

Navigating regulatory risk
The role of the regulatory
liaison office



Executive summary

Over the last five years, as new laws, regulations, and other guidance were introduced, banking and securities firms recognized the need for more visible and strategic management of their complex regulatory relationships. As more and more questions continued to flow from regulatory agencies, it became clear that the current methods of regulatory response may not have been as efficient and proactive as possible.

In response, some firms created a Regulatory Liaison (RL) position (sometimes referred to as Regulatory Affairs Officer, Head of Regulatory Relations, etc.), which combined a sound understanding of the organization's business with an appreciation for the regulatory agencies' supervisory processes. Executives often came to these roles as experienced regulators, or risk and control managers. Other firms took a different route, making the liaison role a responsibility of the Chief Operating Officer (COO) or Chief Administrative Officer (CAO), reporting into the Chief Executive Officer (CEO). Still others took a step further and created a Regulatory Liaison Office (RLO) outfitted with staff.

Today, the regulatory environment that spawned many liaison initiatives is even more complex, with stronger engagement from banking and securities regulators. Continuing shifts in the regulatory landscape, such as Basel II & III, the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the creation of the Consumer Financial Protection Bureau, affect virtually every financial institution in some way. This has led to an emerging recognition among firms that regulatory risk is a relevant part of the organization's risk framework.



What is the role of a RLO and its leadership?

Some forward thinking firms consider the RL role to be integral to the executive management team. Indeed, RL itself is undergoing a transformation as major financial corporations look to enhance their communications with regulators, and effectively represent their franchise and quality control processes, and serve as a conduit for identifying, escalating, and mitigating areas of regulatory risk.

As a result, many of the executives in charge of RLOs have been raised significantly in stature in their respective organization — along with the standards for who fills these roles. Leaders with broad knowledge of the organization's operations — and who understand regulatory points of interest — have become the top contenders to lead these efforts.

In practical terms, the organization's RL should act on behalf of executive management and the board of directors as a central point of contact with regulators. As such, he or she should consider serving as an effective and trusted liaison for regulatory risk management matters. Policies should clearly articulate the RLO's process for engaging with the organization's regulators, so that there is coordination with other executive leaders as situations warrant.

It is important to note that the establishment of an RLO does not preclude other members of executive management and selected lines of business from communicating with the organization's regulators. In fact, the executive management team should develop their own relationships with regulators and work under common protocol and standards. That said, the RLO can coordinate and enhance those communications to reduce the possibility of regulatory misunderstanding or inconsistent messaging, without controlling communication only through the RLO. Having this RLO will help to ensure that the organization speaks with one voice to its regulators — a voice that is consistent and transparent. In turn, the RLO should understand the implications of regulatory messages and help to interpret them back to the business.

RLO structure and leader requirements

Typically, the function of a RLO usually reports to either the Chief Risk Officer (CRO) or to the Chief Compliance Officer (CCO). In some cases, however, it reports to another comparable function within the C-suite, such as the COO or CAO, or a regional management office in the case of foreign banks. Like any other risk control organization, the RLO is a department comprised of staff to execute both its tactical and strategic responsibilities. The RLO leader should be a senior executive with the organizational reporting stature and who has experience to be credible and effective in dealing with executive management and the board, as well as with regulators.

The objective of the RLO is to achieve a more informed, efficient, and effective examination process across the organization, and to help maintain a relationship of trust and transparency with the organization's prudential regulators. This can foster a benefit-of-the-doubt scenario for the organization. The RLO typically guides an organization's regulators to the applicable sources of experience within the institution, helping to avoid contradictory or uninformed responses from management.

Organizations that are considering the creation of an RLO should take the time to get input from internal stakeholders to achieve management buy-in and ensure that expectations are clearly set and understood. Most importantly, the executive chosen to lead the RLO should be able to influence management and the board — and be a change agent for the organization. This requires the ability to help correct a course of action (or inaction) that may be detrimental to the organization's future regulatory relationships and broad regulatory risk issues. Attention to detail is essential, along with the flexibility to change priorities as new situations present themselves. Excellent verbal and writing skills are equally as critical to this role.

