

Supervising Large Complex Financial Institutions: What Do Supervisors Do?

FEDERAL RESERVE BANK *of* NEW YORK

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What is Supervision?

Supervision and regulation

- Supervision is distinct from regulation, but the two activities are often conflated.
- Regulation involves defining the rules:
 - Who can own and control commercial banks
 - What bank holding companies (BHCs) and commercial banks can and cannot do (activities)
 - Minimum requirements to operate without additional regulatory constraints (e.g., capital and liquidity requirements)
- Supervision involves monitoring and oversight of the firm:
 - Compliance with law and regulation
 - Are firms engaging in unsafe or unsound practices?
 - Remediation steps to make the firms correct any unsafe or unsound practices



Goals of Supervision: In the Fed's own words

- “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, “Dodd-Frank Act Stress Test 2015: Supervisory Stress Test Methodology and Results.” (March 2015)

- “The objectives of supervision are to evaluate, and to promote, the overall safety and soundness of supervised institutions (micro-prudential supervision), the stability of the financial system (macro-prudential supervision), and compliance with relevant laws and regulations.”

Federal Reserve Bank of New York website (accessed October 2014)

- “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, “Bank Holding Company Supervision Manual.”(January 2015)



Safety and Soundness: A Critical Concept

- Not hard-coded in regulation, though significant supervisory guidance
 - Supervision and Regulation Letters (SR Letters)
 - Examination Manuals
 - Training
- Role for judgment, in combination with data
 - Analytical though not always based (solely) on numbers
 - Cross-firm comparisons (horizontal perspective)
 - Multidisciplinary
- Tradeoff between flexibility (to adjust to new practices and conditions) and predictability (so that firms understand the expectations)



What Do Supervisors Do?

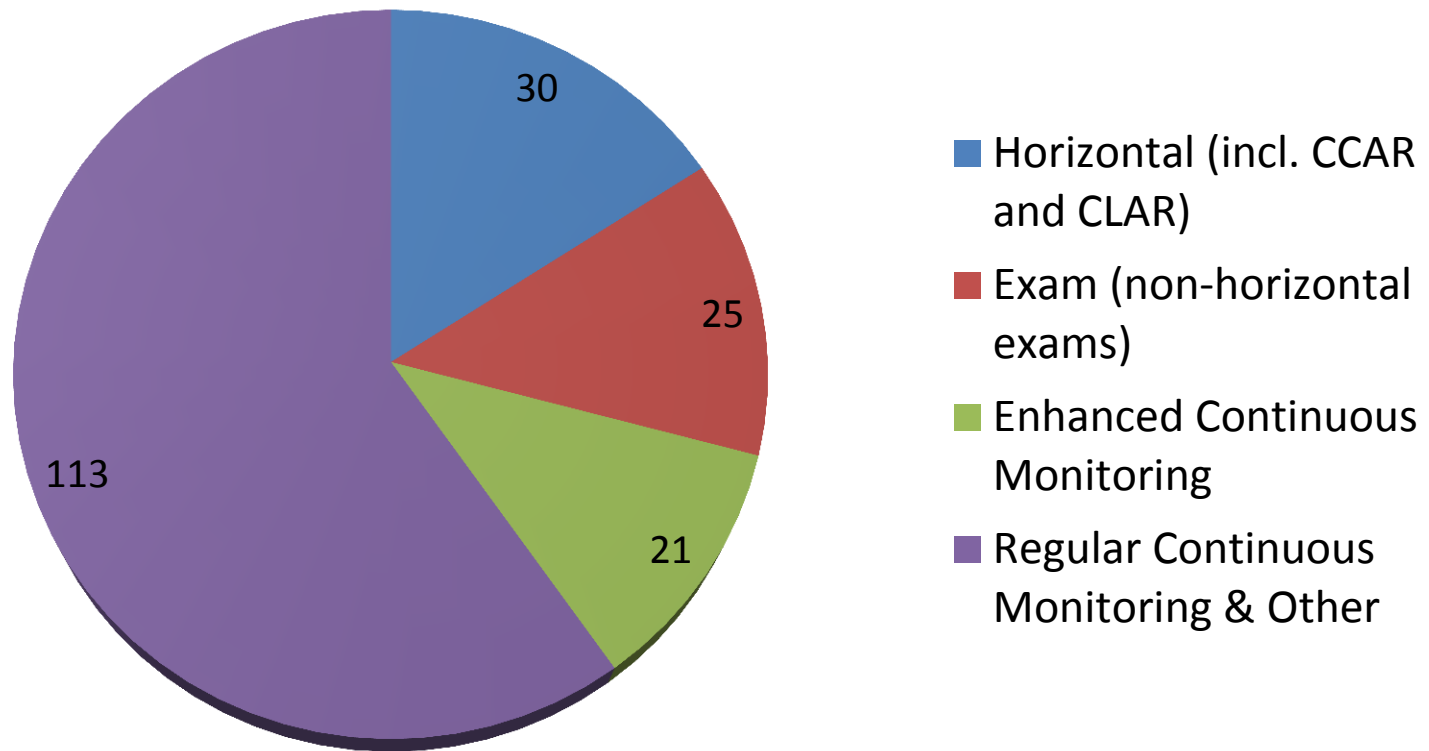
What do BHC supervisors do?

