

2015 FIRMA National Risk Management Training Conference

Nashville, TN

REGULATOR PANEL

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Dept. of Supervision & Regulation:
Asset/Wealth Management &
Operational Risk



**FEDERAL
RESERVE
BANK
of ATLANTA**

DISCLAIMER

The views I express today are mine alone, and do not necessarily reflect those of the Federal Reserve Bank of Atlanta nor should they be construed as the official policy of the Federal Reserve System.

AGENDA

- 1. Federal Reserve AWM Supervisory Approach**
- 2. Supervisory Priorities**
- 3. Common Supervisory Issues**

SUPERVISORY APPROACH

Risk-focused process to determine if firms’:

- **“three lines of defense” adequately identify, quantify, measure & control risks,**
- **residual risks are within board-approved risk appetites / limits, and**
- **are operating within the bounds of sound fiduciary standards of conduct.**

FRB CONSOLIDATED SUPERVISION

Assessment of AWM business lines influenced by overarching FRB consolidated BHC and systemic risk supervisory expectations, including:

- **SR Letter 12-17: Consolidated Supervision Framework for Large Financial Institutions**
- **Enhanced Prudential (Risk Management) Standards: Final Rule Implementing DFA Sec. 165, 12 CFR 252**
- **SR Letter 01-5: Examination of Fiduciary Activities**
- **SR Letter 98-37: Uniform Interagency Trust Rating System**
- **SR Letter 96-10: Risk-Focused Fiduciary Examinations**

SUPERVISORY PRIORITIES

Impact to firms providing AWM services should not be underestimated, especially larger ones:

- **Reach-For-Yield**
- **Conflicts of Interest**
- **Vendor Risk Management**
- **Model Risk Management**

Behavior

New Guidance

REACH-FOR-YIELD

- 1. Significant \$ flows into less liquid (or illiquid) markets**
- 2. Concern over imprudent concentration of higher yielding (risk) strategies in client portfolios / funds**
- 3. Risk of client portfolios & funds, asset classes and investment strategies becoming vulnerable to market bubbles, dislocation and stress**
- 4. Exposure to allegations of banks not fulfilling their fiduciary and/or contractual responsibilities to investment clients**

REACH-FOR-YIELD

Risks

- 1. Problems in the valuation of illiquid assets**
- 2. Placement of client assets in unsuitable and/or excessive risk asset classes**
- 3. Client exposure to fund flow reversals prompted by short-term market distress due to escalating premiums on and demand for liquidity**

CONFLICTS OF INTEREST

- 1. Fiduciaries owe beneficiaries/clients their undivided loyalty, particularly as integrated AWM business models expose firms to a variety of COI situations**
- 2. Continuing challenge for firms is to document how COI are identified and managed amid myriad of state/federal laws/regulations & other restrictions**
- 3. In the current low rate environment, investor 'flight to safety' has highlighted cases whereby fiduciaries may be mismanaging COI**

CONFLICTS OF INTEREST

Areas of supervisory interest include:

- 1. Compensation and incentive payout programs**
- 2. Revenue sharing arrangements w/3rd party investment managers**
- 3. Use of 'soft dollars' under 28(e) exemption**
- 4. Fee disclosure to bank, brokerage and fiduciary clients**
- 5. SRO focus on conflicts of interest**

VENDOR RISK MANAGEMENT

SR Letter 13-19, “Guidance on Managing Outsourcing Risk”

Supervisory Emphasis

- **Types of risk exposure**
- **Board of directors and senior management responsibilities**
- **Service provider risk management programs**
- **Additional risk considerations**

VENDOR RISK MANAGEMENT

Elements of service provider risk management program:

- **Risk assessment**
- **Due diligence & selection of service providers**
- **Contract provisions & considerations**
- **Incentive compensation**
- **Oversight & monitoring**
- **BCP & contingency considerations**

VENDOR RISK MANAGEMENT

Risk of greater AWM exposure:

