in its major business lines and interact with the heads of those business lines. Corporate function specialists interact with the firm's chief operating officer (COO) and staff, and are responsible for understanding a range of governance and operational activities, including the firm's resolution and recovery planning, incentive compensation structure, and enforcement action responses. The precise composition of the team across these three specialties reflects the size and complexity of the firm and the span of its businesses and activities.

[9] As described in SR 15-7, the LISCC coordinates the supervision of firms in the LISCC portfolio; the activities of the New York Fed's SG staff are conducted as part of this Systemwide program. The LISCC Operating Committee is ultimately responsible for execution of the LISCC supervisory program (Board of Governors of the Federal Reserve System 2015c).

[10] Internal supervisory allocation data are self-reported by employees and require subjective work classification—conditions leading to some potential measurement error in the tables and charts that rely on this data source.

Table 2

Staffing for New York Fed Supervision of LISCC Portfolio Firms

Full-Time-Equivalent Headcount Based on Actual Hours in 2014

Firm-Focused Team Staff: LISCC Firms

Total	Average	Median	Minimum	Maximum
137	12	10	8	21

Risk (ERS) Department Staff: LISCC Firms

Total	Average	Median	Minimum	Maximum
104	9	10	2	18

Total Risk (ERS) Department Staff

All	Credit Risk	Funding and Liquidity Risk	Legal and Compliance Risk	Market and Counterparty Risk	Model Risk	Operational Risk
262	55	38	40	66	27	35

Source: Federal Reserve Bank of New York internal supervisory time allocation data.

Notes: This table shows a measure of full-time-equivalent headcount based on actual hours worked by New York Fed Supervisory Group staff on firm-focused teams and risk departments assigned to firms in the LISCC portfolio supervised by the New York Fed. Figures are rounded to the nearest whole number. Average, median, minimum, and maximum are measured across firms in the LISCC portfolio. LISCC is Large Institution Supervision Coordinating Committee. ERS is Enterprise Risk Supervision.

3.3 Risk Department Specialists

In the case of the largest and most complex firms, specialists from the SG's Enterprise Risk Supervision department are assigned to the firm-focused team on a long-term basis. These risk specialists have reporting responsibilities to both the SSO and the head of the risk department. The risk specialists are responsible for understanding the firm's risk exposures and risk management along several dimensions, including credit, liquidity, operational, and market risk. Risk specialists also participate in cross-firm assessments of market developments, emerging risks, and risk management approaches. The work of risk specialists assigned to firms in the LISCC portfolio is also coordinated through the Risk Secretariat, a subgroup of the LISCC Operating Committee charged with reviewing and evaluating risk management practices and helping to prioritize risk-related supervisory activities across the LISCC portfolio (Board of Governors of the Federal Reserve System 2015c).

The number of risk specialists assigned to each firm-focused team and the particular risks covered by those specialists vary according to the business focus and risk exposure of the firm, but a comparison of the upper and middle panels of Table 2 suggests that, as of 2014, risk specialist teams assigned at LISCC firms were typically about 45 percent of the total team assigned to the firm (firm-specific and risk). Risk specialists are most commonly assigned to teams supervising BHCs in the LISCC portfolio, though even on these teams, not every risk type is covered by a specialist from one of the risk departments. When risk types are not covered by a specialist, or when teams have no risk specialists, other team members are responsible for understanding the firm's exposure to and management of the risk in question.

The SG's risk departments cover a range of risks facing large, complex financial institutions. Some risk departments specialize in liquidity risk, others in credit risk, operational risk, legal and compliance risk, market and counterparty risk, or model risk. The bottom panel of Table 2 displays the allocation of staff by risk categories based on actual-hours-equivalent headcounts during 2014 and irrespective of whether the staff was assigned to LISCC firms or not. Within each risk type, department members may focus on particular aspects of the risk in question. For example, the credit risk team has subspecialists in wholesale credit (large loans to corporations or loans associated with commercial real estate) and in retail/consumer credit. The market and counterparty risk team has specialists in particular types of trading

products, such as foreign exchange, interest rate products, equities, or commodities.

The risk specialists assigned to the firm-focused teams represent a large share of the risk departments' staff. In addition to the risk specialists, the risk departments have in-house supervisory and analytical staff. These staff members are responsible for cross-firm analysis, targeted work at a particular firm at the request of an SSO, and coverage of portfolios of firms whose teams do not have dedicated risk specialists. Several risk departments have analytical units that manage and analyze large data sets collected from the banks. These units include staff in the liquidity risk department working with detailed firm-specific data about the maturity, funding, and cash flow characteristics of the assets, liabilities, and off-balance-sheet exposures of the consolidated firm and its major legal entities;[11] staff in the market and counterparty department who analyze counterparty-level exposures at major derivatives dealers; and the Shared National Credit (SNC) team in the credit risk department, which plays a critical role in the interagency program examining the treatment of these large loans across banking companies.[12]

Aside from work done by the risk teams, analysis in other areas of the SG and the New York Fed also serves as a critical input and support to the prudential supervision of the large, complex BHCs and nonbank financial institutions overseen by the New York Fed. For instance, a separate team of analysts assesses business line revenue performance, earnings and financial performance, and capital trends at these firms.[13] The work of these analysts supports the LISCC and its assessment of the large, complex firms in that portfolio, including those located outside the Second District. However, unlike the risk specialists, the "capital and performance" analysts are not integrated with the supervisory teams. Nonetheless, their work helps shape the supervisory agenda for LISCC firms, as explained further in Section 4.

[11] These data are collected on regulatory report forms FR 2052a and FR 2052b. See Board of Governors of the Federal Reserve System (2015d) for more detail.

[12] The Shared National Credit Program was established in 1977 by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency to provide an efficient and consistent review and classification of any large syndicated loan. Today, the program covers any loan or loan commitment of at least $20 million that is shared by three or more supervised institutions. The agencies' review is conducted annually, usually in May and June (Board of Governors of the Federal Reserve System 2015e).

[13] As noted earlier, through 2014, these analysts were part of CFPA, which had a staff of twenty-eight at year-end 2014 (see Chart 2). Following a reorganization of the New York Fed at the beginning of 2015, some of these analysts became part of a unit outside of the SG.