- “Continuous monitoring,” including:
 - Meet with senior management, business line management, risk and control departments, and board members
 - Review internal reports (risk, performance, budget, strategy)
 - Quantitative and qualitative
 - Regular and ad hoc reports
 - Independent analysis of confidential and public information
- Examinations and “enhanced continuous monitoring”
 - Deeper dives focused on special topics, issues, concerns
 - Can be intended to fill a knowledge gap, to assess controls and processes, to identify weaknesses
 - Can involve individual firms or several firms (“horizontal”)
- On-going programs (for large, complex firms), including:
 - Comprehensive Capital/Liquidity Analysis and Review (CCAR/CLAR), Supervisory Assessment of Recovery and Resolution Preparedness (SRP)



How FRBNY LISCC supervisors spend their time

2014 Supervisory Staff Headcount by Activity



Source: FRBNY internal supervisory hours allocation data on 2nd District Large Institution Large Institution Supervision Coordinating Committee (LISCC) firms.



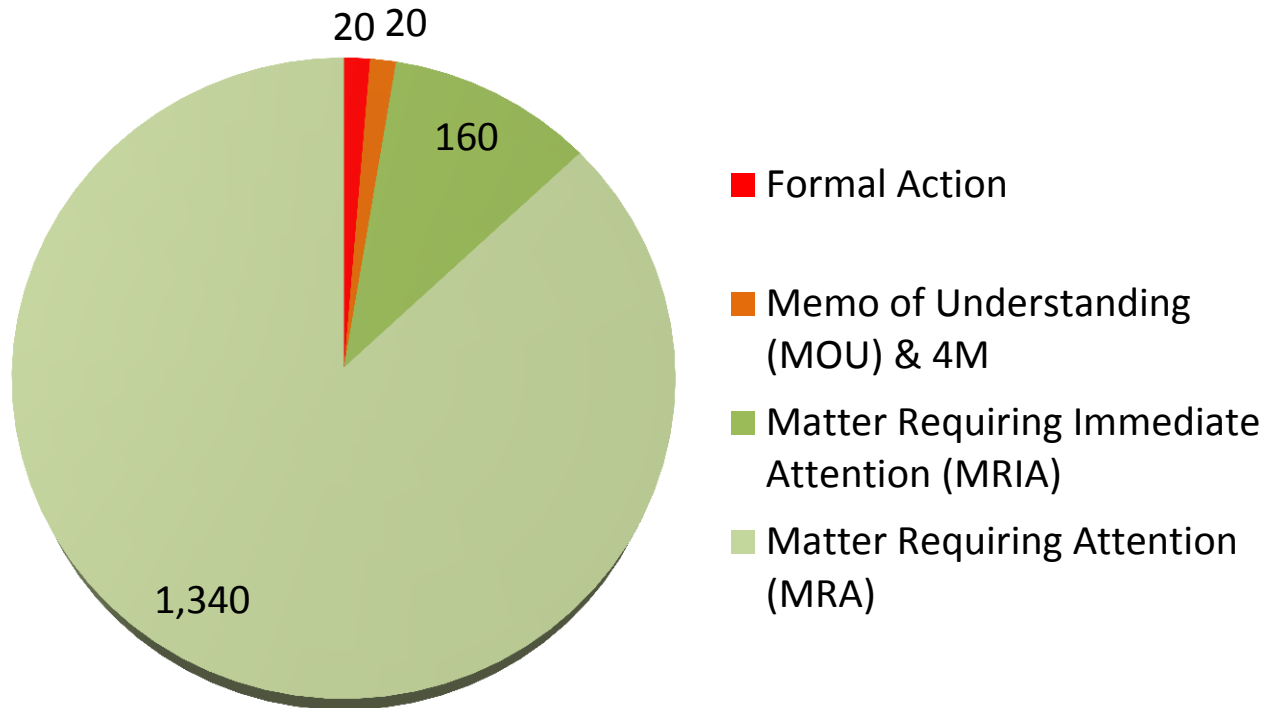
Supervisory results and follow-through

- Enforcement and other supervisory actions
 - Matters Requiring Attention (MRAs), Matters Requiring Immediate Attention (MRIAs), Memoranda of Understanding (MOUs), 4-M agreements, written agreements, consent orders, cease and desist orders
 - Require firms to address unsafe or unsound practices, regulatory compliance
 - Timeline for remediation
 - Some actions public, some confidential
 - Some are joint agreements with BHC (e.g., consent order), some are without consent/agreement



Supervisory Actions

Supervisory Actions Issued to LISCC Institutions In the 2nd Federal Reserve District (Jan 2011-Nov 2014)