- **Inadequate due diligence performed to support prudent fiduciary discharge of selection, monitoring of service providers.**
- **Increasing use of outsourcing, sub-advisory & open architecture platforms to reduce costs while providing clients access to diverse asset classes.**
- **Vendor negligence in preserving sensitive fiduciary client data.**
- **Breach of fiduciary standard of conduct in failing to conduct due diligence beyond SR letter guidance.**

MODEL RISK MANAGEMENT

SR Letter 11-7, “Model Risk Management”

- **Provides comprehensive guidance to all banks/BHCs on effective model risk management**
- **Expands upon existing guidance by broadening scope beyond validation to include all aspects of MRM**
- **Requires development of sound MRM framework**
- **Acknowledges that the rigor, sophistication of framework is a function of model materiality & use**
- **Emphasizes strong MRM governance practices**

MODEL RISK MANAGEMENT

AWM considerations:

- **AWM models generally lower rated as to materiality and risk relative to CCAR, DFAST-related models**
- **Higher risk models converge around portfolio management (PM), quant index funds, and/or alpha generation components of FI/equity PM, followed by client asset allocation models**
- **How do firms identify, inventory, and rate AWM-related primary models?**
- **Are model assumptions effectively challenged by objective parties in re: assumptions, outputs versus objectives, and overall reliance?**

COMMON SUPERVISORY ISSUES

- **Risk Management & Corporate Governance**
- **Review of Fiduciary Accounts**
- **Internal Audit**

RISK MANAGEMENT & CORPORATE GOVERNANCE

- 1. ERM – LOB Risk Management: Ineffective LOB risk management function as LOB roles, responsibilities and capabilities for key risk management activities are not consistent with risk ownership.**
- 2. Fiduciary Strategy Oversight: Failure of the BOD to evaluate and monitor strategic initiative implementation and the impact it may have on fiduciary activities.**
- 3. Policies/procedures are subject to prolonged review cycles, particularly in consideration of changing business conditions and associated risks.**

REVIEW OF FIDUCIARY ACCOUNTS

- 4. Account Admin. Reviews: Ineffective controls/processes to ensure account administrative reviews, policies, and procedures are consistently & timely executed.**
- 5. Unique Assets: Failure to demonstrate that all discretionary account holdings, including unique assets, are appropriate, individually and collectively for fiduciary accounts.**
- 6. Account Reviews: Failure to confirm that valuations and inspections are completed in accordance with fiduciary policy.**

INTERNAL AUDIT

- 7. Weaknesses in the quality of internal audit supervision, staff expertise, and resources which are necessary to identify the risks inherent in fiduciary activities.**
- 8. GLBA/Regulation R: Failure to assess all exceptions/exemptions that apply & to consider the processes & controls used to demonstrate compliance.**



**APPENDIX 1:
ASSETS UNDER MANAGEMENT, REVENUE
STATISTICS**

AWM INDUSTRY: FRB ATLANTA PROFILE

2Q14 (\$B) (unless otherwise indicated)	#	CLIENT ASSETS	MANAGED	NON- MANAGED	CUSTODY & SAFEKEEPING
TRUST & FIDUCIARY					
SMBs	11	\$218.4	\$74.2	\$58.3	\$85.9
FBOs ¹	6	\$41.7	\$3.6	\$32.6	\$5.5
FDIC/OCC	28	\$45.9	\$25.6	\$8.5	\$3.6
NON-BANK					
RIAs ²	26	\$522.4	\$200	\$322	N/A
- SMB affiliates	7	\$34.2	\$19.7	\$14.5	N/A
	#	FIRM ASSETS	FIRM SEC'S INVENTORY	FIRM REVENUE	
B/Ds (YE13)	21	\$12.5	\$1.8	\$1.12	
- SMB affiliates	5	\$3.08	\$1.4	\$0.23	

^{1/} Derived from combination of FFIEC 002 (branches/agencies) & management-prepared reports (Edges), as of YE13/3Q13 (depending upon firm).