3.4 Coordination and Information Sharing within the Supervision Group

Over time, supervisory staff members rotate across the firm-focused teams and, less frequently, among the risk departments. The Board of Governors requires that SSOs rotate at least every five years, with the possibility of extensions in special circumstances. New York Fed headcount data starting in 2000 indicates that the SSO spells at LISCC firms have generally been significantly shorter than five years, with an average of about 2.3 years.[14] The tenure limit is applied to all firm-focused team members in the SG, including the risk specialists. Thus, it is common for individuals to move from team to team over time, with the goal of balancing the in-depth knowledge gained about a particular firm with the fresh and independent perspective acquired by exposure to more than one institution. Rotation is intended to benefit the team as well as the individual, both by bringing in staff who do not necessarily share common assumptions with existing team members and by mitigating any tendencies to adopt the perspective of the firm being supervised. It is less common for staff to move from one risk department to another, given the specialized knowledge required to be an effective risk specialist. Risk specialists do, however, move to different firm-focused teams and into different assignments within the risk departments.

Members of both firm-focused teams and risk departments meet regularly to share information and observations and to coordinate analysis when appropriate. The most important mechanism for this interaction is provided by the so-called affinity groups, cross-firm groups of SG staff members who have common specialties and work focuses, such as financial analysts, business line analysts, and corporate function specialists. These groups generally meet weekly, with members attending in person at the New York Fed offices. Analysts and specialists from supervisory teams at other Reserve Banks and at the Board of Governors also participate in the affinity groups to facilitate broader information sharing and knowledge building.

[14] This figure excludes the most recent SSO assignments since these have not yet been completed. Including them in the calculation would otherwise lead to a right-truncation bias.

3.5 Impact of 2011 Reorganization

As noted above, a reorganization of the New York Fed's supervisory staff for the large, complex bank and nonbank firms took place in 2011. The goal of the reorganization was to build on lessons learned from the financial crisis about the importance of having a holistic understanding of risk and return at large, complex firms, including an understanding of the firms' business strategies and key revenue drivers. A primary objective was to broaden knowledge of each firm by moving away from a narrower focus on risk management and controls to a more integrated assessment of risk, revenue, and business strategy (Dahlgren 2011).

Prior to the reorganization, the firm-focused supervisory teams (shades of gray in Chart 2) were part of a single relationship department (Chart 3), although within that department, the teams were managed on a portfolio basis. More significantly, the teams focused on individual firms (known as "relationship" teams at that time) and the analysts specializing in different types of risk (known as "risk" teams) were less closely integrated. Risk specialists were not assigned to firm-focused teams on a long-term basis, but instead went from firm to firm on a project basis. SSOs (then referred to as central points of contact, or CPCs) would make requests for assistance from risk specialists to participate in firm-specific examinations; in some cases, risk specialists would work with the relationship team as part of a broader horizontal exam sponsored by the risk department and designed to cover several firms.

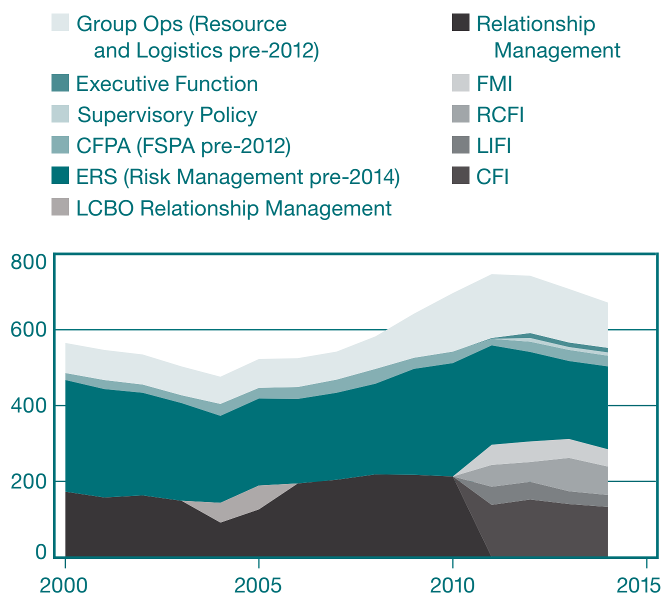
As a result of the reorganization, risk staff members now allocate an increasing portion of their time to a single firm. Chart 4 shows the portion of the risk department staff that is assigned to a single institution, as measured by the share of staff members who devote at least two-thirds of their time to one firm. This share rose from less than 5 percent to more than 30 percent after 2011.

Further, the new organizational structure formalized the three distinct roles within each firm-focused team (financial analyst, business line analyst, and corporate function specialist). Under the previous structure, relationship team members covered many of the same topics addressed by the financial analysts and corporate function specialists. However, the emphasis on business line strategy and performance is a new orientation (Dahlgren 2011). This new orientation—which is consistent with guidance that applies to the supervision of large, complex financial companies across the Federal Reserve[15]—is intended to provide insight into how the firms are generating profits and what risks are posed by the strategies the firms are pursuing, as a way of providing context to the evaluation of risk management and internal audit. Thus, the new approach involves a less direct focus on a firm's risk management and internal audit units as ends in themselves, and more focus on how the work of these areas supports (or does not support) the firm's business strategies and risk appetite.

Until recently, firm-focused teams were on-site in the sense that they were located in offices at the institution they were supervising. Typically, the supervised firm would provide a separate, dedicated area for the supervisory team. Team members also had access to work areas in New York Fed offices so that they could work off-site as needed. The idea in locating firm-focused supervisory teams on-site at the supervised institutions was to provide ready access to senior management and to internal systems and information networks at the supervised firm. Over time, however, technological enhancements have made access to firms' internal

Chart 3

The Evolving Department Allocation of Supervision Group Staff, Based on Headcount: 2000-14

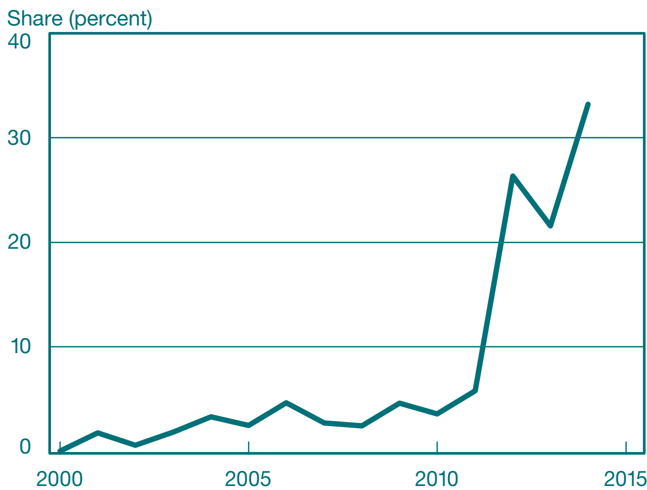


Source: Federal Reserve Bank of New York internal staff allocation data.