Source: FRBNY internal data on enforcement activity. All counts are rounded to the nearest 10 and included irrespective of whether the action is ongoing (open) or resolved (closed).

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- Supervisory Ratings
 - 1 to 5 rating (RFI/C for BHCs; CAMELS for commercial banks)
 - Confidential, not public
 - Bad rating can result in limits on actions (e.g., acquisitions, removal of management)
- Outcomes of specific programs
 - CCAR: can result in limit on dividends and repurchases



Supervisory Data used in our Analysis

- **Supervisory hours data**
 - Hours spent by supervisors at each of the 12 Reserve Banks on work related to a specific bank or bank holding company
 - Excludes hours spent by supervisors not directly related to an individual bank
 - Excludes hours spent by Board of Governors, non-supervisory Federal Reserve staff, and officials
 - Used to construct aggregate hours spent on each institution in each quarter
 - Self-reported, with reporting conventions that can vary across districts and over time
- **Matters Requiring Attention and Matters Requiring Immediate Attention (MRAs and MRIAs)**
 - Number of MRAs and MRIAs given to individual banks and bank holding companies
 - Data covers 2008 to 2014
 - Date MRA/MRIA was issued and closed (if closed)
 - Text description of the issue raised in the action
- **Supervisory ratings**
 - Composite RFI or CAMELS rating assigned to bank holding company/bank
 - Date of issuance



Topics for the Day

Important Questions

- How to think about the goals of supervision? What is the objective function?
- What is the “output” of supervision? What do we measure?
- What can/should supervision contribute relative to regulation?
- Observational equivalence: well-functioning supervision may be hard to distinguish from lack of shocks
- Much of supervision is confidential and not publicly observed