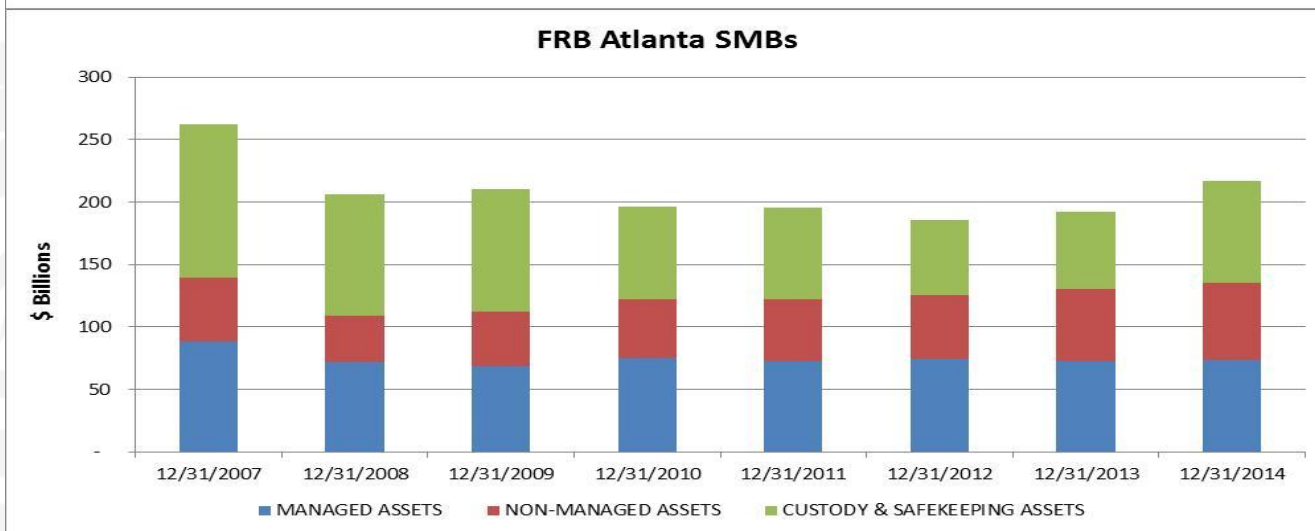
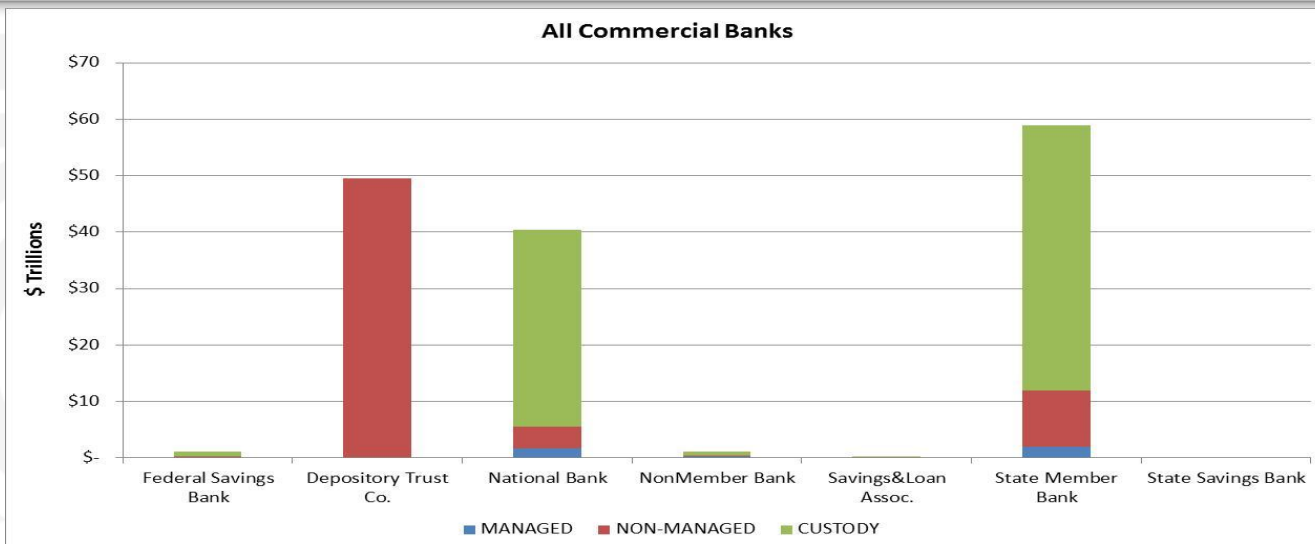
^{2/} Includes \$1.9B proprietary mutual fund family sub-advised by one NMB domiciled in the Sixth District.