Note: CFPA is Cross-Firm Perspectives and Analytics; FSPA is Financial Sector Policy Analysis; ERS is Enterprise Risk Supervision; LCBO is Large Complex Banking Organizations; FMI is Financial Market Infrastructure; RCFI is Regional, Community, and Foreign Institutions; LIFI is Large International Financial Institutions; CFI is Complex Financial Institutions.

[15] SR 12-17 describes the conceptual framework for supervision of large financial institutions, which focuses on enhancing resiliency and reducing the impact of a firm's failure. See Board of Governors of the Federal Reserve System (2012).

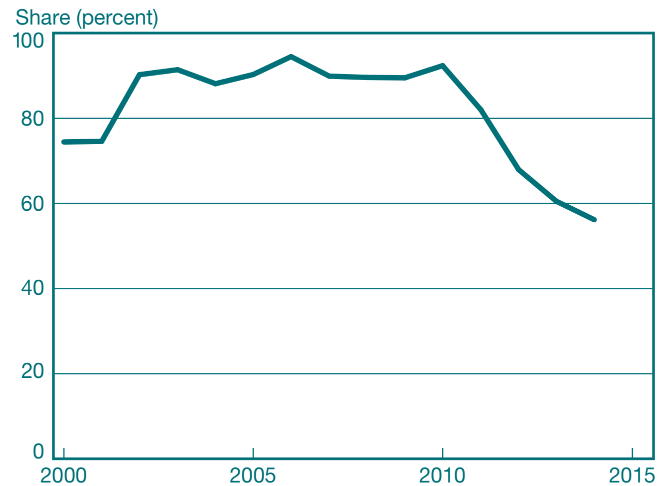
Chart 4
Risk Department Staff Allocated to a Single Institution



Source: Federal Reserve Bank of New York internal time allocation data.

Notes: The chart shows the share of risk department staff members who devote at least two-thirds of their supervisory hours to a single firm. Total supervisory hours exclude absences, training, and technical assistance.

Chart 5
Fraction of Hours Spent by LISCC Firm-Focused Staff On-Site



Source: Federal Reserve Bank of New York internal time allocation data.

Note: LISCC is Large Institution Supervision Coordinating Committee.

systems from remote locations much easier. As a result, the supervisory teams are being relocated to New York Fed offices on a permanent basis to facilitate interaction, cooperation, and information sharing among SG staff, as well as to foster analysts' independence. This pattern is evident in the fraction of on-site hours spent by LISCC firm-focused SG staff, which was about 55 percent in 2014 as compared with roughly 90 percent in the ten years prior (Chart 5).

3.6 Interaction with Other Supervisors

The Federal Reserve is the consolidated supervisor of BHCs and systemically important nonbank financial companies, meaning that it is responsible for having an integrated view of "the organization's structure, activities, resources and risk, as well as [addressing] financial, managerial, operational or other deficiencies" (Board of Governors of the Federal Reserve System 2015a). This consolidated oversight encompasses the parent holding company and its subsidiaries. Many of these subsidiaries are themselves regulated and supervised entities, such as commercial banks, thrifts, registered broker-dealers, and insurance companies. Thus, as part of the consolidated oversight of a bank holding company, members of the Federal Reserve supervisory staff interact with supervisory staff from other federal agencies, including the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission, and with state financial sector supervisors (for instance, the New York State Department of Financial Services).[16]

Federal Reserve supervisors make use of the work carried out by other federal and state supervisors in their oversight of commercial bank and other regulated holding company subsidiaries. Under the terms of the Gramm-Leach-Bliley Act (GLBA), Federal Reserve supervisors rely as much as possible on the examination reports of these other agencies in assessing the condition of these subsidiaries (Board of Governors of the Federal Reserve System 2015a). Beyond relying on reports, Federal Reserve supervisors meet regularly with supervisory staff from the other agencies to share information about the firm and the relevant subsidiary, as well as information about supervisory plans, activities, and findings. In addition

[16] The Federal Reserve is the primary federal supervisor of state-chartered commercial banks that are members of the Federal Reserve System ("state member banks"). The Federal Reserve shares supervisory responsibility for state member banks with state banking or financial services supervisors. In supervising these entities, which are often subsidiaries of bank holding companies, members of the Federal Reserve supervisory staff coordinate extensively with staff from state supervisory agencies.

to gaining the insights of other federal and state supervisors, Federal Reserve supervisors convey "information relating to the financial condition, risk-management policies, and operations of a banking organization that may have a material impact on the regulated subsidiary, as well as information concerning transactions or relationships between regulated subsidiaries and their affiliates" (Board of Governors of the Federal Reserve System 2015a).

Federal Reserve supervisory staff members also interact with home country supervisors of foreign banking organizations (FBOs) operating in the United States. As noted in a Federal Reserve policy document describing the supervision of the combined U.S. operations of foreign banks (SR 08-9), "supervision of a large complex FBO requires cooperation and information exchange between home and host country supervisors" (Board of Governors of the Federal Reserve System 2008). In practice, this cooperation involves formal sharing of information derived from supervisory activities, generally "facilitated by an MOU [memorandum of understanding] that establishes a framework for bilateral relationships and includes provisions for cooperation during the licensing process, in the supervision of ongoing activities, and in the handling of problem institutions" (Board of Governors of the Federal Reserve System 2008). These formal arrangements are augmented by periodic visits between the Federal Reserve and home country supervisory staff that include discussion of general topics concerning banking industry developments as well as "strategy sessions focusing on individual FBOs and specific supervisory issues and initiatives" (Board of Governors of the Federal Reserve System 2008).