In addition to being a good communicator, a potential candidate to lead the RLO should have a diverse background, with practical risk and control experience, and expertise in one or more of the risk disciplines (such as credit, market, and/or operational risk). Relevant regulatory experience is almost mandatory for the organization to benefit from an understanding of how regulators think and respond to different matters of interest.

Finally, the role of the RL and RLO has both strategic and tactical dimensions. An effective leader should possess a strategic vision, while maintaining a strong tactical foundation to address issues as they arise.

Strategic approach

Central to the RL and their RLO's strategic approach is their ability to advise the organization on how current and proposed business activities will be affected by shifts in the regulatory landscape. In addition to understanding the impact of the business' strategy on the inherent regulatory risk of the organization, the RLO needs to understand the expectations from their regulators as to how the organization can mitigate that inherent risk. The RLO should be able to anticipate regulatory challenges based on the organization's strategy and risk appetite. In some instances, input from the RLO may help craft, change, or redirect the organization's approach.

To facilitate this forward-looking approach, the RLO should have the capacity to monitor and analyze regulatory developments and help determine what parts of the organization may be affected by new regulatory initiatives. To help perform this, the RLO should develop a strong network of internal and external contacts to gather intelligence regarding developing areas of interest on the U.S. and international regulatory agendas. Active networking with peers at other financial institutions and memberships in industry organizations are also effective ways to remain informed. This kind of active marketplace involvement will help identify emerging issues and determine the regulatory impact to the organization.

This proactive posture will allow time for targeted internal assessments of risk areas and the implementation of required changes before full-blown regulatory issues develop or regulatory changes occur. Depending upon the size of the institution, these efforts may need to be supported by both regional and country teams. Country teams will understand local regulations, allowing the RLO to achieve an aggregated view of regulatory change across markets, and what it means globally for an institution. This is essential for achieving a common approach to regulatory relationships and issues across the organization.

Understanding strategy in the context of Memorandums of Understanding

Contributing to the strategy of the RLO, a focus on home prudential regulators is important, but the RLO cannot lose sight of its host regulators' requirements in other countries where the organization does significant business. Information sharing agreements, known as Memorandums of Understanding (MOUs), between and among home and host regulators, is commonplace today. MOUs give regulators insight into both foreign and domestic activities. Governments and regulators have conducted "Colleges," which are meetings held on a quarterly or semi-annual basis among the primary country regulators supervising the organization. For example, during the financial crisis, countries like the United Kingdom requested that the home and primary host regulators of institutions meet to share information about the institutions they supervise in order to avert future systemic risk issues.

Intermittent conversations among an organization's regulators are common, which increases the importance of communication between the organization and its own prudential regulators on a consistent and timely basis. Regulators want to know what is happening in other parts of the organization, regardless of location, with full visibility to the potential effects on the organization. Of particular interest is the impact that foreign oversight may have on the legal entity which they regulate. The RLO should be able to speak on an intelligent and informed basis to regulators regardless of home or host location. In addition, the RLO should have a good rapport with all of the institution's regulators in order to stay informed about intra-agency meetings, issues, and concerns.

An effective RLO will promptly add value by improving the communication and coordination of regulatory risk activities across national and multinational firms, including within individual business units and regions. In addition, the RLO should build transparent and detailed approaches to identifying, monitoring, and reporting on matters of regulatory risk. Having personnel from the RLO in all regions, coordinated through global reporting lines, will help facilitate the acceleration of delivery of critical regulatory information to the home office. This centralized information flow can be invaluable to senior management as an early warning indicator for emerging issues.