AWM INDUSTRY: FRB ATLANTA (SMB) SELECTED TRUST & FIDUCIARY DATA

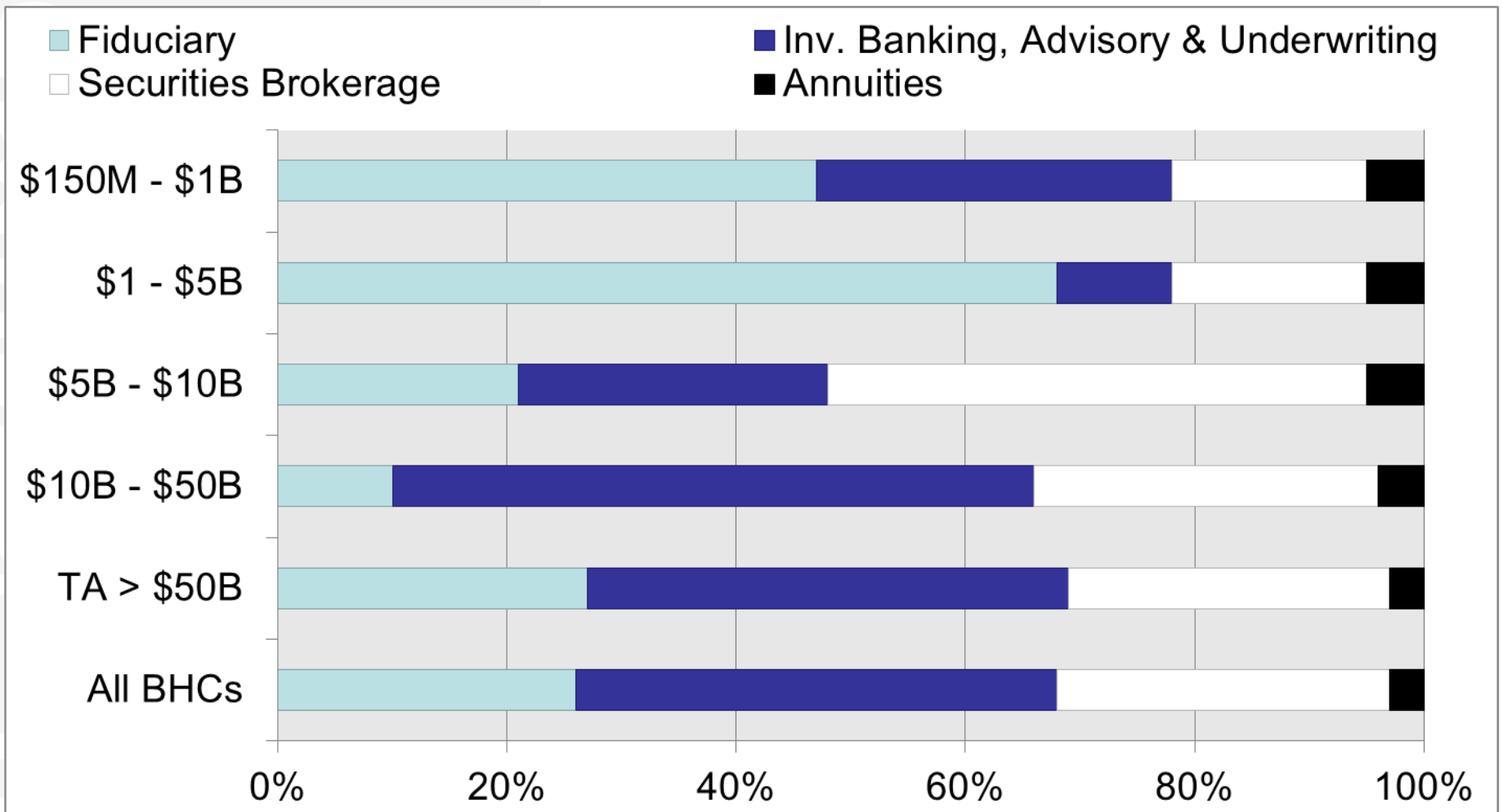
(\$B)	2Q14	2Q13	% Change
Fiduciary & Related Assets – Managed Accounts			
Personal Trust & Agency	\$30.92	\$29.65	4.3
EB-Defined Contribution	\$1.92	\$2.08	(7.5)
EB-Defined Benefit	\$3.07	\$2.86	7.2
Other EB & Retirement-Related	\$6.95	\$8.54	(18.5)
Corporate Trust & Agency	\$0.24	\$0.13	94
Inv. Management & Advisory Agency	\$19.81	\$18.07	9.6
Endowments & Foundations	\$9.52	\$9.18	3.7
Other Fiduciary	\$1.75	\$2.43	(27.8)
Total Managed Fiduciary Accounts	\$74.19	\$72.94	1.7
Total Trust Assets	\$218.4	\$189.71	15.2