4. Work Content: What Do Supervisors Do?

4.1 Overview

This section describes how the supervision of large, complex bank and nonbank companies is conducted on a day-to-day basis at the New York Fed. The discussion primarily covers the work of the firm-focused supervisory teams, including the risk specialists embedded on those teams, but also describes how the analytical work done by the risk departments and other cross-firm analysts is integrated with the supervision of these firms.

Most of the work of the firm-focused supervisory teams can be classified as either information gathering and analysis or follow-up to that analysis, including assigning supervisory ratings, determining enforcement actions, and tracking subsequent remediation efforts. The section first describes the different ways in which the firm-focused teams conduct information gathering—including continuous monitoring and examinations—as well as the range of subsequent outcomes. The section then describes how the teams determine which projects and type of monitoring to pursue, including a description of the annual supervisory planning cycle and the process of synthesizing supervisory work to assign a rating to each firm. Finally, the discussion covers the process by which priorities are set between work that is particular to an individual firm and work that covers multiple firms—known as "horizontal" work.

4.2 Activities of the Supervisory Teams

The work of the supervisory teams is shaped by supervisory guidance in the form of manuals, supervisory letters, and other written policies and procedures that codify supervisory expectations and provide direction to the teams in structuring their activities at the firms. These materials include the Bank Holding Company Supervision Manual, a publicly available document that provides instructions "for conducting inspections of bank holding companies . . . to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its nonbanking subsidiaries and its subsidiary banks" (Board of Governors of the Federal Reserve System 2015a, 2015f).[17] Supervision and Regulation Letters address "various policy and procedural matters related to the Federal Reserve's supervisory activities" (Board of Governors of the Federal Reserve System 2015g).[18] The SR Letters, which are also publicly available, are intended to provide information both to supervisors and to supervised institutions. As such, the letters address a diverse range of topics, including the overall supervisory program for large, complex financial institutions (SR 12-17), recovery planning (SR 14-8), model risk management (SR 11-7),

[17] A similar manual focused on the supervision of commercial banks is also available; see Board of Governors of the Federal Reserve System (2015f).

[18] According to the Board of Governors website, "Supervision and Regulation Letters, commonly known as SR Letters, address significant policy and procedural matters related to the Federal Reserve System's supervisory responsibilities. These letters are issued by the Board of Governors' Division of Banking Supervision and Regulation and are a means of disseminating information to banking supervision staff at the Board and the Reserve Banks, as well as to supervised banking organizations" (Board of Governors of the Federal Reserve 2015g).

counterparty credit risk management (SR 11-10), and stress testing (SR 12-7). Finally, these public documents are supplemented by internal policies and procedures intended to provide direction to supervisory staff in designing and implementing their supervisory work programs.

The traditional model of bank supervision involves a full-scope examination of a bank's financial condition and operations that is conducted annually and assesses the bank as of a moment in time. While this approach is still used for smaller banks and BHCs, the larger and more complex bank and nonbank firms have for some time been subject to ongoing supervision over the course of the year. Under an ongoing supervisory approach, the firm-focused supervisory teams engage with management at the firm and review and analyze information that is provided to them on a continuous basis; this type of oversight is referred to as "continuous monitoring." The teams also engage in more detailed analyses and assessments of particular issues at different points over the course of the year,[19] through "enhanced continuous monitoring" and formal examinations. These more detailed forms of information gathering and analysis can be firm-specific and conducted by a single team, or can involve multiple banks and thus be coordinated across several teams, including in-house analyst teams in the risk departments and other areas of the SG as well as other Reserve Banks and other supervisors.

The three approaches used to gather information about larger and more complex firms—continuous monitoring, enhanced continuous monitoring, and formal examinations—differ in their goals as well as in their structure and execution. The following sections discuss each of these supervisory approaches in greater detail. The conceptual and practical boundaries between the approaches are not always distinct. For instance, it can be difficult to distinguish the intense scrutiny of an issue identified through continuous monitoring from enhanced continuous monitoring, or to determine whether a particular issue should be pursued by means of enhanced continuous monitoring or a formal, targeted examination. The following discussion thus focuses on the broad differences rather than some of the finer nuances.

[19] These more detailed assessments can occur at any point during the year, in contrast to the traditional supervisory model, in which all assessment of the bank occurs at the same "as of" date.

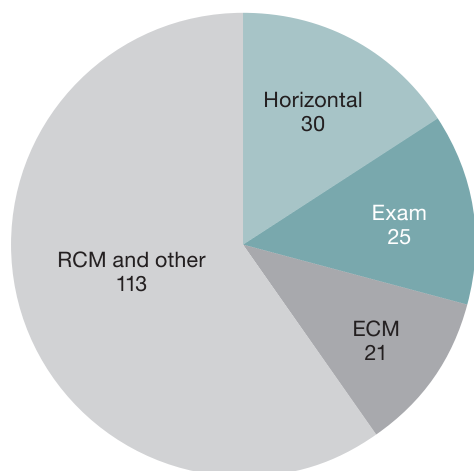
4.3 Continuous Monitoring

Continuous monitoring activities are intended to enable each firm-focused supervisory team to "develop and maintain an understanding of the organization, its risk profile, and associated policies and practices" (Board of Governors of the Federal Reserve System 2015a), as well as to identify gaps or issues that might lead the team to do more in-depth analysis. Continuous monitoring involves meetings with bank management, review of internal reports, and regularly produced analysis based on internal firm data. Continuous monitoring activities are almost always focused on, and structured around, an individual firm and its particular characteristics, business focus, and management structure. In contrast, enhanced continuous monitoring and formal examinations are intended to be "deeper dives" into particular issues or concerns about the firm, involving more analytical work and leading to conclusions about the effectiveness of internal controls, risk management, or business strategies, as well as offering an assessment of the firm against its internal guidelines, regulatory or industry standards, or peer practice. Enhanced continuous monitoring can be less formal and more exploratory than formal examinations, but with both approaches, the teams focus on a particular issue that has been identified as a potential concern. The allocation of hours to each type of activity in 2014, expressed in headcounts of SG staff working on firms in the LISCC portfolio, is shown in Chart 6.