Regulatory relationships — development, communication, and management

An RLO should develop a formal communications plan — extending to all regulatory agencies — to facilitate scheduling of important meetings and promoting information-sharing at all levels of the organization (see Figure 1). The plan should address requirements for the board of directors, executive management, and senior risk management at the corporate level. This includes taking the view that your approach to your regulator is just like that of your top client — with targeted points of contact, a communications plan, and an integrated approach to delivering your institution’s messaging.

Figure 1. Regulatory Liaison Plans map board, senior management, and other regulatory liaison roles to key regulatory contacts and provide protocols for frequency and type of communication.

	Key contacts	Key regulatory contacts	Representative communications
Board	<ul style="list-style-type: none"> • Chair, Audit Committee • Chairman and CEO 	<p>Board of Governors</p> <ul style="list-style-type: none"> • Lead Federal Reserve Governor <p>Federal Reserve Bank</p> <ul style="list-style-type: none"> • Central point of contact team lead 	<ul style="list-style-type: none"> • Strategic plan and results against plans • Significant and material governance, risk, and control concerns in US/non-US businesses
Senior manager	<ul style="list-style-type: none"> • Chairman and CEO • COO • General Counsel • CRO • CCO • CFO • Heads of key businesses 	<p>Board of Governors</p> <ul style="list-style-type: none"> • Director, Division of Banking Supervision and Regulation • Deputy Director, Division of Banking Supervision and Regulation • Associate Director, Large Institutions Group • Legal <p>Federal Reserve Bank</p> <ul style="list-style-type: none"> • President • Bank supervision • General Counsel • Relationship manager, team leader • Central point of contact 	<ul style="list-style-type: none"> • Headline issues/provide escalation regarding significant and material news to key regulatory contacts • Strategy of supervision/evolving holding company strategy • Operating model of bank/key functions • Ongoing financial/operating results • Significant governance, risk, and control concerns in US/non-US businesses • Escalation of items in outstanding applications or approvals • Responding to material examination issues during the examination processes • Business leaders/functional/support group leaders in overviews and governance, control discussions
Regulatory relations – liaisons	<ul style="list-style-type: none"> • CCO • CRO • Regulatory relations • CFO • Heads of key businesses 	<p>Board of Governors</p> <ul style="list-style-type: none"> • Bank supervision, board analyst <p>Federal Reserve Bank</p> <ul style="list-style-type: none"> • Bank supervision relationship teams • Bank supervision (central point of contact) • Central point of contact team lead 	<ul style="list-style-type: none"> • Organizing information exchange protocols (e.g., electronic or hardcopy transfers) • Responding to logistical requests • Coordinating ongoing risk and financial reporting with on-site teams • Responding to informal (ad hoc) and formal (information request letters) and first-day letters for targeted examinations • Seeking clarification of requests • Ongoing weekly or bi-weekly status meetings as protocols are built

In creating the plan, the RLO will map organization contacts from across the institution and C-suite to their regulatory counterparts, and provide protocols for the frequency and type of communication required. This will involve establishing a schedule of recurring meetings between the organization and its regulators. These regularly scheduled meetings send a strong signal to regulators that the organization takes its regulatory obligations seriously.

Tactical foundation for executing the strategy

The RLO is also responsible for day-to-day management of relationships with regulators, including examination coordination. Specifically, a primary point of contact within the RLO should be available for a regulator during an examination. This contact is responsible for coordination and oversight of various aspects of the examination, with some delegation as appropriate, depending upon the size of the review.

In support of its examination oversight responsibility, the RLO should establish a formal examination management program, which may be centralized or decentralized depending upon the size of the organization. Regardless of the chosen approach, the following items should be considered in order to promote a smooth examination process:

- Process for responding to regulator requests
- Meeting scheduling and participation
- Logistics preparation and coordination (e.g., provision of space, location, equipment, and technology connections)
- Control of management information submissions
- Assessment of lines of business preparedness for the examination process
- Coaching of lines of business on examination protocol
- Examination response quality control
- Process for issues escalation
- Process for monitoring the full lifecycle of a regulatory issue that is identified (with the same discipline and rigor of an operational risk or internal audit issue – from identification to closure to validation)

Information management

The RLO should establish and maintain policies surrounding regulatory interaction and exam management. These policies will help standardize interaction with the regulators across different lines of business and regions within the organization.