Source: FFIEC 031/041 Schedule RC-T

AWM INDUSTRY: TRUST ASSETS UNDER MANAGEMENT, ADMIN. & CUSTODY (4Q14)



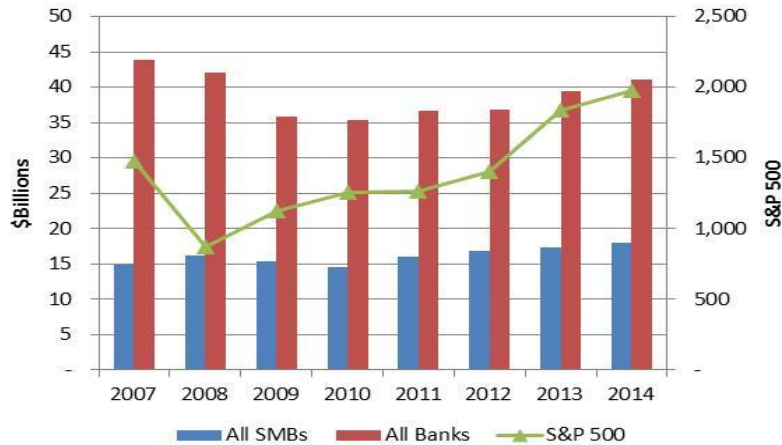
AWM INDUSTRY: AWM REVENUE MIX, BY BHC SIZE



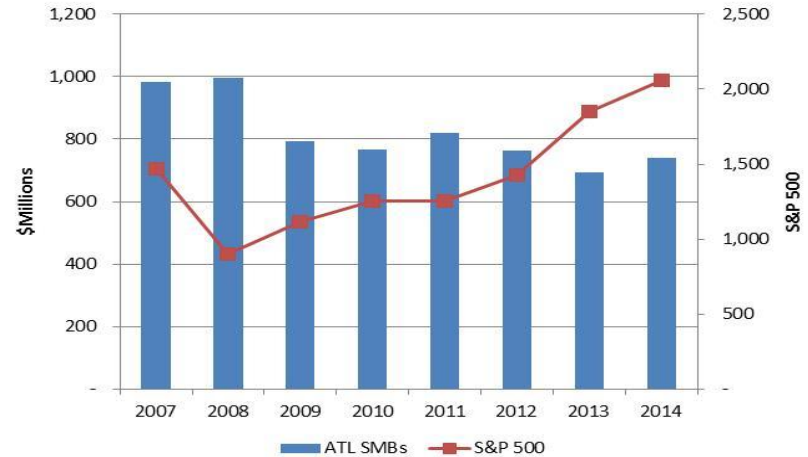
Source: FR Y9-C Report, as of 2Q14

AWM INDUSTRY: REVENUES & TRENDS

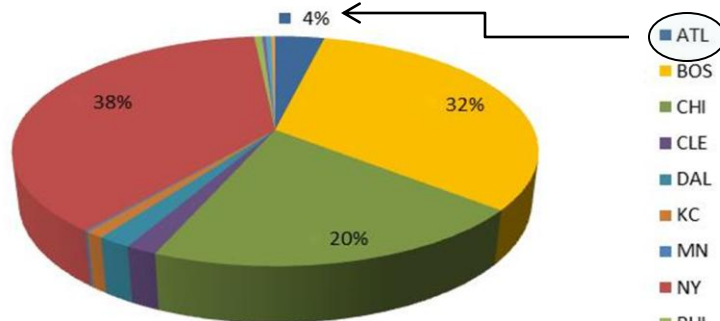
All SMBs vs. All Commercial Banks: Total AWM Revenue



