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regs.comments@federalreserve.gov

March 15, 2018

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., N.W.
Washington, D.C. 20551

Re: Proposed Supervisory Guidance on Management of Business Lines and Independent Risk Management and Controls for Large Financial Institutions (FRB Docket No. OP-1594)

Dear Ms. Misback:

On behalf of Nationwide Mutual Insurance Company ("Nationwide Mutual") and its affiliated companies, we appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System ("FRB") on its proposal addressing supervisory expectations for effective senior management, the management of business lines, and independent risk management ("IRM") and controls for large financial institutions (the "Proposal").[1]

Nationwide Mutual is a mutual insurance company organized in 1925 under the laws of the State of Ohio. Nationwide Mutual is the lead entity and ultimate controlling parent of all entities in the Nationwide group of companies (collectively, "Nationwide"). Nationwide is a diversified financial services organization offering a wide range of insurance, annuity, investment and banking products and services.

Nationwide Mutual and its property and casualty insurance subsidiaries primarily underwrite personal automobile, homeowners and commercial insurance products. Nationwide Financial Services, Inc. ("Nationwide Financial"), an indirect subsidiary of Nationwide Mutual, develops and sells a diverse range of products, including individual annuities, private and public sector retirement plans and other investment products sold to institutions, life insurance and advisory services. In addition, Nationwide Financial provides mutual funds through Nationwide Funds Group and banking products and services through Nationwide Bank.

By virtue of their ownership of Nationwide Bank, a federal savings bank and member FDIC, Nationwide Mutual and Nationwide Financial are both registered as savings and loan holding companies ("SLHCs") pursuant to Section 10 of the Home Owners' Loan Act of 1933 ("HOLA"), subjecting Nationwide to this Proposal.

[1] Proposed Supervisory Guidance, 83 Fed. Reg. 1351 (Jan. 11, 2018).

<u>Nationwide Support for a Principles-Based Approach to Evaluating Senior Management, Business Line Management and IRM</u>

Nationwide supports the FRB's efforts to consolidate and clarify existing supervisory expectations regarding senior management, business line management, IRM and internal controls, and to distinguish these expectations from those placed on boards of directors. We further support the FRB's decision to utilize a principles-based approach in developing this Proposal, recognizing that there are multiple structures and methods for firms to demonstrate effective management.

Broadly, we agree with the proposed core principles and consider them to be sound operating practices. To the extent these principles "enable the Federal Reserve to provide firms with more specific and consistent supervisory feedback,"[2] we welcome the updated approach.

While we support the direction of this Proposal, we have concerns that the detailed descriptions following the principles could be misconstrued by examiners as prescriptive requirements that must be satisfied in order to conclude that the principle has been met. Therefore, we urge the FRB to clarify that such language should be viewed as illustrative in nature rather than expectations that demand strict adherence.

In addition, as indicated in our prior comments on the FRB's Board Effectiveness Proposal, we have concerns with the creation in this Proposal of a one-size-fits all approach to effective risk management by prescribing reporting lines for the Chief Risk Officer ("CRO") and Chief Compliance Officer ("CCO"); prescribing the creation of a risk committee of the board of directors; and including reference to regulations that, by statute, apply only to bank holding companies with over $50 billion in assets and nonbank financial companies supervised by the Board under Title I of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (the "Dodd-Frank Act"). To this end, we believe the FRB should establish the principle that supervised firms must be able to demonstrate adherence to sound risk management principles and practices and demonstrate that their selected approach results in effective board and management oversight of risk.

Nationwide's more detailed comments are provided below:

1. The FRB should clarify and reinforce the principles-based nature of this Proposal

Although the Proposal articulates a principles-based approach to evaluating senior management, business line management, IRM and internal controls, we are concerned that, in practice, FRB examiners will apply this guidance in a "check-the-box" manner. In our view, the examples offered to provide specificity in support of the core principles—and in some cases the principles themselves[3]—are overly prescriptive. This threatens to create a one-size-fits-all approach to assessing management effectiveness that fails to allow for alternative approaches that may be just as effective.

[2] Id. at 1353.
[3] Id. at 1358 (e.g., under "B. Risk Identification and Risk Management," a principle worded such that business line management should *ensure* risks are identified, measured, and managed over a broad range of conditions would capture the same intention while providing greater freedom of methodology).

Rather than specifying a singular approach to management effectiveness, there should be flexibility for firms to develop appropriate models, methods and processes that can demonstrate achievement of these principles. To be consistent with the FRB's principles-based approach, we recommend that the FRB clarify that the "should statements" that follow each principle are illustrative in nature rather than expectations that demand strict adherence; that meeting the principles, themselves, should be the focus for firms which can be demonstrated without providing a "checklist" of expectations for examiners to follow.

2. The FRB should avoid prescribing governance structures and reporting relationships for the CRO, CCO and the IRM function

We urge the FRB to resist mandating a singular approach to effective governance and risk management. In a number of instances, the Proposal appears to prescribe required elements of an effective risk management program, including committee structure and reporting relationships. We believe the FRB should focus on the outcomes of effective risk management and recognize that there are multiple viable structures for achieving effective risk oversight.

Risk Committee of the Board

The Proposal indicates that "[t]o promote the stature and independence of IRM, the [CRO] must report directly to the board's risk committee as well as to the CEO."[4] We agree that, in order to be effective, IRM must have sufficient stature and independence within a firm. However, stature and independence does not necessitate a single risk committee oversight structure; nor does it require direct reporting to the CEO. While a single risk committee of the board and direct reporting to the CEO may be an effective risk governance approach for certain firms, experience has shown that effective board oversight of risk can be accomplished in ways other than through a separate risk committee with prescribed CRO reporting lines. For example, Nationwide successfully utilizes a distributed risk governance model, where multiple committees (e.g., Audit, Finance, Governance) are assigned clearly delineated, but complementary, risk oversight responsibilities that are designed to work in concert.