As part of continuous monitoring, firm-focused team members meet with bank management on both a scheduled and an ad hoc basis. The regularly scheduled meetings can have specific agendas focused on issues of interest to the team or can be open ended to provide an opportunity for bank management to share its view of important developments. Team members may also use open-ended meetings to ask questions about recent decisions or steps taken by the firm, as a way of gaining further insight into the firm's governance processes.[20] Different team members typically meet with different levels of bank management and with managers whose responsibilities span different areas. For instance, as noted above, the SSO meets frequently with the firm's CEO and board members. Financial analysts meet with the firm's CFO and senior staff; the business line specialists meet with the corresponding business line managers; corporate function specialists meet most often with the COO; and the risk specialists meet with internal auditors and staff at the supervised

[20] In these settings, team members might ask questions such as "How did you get comfortable with that decision?" or "How did you gather the information to make that choice? What analysis did you do?"

Chart 6
Activity Allocation of LISCC Team in 2014, Based on Headcount



Source: Federal Reserve Bank of New York internal supervisory hours allocation data.

Notes: "Horizontal" includes cross-firm programs such as the Comprehensive Capital Analysis and Review (CCAR) and Comprehensive Liquidity Analysis and Review (CLAR). "Exam" refers to nonhorizontal examination activities. ECM is enhanced continuous monitoring; RCM and other is regular continuous monitoring and all other activities (including nonsupervisory ones). LISCC is Large Institution Supervision Coordinating Committee.

institution who report to the chief risk officer (CRO). Team members often meet with multiple individuals at the firm to discuss the same topic or ask the same questions, since inconsistent responses can be indicative of an issue at the firm. Aside from their use in gathering information, meetings can also be a means of conveying feedback, especially to senior management and board members.

A second key component of continuous monitoring is the review of internal data produced by the firm. These data include regulatory reports, which provide comprehensive and standardized reporting across firms and over time; internal reports, which offer customized, nuanced reporting by the firm using metrics developed for internal management purposes; and external reporting, such as financial statements, which complement information from regulatory reports. The teams have the authority to request any report or data produced by the firm and, as a matter of practice, regularly receive a very large number of internal reports and analyses as well as access to the firms' internal reporting systems. Reports generated for business line managers, senior managers, and the board of directors are of particular interest, since they yield insight into the information available to decision makers at the firm and thus into the decision-making process. Aside from these materials, the teams also receive daily, weekly, monthly, and quarterly reports containing business line, risk management, and other internal control metrics; such documents frequently contain very detailed information about the firm's performance, risk exposures, and internal oversight.

One challenge faced by the teams is the large volume of information provided, which increases the difficulty of conducting a comprehensive, detailed assessment. Reviews of regular management reports focus primarily on identifying changes and new developments; these assessments can provide topics for discussion in meetings with the firm and/or spur further exploration and analysis. Analysis provided by the firms' in-house risk departments and by analysts in other parts of the SG and the New York Fed complements the examination of internal management reports that is conducted by team members. For instance, analysis of detailed liquidity data by the New York Fed liquidity risk department can identify changes in a firm's liquidity position or liquidity risk profile that might lead to discussion with the firm and further analysis and exploration by the firm-focused team or the liquidity risk department.

4.4 Enhanced Continuous Monitoring and Examinations

In contrast to continuous monitoring, which consists of ongoing, repeated activities of the firm-focused supervisory teams, enhanced continuous monitoring and formal examinations involve discrete supervisory "projects" that are generally conducted on a onetime basis. As noted above, enhanced continuous monitoring is intended to provide insight into a particular topic or business strategy, risk levels, or risk management practices and controls. It can also be used to learn more about an area or fill a knowledge gap. As such, it is a "deeper dive" into an issue or question that has already been identified—an effort to understand the scope and depth of the issue and whether further information gathering and analysis or remedial actions on the part of the firm are warranted. Enhanced continuous monitoring could involve more extensive meetings with firm management to discuss particular issues or topics in detail (in other words, with specific, pre-planned agendas); special requests for data beyond what is provided in the internal management reports normally received by the team; limited testing of individual transactions to assess compliance with internal policies, supervisory guidance,

or regulation; and assessment and documentation of the information gathered. Enhanced continuous monitoring can be focused on issues specific to an individual firm, or can be used to develop a horizontal, cross-firm perspective on an area or topic.

The results of enhanced continuous monitoring vary according to the nature of the particular project and what is discovered during the exercise. For instance, enhanced continuous monitoring exercises that are aimed at filling knowledge gaps result primarily in enhanced information and understanding by the supervisory team. Review of the findings and communication back to the firm could be limited and informal in these cases. In contrast, enhanced continuous monitoring projects that are intended to explore control or risk management weaknesses at one or more firms could result in enforcement actions ranging from informal "supervisory observations" to public "cease and desist" orders. In these latter cases, there would be extensive vetting (review) of the findings by supervisory team members, by one or more of the risk departments, by more senior management within the SG, and, for companies in the LISCC portfolio, by the LISCC Operating Committee. Outcomes would be communicated to the firm in writing, with subsequent tracking and follow-up by the firm-focused team to ensure that the deficiencies that have been identified are being addressed.

Like enhanced continuous monitoring, formal examinations also involve a "deep dive" into a particular topic or issue affecting one or more firms. There are several types of examinations, including target examinations, which assess a firm's practices against its internal guidelines, regulatory or industry standards, or peer practice; discovery examinations, which focus on "understanding . . . a particular business activity or control process—for example, to address a knowledge gap identified during the risk assessment or other supervisory process" (Board of Governors of the Federal Reserve System 2015a); and horizontal examinations, which involve coordinated work across several institutions. Procedurally, target examinations involve several stages, including the delivery of introductory letters to the banks notifying them of the examination and requesting information; a "scope" memo that defines the rationale and objectives of the examination, including questions to be answered and procedures to be performed; memos documenting the findings and conclusions ("product memos"); meetings with the firms to present the results verbally ("close-out meetings"); and a formal examination report communicating findings to the firm. Depending on the focus, examinations can also involve more extensive transaction testing than is typically done during enhanced continuous monitoring. Each stage of the examination process is vetted by various participants and management within the SG and, for horizontal examinations, with System oversight groups.