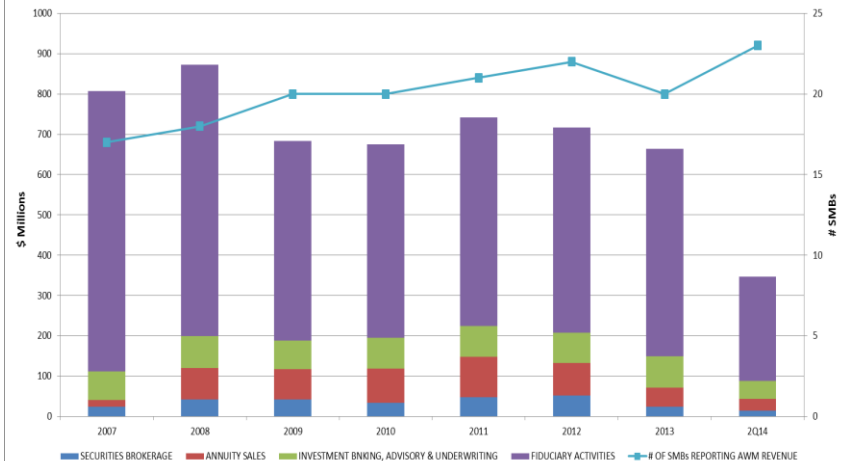
FRB Atlanta SMBs: Total AWM Revenue




ALL SMBs: Fiduciary Related Svcs Revenue 2014 Q4



FRB Atlanta: Profile of SMBs Reporting AWM Revenue





**APPENDIX 2:
AWM-RELATED SUPERVISORY GUIDANCE
REFERENCE**

SUPERVISORY GUIDANCE

SR 13-19: Vendor/Outsourcing Risk Management

SR 11-07: Model Risk Management

SR 12-17: Large Bank Consolidated Supervision Program

SR 14-01: Recovery & Resolution Plans, Living Wills

Enhanced Prudential (Risk Management) Standards: Final Rule Implementing DFA Sec. 165, 12 CFR 252

SUPERVISORY GUIDANCE

SR 08-8: Compliance Risk Management Programs & Oversight at Large Banks with Complex Compliance Profiles

SR 04-7: SEC Guidance on the Potential Liability of Financial Institutions for Securities Law Violations Arising from Deceptive Structured Finance Products and Transactions

SR 04-1: Interagency Policy on Banks/Thriffs Providing Financial Support to Funds Advised by the Banking Organization

SUPERVISORY GUIDANCE

SR 01-5: Examination of Fiduciary Activities

SR 99-7: Supervisory Guidance Regarding the Investment of Fiduciary Assets in Mutual Funds and Potential Conflicts of Interest

SR 98-37: Uniform Interagency Trust Rating System

SR 97-3: Conversion of Common Trust Funds to Mutual Funds

SUPERVISORY GUIDANCE

SR 96-10: Risk-Focused Fiduciary Examinations

SR 94-53: Investment Adviser Activities

SR 91-4: Guidelines for the Inspection of Investment Adviser Subsidiaries of Bank Holding Companies

SR 83-39: Trust Department Uses of Options and Futures Contracts

SUPERVISORY GUIDANCE

SR 81-697: Uniform Interagency Agreement for Reporting Violations of ERISA

SR 77-395: Exemptions from Prohibited Transactions Provision of ERISA

SR 72-180: Analysis of Trust Provisions of the Bank Holding Company Act

Federal Reserve Bank Holding Company / Commercial Bank Exam Manuals

QUESTIONS

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