We believe that the FRB's goal of effective risk management is laudable, but we urge the FRB to not create a one-size-fits-all approach to effective risk oversight by requiring SLHCs to have a risk committee of the board under its general safety and soundness authority. We note that Congress in Section 165 of the Dodd-Frank Act and the FRB's Regulation YY did not extend the risk committee requirements to SLHCs. Thus, we have concerns with any attempt at bypassing the will of Congress and relying on the FRB's general safety and soundness authority to impose a risk committee requirement.

Instead of prescribing a narrow approach to effective board-level risk oversight, we believe the FRB should establish the principle that supervised firms must be able to demonstrate adherence to sound risk management principles and practices and demonstrate that their selected approach results in effective board and management oversight of risk.

[4] Id. at 1360.

Reporting Structure of the CRO and IRM

While we agree that the CRO should have appropriate stature and independence from the business lines and an open and transparent relationship with the board of directors and its committees, we urge the FRB to avoid creating any expectation that the CRO have a direct reporting relationship to the board or any specific committee of the board.

Nationwide, like many other firms, follows a three lines of defense approach to risk governance (i.e., first-line business units, second-line objective risk functions (which includes IRM and compliance), and third-line independent internal audit function). Under this approach, only the third line of defense (i.e., the Chief Audit Executive as head of the internal audit function) has a direct reporting relationship to the Audit Committee of the Board. The second line of defense programs (i.e., the CRO and CCO as the respective heads of IRM and Compliance) maintain open and transparent dialogue with the board and its committees, but do not have a direct reporting relationship to the board. We believe this approach achieves objectivity and independence, while allowing the risk management and compliance functions to be viewed as strategic risk partners to the first-line business units.

Relationship between IRM and Compliance

Similar to our comments above, we urge the FRB to resist creating an expectation that a firm's compliance function report up through the CRO and ultimately to a single risk committee. The Proposal appears to imply that a firm's compliance function, which would necessarily include its CCO, is to have a reporting line to the CRO.[5] While we agree that the compliance function needs to be objective and have appropriate stature and independence from the first-line business units, multiple approaches exist to achieve these goals. We believe this can be achieved by alternative reporting relationships for the CCO and the compliance function (e.g., reporting to the Chief Legal Officer). In other words, the CRO can be accountable and empowered to ensure the firm has established and maintains effective risk management without having to "own" all associated resources.

As a result, we support the principle that the compliance function should be closely connected with the IRM function to ensure that compliance risk is identified, measured, monitored, and reported in a comprehensive manner, consistent with the firm's IRM framework. However, we urge the FRB to avoid prescribing a one-size-fits-all expectation that the compliance function report up through the CRO and ultimately to a single risk committee of the board. The FRB should establish the principle that firms must have clear and effective oversight over risk, including compliance risk, without prescribing which committee of the board has the responsibility to oversee that risk or specific reporting lines for functions within IRM and compliance.

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[5] Id. at 1360 (In footnote 49, the Proposal indicates IRM is to be comprised of multiple risk management functions, including compliance. Then, under the principle that "IRM should establish enterprise-wide risk limits consistent with the firm's risk tolerance and monitor adherence to such limits," the proposal states that IRM is "[u]nder the direction of the CRO.")

Relationship between IRM and Business Line Management

We are concerned that the traditional—and we believe appropriate—expectation of IRM's role as managing risk (including independence in assessing and escalating material risks or control deficiencies) is shifting into IRM being the functional control over these potential risk-creating activities, which is more suitably the responsibility of business line management. We are concerned this Proposal could unintentionally work against the intent of FRB guidance and sound business practices. In our experience, sound business practices call for the lines of authority within the business to be the primary method of control, with IRM and compliance both supporting sound operation while ensuring an appropriate independent check and mechanism for escalation of concerns. We believe that business lines should have control cascaded from business management and senior management and that normal operating controls, including adherence to operating standards and limits, is first and best controlled within business functions and lines.

When utilized, illustrative examples should be chosen to ensure primary risk takers (e.g., business line management) can serve as the first line of defense in support of risk management, such as through the appropriate cascading of thresholds and policies. This will, in our opinion, provide greater clarity around lines of normal operating control, including escalation within the business and senior management, from those of IRM and avoid situations in which business lines and leadership are structurally placed in an antagonistic relationship with risk management or compliance functions.

Conclusion

As stated above, Nationwide supports the FRB's efforts to consolidate and clarify its existing supervisory expectations regarding senior management, business line management, IRM and internal controls, and to distinguish these expectations from those placed on boards of directors. We believe that evaluating a firm's management effectiveness is best achieved through a principles-based, as opposed to a prescriptive, "one-size-fits-all" approach. In finalizing this Proposal, we urge the FRB to clarify that any descriptive language outside of the principles should be viewed as illustrative in nature rather than expectations that demand strict adherence. In addition, when articulating expectations of effective risk management, we urge the FRB to avoid prescribing reporting structures for the CRO, CCO and governance structures for IRM and, instead, focus on establishing principles and outcomes of effectiveness.

As always, we appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,

NATIONWIDE MUTUAL

Mark R. Thresher
Executive Vice President and Chief Financial Officer