Distinguishing formal examinations from some forms of enhanced continuous monitoring can be difficult. Both involve a thorough analysis and assessment of a particular issue or area accompanied by extensive information gathering, either at an individual firm or across several firms; the actual activities carried out—meetings, information requests, testing, and analysis—can be identical. In addition, both can result in enforcement actions requiring substantive change in processes, governance, and activities at the firm. However, the two approaches differ in the level of formality and structure involved in the exercise. Typically, examinations are far more structured than enhanced continuous monitoring and can take much longer to get started and to complete. Thus, the supervisory teams often favor enhanced continuous monitoring over formal examinations because it is more flexible and can be timelier. That said, the structured nature of a formal examination can mean that resources (principally, the time of team members) are officially allocated to the exam, whereas staffing of enhanced continuous monitoring is more fluid.

As noted earlier, both enhanced continuous monitoring and examinations tend to be discrete exercises carried out on a onetime basis. The Federal Reserve also conducts several large horizontal supervisory programs that involve similar activities but occur on an annual or ongoing basis. These programs include the Comprehensive Capital Analysis and Review (CCAR), which focuses on internal capital planning and capital adequacy; the Comprehensive Liquidity Analysis and Review (CLAR), which focuses on internal liquidity planning and liquidity resources (Tarullo 2014); and the Supervisory Assessment of Recovery and Resolution Preparedness (SRP), the Federal Reserve's annual horizontal review of the LISCC firms' options to support recovery and progress in removing impediments to orderly resolution (Board of Governors of the Federal Reserve System 2015c). While many of the activities conducted under these programs are similar to those involved in enhanced continuous monitoring and horizontal examinations, there are some important distinctions. The programs can involve more firms than would typically be involved in a horizontal exam—for instance, in 2016, the CCAR included thirty-three firms spanning the LISCC and large banking organization (LBO) portfolios. CCAR and CLAR are the primary lenses through which capital and liquidity adequacy at the participating firms are assessed (which is why they are "comprehensive" analyses and reviews), whereas a typical target examination is more narrowly focused. In some cases, the programs also have their own distinct set of possible remedial actions; for example, the Federal Reserve can object to a firm's capital plan in the CCAR (in which case the firm's ability to pay dividends and make share repurchases is restricted) or require substantial structural changes at a firm whose resolution plan is deemed not credible.

4.5 Remedial Steps and Follow-Up

Aside from the follow-up actions discussed previously, which are specific to these large, horizontal programs, both the programs and day-to-day supervision conducted by the firm-focused supervisory teams can result in a range of supervisory actions intended to make firms address shortcomings identified through the supervisory process. When deficiencies in a firm's risk management, governance, or other controls are revealed through regular or enhanced continuous monitoring, formal examinations, or a supervisory program, or if a firm is found to be in a financial condition that threatens its safety and soundness, supervisors can take various actions to compel the firm to address the deficiencies. These supervisory actions generally take the form of written communication to the firm's board of directors or to an executive-level committee of the board (Board of Governors of the Federal Reserve System 2013).

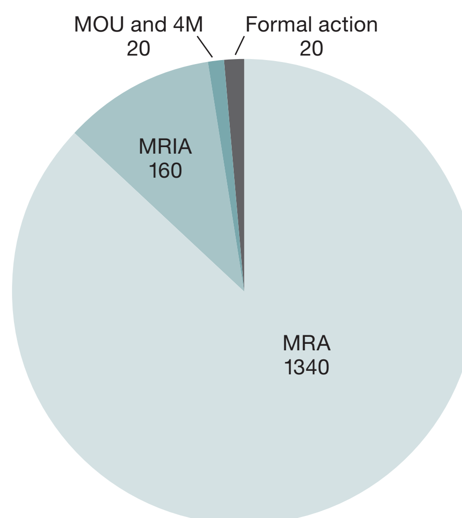
The prevalence of various types of supervisory actions issued to LISCC institutions overseen by the New York Fed is shown in Chart 7. The mildest of these supervisory actions are matters requiring attention (MRAs) and matters requiring immediate attention (MRIAs). MRAs are about eight times as frequent as MRIAs. According to SR 13-13, MRAs "constitute matters that are important and that the Federal Reserve is expecting a banking organization to address over a reasonable period of time, but the timing need not be 'immediate.'" MRIAs, meanwhile, are "matters of significant importance and urgency that the Federal Reserve requires banking organizations to address immediately and include: (1) matters that have the potential to pose significant risks to the safety and soundness of the banking organization; (2) matters that represent significant noncompliance with applicable laws or regulations; [and] (3) repeat criticisms that have escalated in importance due to insufficient attention or inaction by the banking organization." The distinction between an MRA and an MRIA lies in the "nature and severity of the matters requiring corrective action" and the "immediacy with which the banking organization must begin and complete corrective actions."

The MRA or MRIA specifies the particular concern being raised as well as a time frame in which the firm must remediate the deficiency. Firms receiving MRAs or MRIAs will typically develop a remediation plan; the supervisory team then reviews the plan and is responsible for following up to ensure that it has been implemented. This follow-up can take the form of a subsequent examination or regular or enhanced continuous monitoring. If the firm fails to sufficiently address the concerns identified in the MRA or MRIA, the matter can be escalated into more severe enforcement actions (Board of Governors of the Federal Reserve System 2013). It is typical for a banking organization to have many outstanding MRAs and MRIAs at any given time, reflecting the outcomes of the range of supervisory activities undertaken by the firm-focused supervisory team and other Federal Reserve supervisory staff.

Chart 7

Supervisory Actions Issued to LISCC Institutions in the Second Federal Reserve District

January 2011–November 2014



Source: Federal Reserve Bank of New York internal data on enforcement activity.