The RLO should determine what tools are required to execute its responsibilities. For instance, tracking meetings and information deliverables is critical. It's not unusual to have in-house systems in place or systems that combine both automated and manual applications. Establishment of regulatory portals that house meeting and issue trackers, respectively, are common.

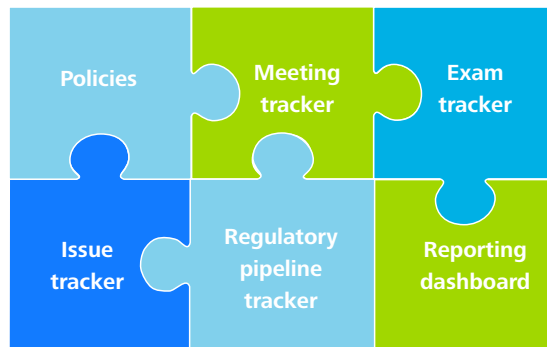
During current examinations, the RLO should use an exam tracker to monitor regulatory requests. This tool will assign ownership and track progress for each request. The exam tracker will also keep a record of requests for meetings and interviews which the regulators may want to hold during the examination.

The RLO may also manage the issue tracker, which captures issues from many different sources of information, including regulators (e.g., Matters Requiring Immediate Attention (MRIA) and Matters Requiring Attention (MRA)), legal, compliance, audit, individual business lines, or the RLO itself. The issue tracker can be used to identify systemic problems and underlying causes. In addition, it can help drive single solutions for commonly experienced issues across various lines of business. This topical overview helps the organization understand the impact of risk and any breakdown in compliance and control systems. The issue tracker should assign an issue owner and track remediation responses, remediation progress/milestones, and, if applicable, results from testing and monitoring of controls in place to remediate.

The RLO may also benefit from a regulatory pipeline tracker to follow pending and proposed legislation that may likely affect the organization in the future. Forecasting and staying ahead of these new rules will give the organization additional time to implement required compliance processes and controls. In some instances, the RLO may be able to influence regulatory guidance in the comment stage by having a member seat at the table, who responds on behalf of the organization. Being able to envision the big picture of regulatory change will help the RLO when making strategic decisions about future events. Working closely with the organization's legal and lobbying departments is beneficial in this regard.

The RLO should consider establishing organization-wide oversight of regulatory relations to ensure effective monitoring of examination activities, and to identify and to escalate issues to senior management in real-time. This will also enable the RLO to report to management and to the board in a timely and effective manner. The RLO should develop a proactive approach to regulatory interactions, ensuring full visibility into what is happening in the business units, and allowing for a "no surprise" environment.

The RLO may also develop dashboards for reporting to management and the board, highlighting specific regulatory interactions with examiners, key regulatory findings, and other notable changes in the regulatory environment.



Getting to the next level

A well-staffed, focused, and highly regarded RLO with the proper executive leadership can be an effective way for an organization to manage regulatory concerns and speak with a single voice to the regulators, who oversee an organization's operations. Regulatory management is critical in today's fluid and demanding regulatory environment and is no different than any other risk discipline that requires an investment. Investment in a RLO with the proper organization-wide stature, gravitas, and reporting line can increase an organization's credibility with their regulators and may reduce misunderstandings related to issue remediation. Quantifying value in terms of absolute dollars may be difficult, but improved regulatory relations should evidence itself promptly and be the best tell-tale sign of value. In today's climate of fast-paced change and increased scrutiny, it may very well be a necessity.



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Beth Leesemann, marketing manager, Deloitte Services LP

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