Notes: The chart shows the number and type of supervisory actions issued to LISCC financial institutions supervised by the Federal Reserve Bank of New York between January 2011 and November 2014, irrespective of whether the action is ongoing (open) or resolved (closed). All counts are rounded to the nearest ten. Blue areas include MRAs (matters requiring attention), MRIAs (matters requiring immediate attention), MOUs (memoranda of understanding), and 4Ms (4(m) agreements). Formal enforcement actions include cease and desist orders, written agreements, and other formal actions. LISCC is Large Institution Supervision Coordinating Committee.

A third type of supervisory action is the memorandum of understanding (MOU). Chart 7 shows the joint incidence of MOUs and the formal supervisory actions known as 4(m) agreements ("4Ms").[21] MOUs and 4Ms are distinct but are grouped together in the chart because they are the most severe actions that are not publicly disclosed. An MOU is considered to be more severe than an MRA or MRIA, typically encompassing multiple deficiencies at a firm. MOUs also differ from MRAs and MRIAs in that MOUs are agreements between the

[21] The term 4(m) agreement comes from the corresponding section of the BHC Act.

Federal Reserve and the supervised firm while MRAs and MRIAs are determined by the Federal Reserve alone. MOUs often incorporate restrictions on a firm during the period in which it is remediating the concerns raised in the MOU.

MRAs, MRIAs, MOUs, and 4Ms are typically considered confidential supervisory information and thus are not publicly disclosed by the Federal Reserve. In contrast, most formal supervisory actions such as written agreements, cease and desist orders, and fines ("civil money penalties") are publicly disclosed by the Federal Reserve Board. Written agreements and certain cease and desist orders (referred to as "consent orders") are agreed to by the Federal Reserve and the supervised institution, stipulate findings about the firm, and specify a course of action to address the findings. Cease and desist orders can also be imposed without the agreement of the firm. A 4M agreement may be issued when a holding company is either engaged in impermissible activities or when the holding company or one of its depository institution subsidiaries is either inadequately capitalized or not well managed. These formal supervisory actions have legal force, meaning that should the firm fail to meet the terms of the action, it can face fines and other actions, such as a requirement to restrict its growth or to divest certain assets.

The severity of the supervisory action taken depends on the severity of the deficiency that has been identified. Supervisors need not start with less severe actions before imposing more severe ones or take informal enforcement actions before taking formal ones, though escalation of insufficiently addressed actions certainly does occur. MRAs, MRIAs, and both formal and informal enforcement actions can be initiated by the firm-focused supervisory team; they can also be initiated by other supervisory staff in the SG or at the Board of Governors in coordination with the firm-focused team—for instance, as part of broad programs such as the CCAR and CLAR. If sufficiently severe, MRAs and MRIAs given to firms in the LISCC portfolio can be reviewed by or be subject to the approval of the SSO's management or the LISCC Operating Committee. MOUs and formal enforcement actions are developed jointly by New York Fed and Board of Governors staff, and are signed by officials of the Reserve Bank and/or officials of the Board of Governors.

Supervisory actions typically are in force for a year or more as the firm's management implements changes to address issues raised in the actions. Table 3 shows the duration of supervisory actions at Second District LISCC institutions issued between 2011 and 2014 that were closed or still ongoing as of November 2014.

Tracking progress against supervisory actions, especially MRAs and MRIAs, is one of the key elements of continuous monitoring. Typically, the corporate function specialists on the team are administratively responsible for this tracking, with assessment of the steps taken by the firm to address the issues identified in the action conducted by subject matter experts, such as other team members or staff from the risk departments. A variety of inputs can help determine whether an action can be lifted, including independent review and testing done by the supervisory team and the work of the firm's internal audit team (which would typically be the group within the firm responsible for tracking and determining compliance with enforcement actions). A key question in determining whether the action can be closed is whether the changes implemented by the firm to address the concerns in the enforcement action are sustainable over time. Depending on the severity of the deficiency addressed in the action, the decision about whether the issues have been addressed could rest with the supervisory team and SSO or could require vetting and approval by the LISCC Operating Committee (for firms in the LISCC portfolio) or by more senior officials at the Reserve Bank or Board of Governors.

4.6 BHC Ratings

In addition to enforcement actions, supervisory ratings are a critical product of the information gathering and analysis done by the team over the course of the year. Bank holding companies are assigned a rating from 1 to 5 under the "RFI/C(D)" rating system. The letters indicate different components considered in the rating—"R" is for risk management, "F" is for financial condition, "I" is for the potential impact of the nondepository entities in the holding company on the depository institution(s) in the holding company, "C" is for the composite rating (that is, the overall rating considering and weighing the ratings on "R," "F," and "I"), and "D" is the rating assigned to the depositories (such as commercial banks or thrifts) owned by the holding company. The "R" and "F" ratings have subcomponents capturing different aspects of risk management (for example, board and senior management oversight) and financial condition (capital, liquidity, asset quality, and earnings), each of which is assigned its own rating. The "R" and "F" ratings are a summary of these subcomponents (though generally not a simple average) and the composite "C" rating reflects the ratings of the individual "R," "F," and "I" components (though, again, generally not a simple average). The highest rating is a "1," indicating the strongest performance and practices and least amount of supervisory concern, while a rating of "5" indicates the lowest performance and a very high degree of supervisory concern (Board of Governors of the Federal Reserve System 2004). Ratings are assigned on an absolute basis rather than a relative one, so the

Table 3
Duration in Years of Supervisory Actions Issued to LISCC Institutions in the Second Federal Reserve District
January 2011–November 2014

Issues Closed (Resolved) as of November 2014				
Issue Type	Average	Minimum	Maximum	Count
Matter requiring attention (MRA)	1.4	0.0	3.5	680
Matter requiring immediate attention (MRIA)	1.0	0.0	2.7	110
Formal action	0.5	0.0	1.5	10

Issues Open (Ongoing) as of November 2014				
Issue Type	Average	Minimum	Maximum	Count
Matter requiring attention (MRA)	1.7	0.1	3.9	660
Matter requiring immediate attention (MRIA)	1.8	0.2	3.8	50
Formal action	2.7	0.9	4.0	10
Memorandum of understanding (MOU) and 4M	2.3	0.1	3.2	20

Source: Federal Reserve Bank of New York internal data on enforcement activity.

Notes: The table shows summary statistics for the duration of supervisory actions. All counts are rounded to the nearest ten. Because the table covers the interval between January 2011 and November 2014, the maximum duration is about four years. LISCC is Large Institution Supervision Coordinating Committee.

median rating across firms can vary over time and with economic and financial market conditions. In addition, some studies have found differences in supervisory stringency in assigning ratings over the business cycle (Krainer and Lopez 2009).

Ratings are important supervisory outputs because they help communicate supervisors' views of the firm to its management and board of directors (typically, information about a BHC's RFI/C(D) rating is closely held within the firm); because they foster communication and common understanding within the Federal Reserve about relative and absolute assessments of different BHCs; and because BHCs with low ratings can face constraints on their activities and growth—for example, through merger and branching restrictions.

Ratings can be changed at any point during the year based on new information or analysis, but in general, ratings for the large, complex firms in the LISCC portfolio are assigned annually. The process of assigning ratings is referred to as "roll-up," reflecting the idea that the rating incorporates all the information and analysis generated by the firm-focused supervisory team and other supervisory staff over the course of the year. For the large, complex banking firms, the roll-up begins with the SSO and supervisory team proposing ratings for the components and composite. The team documents the rationale for the ratings based on assessments made over the course of the year using continuous monitoring, enhanced continuous monitoring, and examinations; on input from supervisory programs such as the CCAR and CLAR (which are critical in determining the capital and liquidity subcomponents, respectively, of the "F" rating and the risk management elements of the "R" rating); on peer comparisons; and on other data and analysis. Ratings changes receive particular attention. The proposals developed by the supervisory team are reviewed by others in the SG, and then by the LISCC Operating Committee, which has final approval of the rating. Typically, vetting of these ratings is performed for all firms in the LISCC portfolio at the same time as a way of promoting consistency across firms and across Federal Reserve Districts.

4.7 Planning and Priorities

While the work of the firm-focused supervisory teams takes place throughout the year, it is based on an annual cycle of planning and evaluation. The cycle begins with the teams' assessment of the key risks facing each firm based on the firm's business line focus, strategies, and financial condition. Identifying these risks helps direct the work of the supervisory teams by ensuring that the most important risks are addressed in the work plan for the year.

The key output of this process is the "supervision plan," which outlines what the firm-focused team plans to do over the coming year, including continuous monitoring, enhanced continuous monitoring, examinations, and work on horizontal programs such as CCAR, CLAR, and the SRP. The supervision plan is developed by the SSO based on guidance provided by the relevant System oversight group for firms in the LBO and FBO portfolios and by the LISCC Operating Committee for firms in the LISCC portfolio; the LISCC Operating Committee sets final priorities for supervisory plans for firms in the LISCC portfolio. The guidance helps the SSO establish priorities among various cross-firm projects and programs, such as the CCAR, and firm-specific work. For firms in the LISCC portfolio, these plans are discussed with the LISCC Operating Committee twice a year to reconfirm priorities and to establish new areas of focus based on industrywide or firm-specific developments. The supervisory plan is not shared with the supervised firm.

The goals of the planning process are to identify the key supervisory objectives for the coming year—for example, the areas or topics that the team will analyze in depth or issues that will be the key focus of continuous monitoring and enhanced continuous monitoring—and to ensure that the team has sufficient resources to achieve those objectives. Ideally, the supervision plan also allows time to address unforeseen developments so that these events do not crowd out other important work.

Often, there is more work that could be done than time or staff to do it. Given these resource constraints, the SSO sets priorities for the team based on input from several sources, including the firm-focused supervisory team, the risk departments, other areas of the SG, and the relevant management oversight group. The LISCC Operating Committee, for instance, has subcommittees that review and suggest priorities in coordination with the risk departments and with analysts assessing capital and performance. These subcommittees bring together risk specialists, SSOs, other team members, and analysts from the New York Fed and other District Banks to share information and identify cross-firm issues (Board of Governors of the Federal Reserve System 2015c). This process results in suggestions for more in-depth work using enhanced continuous monitoring or horizontal examinations. Members of the SG risk departments and business line specialists are actively involved in these subcommittees and so have a role in proposing these cross-firm projects.

Firm-specific work is generally proposed by the SSO and the firm-focused supervisory team. The risk specialists, in coordination with the risk departments, may also suggest potential areas for further analysis at individual firms. Overall, about half the work done by the firm-focused teams (including the risk specialists) is firm-specific and half involves cross-firm work, including Systemwide programs such as CCAR and CLAR.

5. Summary

The supervision of large, complex financial institutions is one of the most important, but least understood, elements of the Federal Reserve's efforts to foster financial stability. Supervision involves oversight and monitoring to assess whether these firms are engaged in unsafe or unsound practices, and to ensure that the firms take appropriate actions to correct these practices. Importantly, supervision is distinct from regulation, which involves defining the rules under which these firms operate. Much of supervision is confidential—supervisors work with confidential information about the firms and many supervisory actions are not publicly disclosed. While the Federal Reserve has publicly described the goals and objectives of supervision, the confidentiality surrounding supervisors' day-to-day work makes it difficult for outsiders to understand what supervisors do and how they do it.

The goal of this article has been to bring greater transparency to System supervisory activities by describing how the supervision of large, complex financial organizations is carried out at the Federal Reserve Bank of New York as part of the Federal Reserve System's broader supervisory structure for these firms. We provide an overview of the departmental and team structure of the New York Fed's Supervision Group and data about staffing levels and time allocation across various supervisory activities. In particular, we document the shift in focus since the financial crisis toward greater specialization of supervisory staff at individual banking companies and the integration of risk specialists with firm-focused teams.

We also describe the day-to-day work of supervisors on various types of monitoring and analysis, including both firm-specific activities and "horizontal" analysis, in which similar issues are examined across a set of BHCs. We detail the most common approaches used by supervisors to ensure that firms take steps to correct practices or conditions that might threaten the safety and soundness of the firm or the financial system, including the assignment of supervisory ratings and the issuance of enforcement actions such as MRAs and MRIAs.

Understanding how supervision works is a critical precursor to determining how to measure its impact and effectiveness. This article takes a first step toward that understanding by clarifying the objectives of supervision and by showing what supervisors do on a day-to-day basis to meet these objectives.

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