Rethinking the supervisory approach

2023

Front-office supervision is a complicated undertaking due to a constantly evolving regulatory framework, rapid pace of change in the business, and ongoing evolution of both management and regulatory expectations. Over time, monitoring tools, notification alerts, and other controls meant to ensure supervisors execute against their mandate have, in some ways, contributed to the complexity and challenge associated with the role. Organizations today are working to reduce this burden on supervisors, allowing them to fulfill their obligations while focusing on the market and driving business for the organization.

Addressing these challenges can reduce the cost to support the supervisory function and create supervisor bandwidth, so these critical resources can adapt to other changes and demands in the current environment. Firms should reevaluate their supervision strategy for ways to optimize the framework while balancing cost, efficiency, and supervisory effectiveness[1].

Challenges of effective supervision	Levers to address
Heightened regulatory focus[2] Frequent "failure to supervise" fines; new regulatory focus areas	• Refresh tools to enable adherence to expanding supervisor regulatory obligations and scope (e.g., mobile device software) • Introduce dynamic mapping of regulatory expectations and obligations to risk assessments and supervisory controls
Increased focus on proactive identification of ethics and conduct risks "Should have known" standard; emerging risk awareness	• Enable targeted supervisory oversight with behavioral trend-spotting tools and reporting • Embed risk management accountability and awareness via transformative training • Demonstrate enhancements to ethics, compliance, and culture/conduct incentives
Stale supervisory and surveillance tools and technology Aged alerting tools and logic; lagging surveillance innovation	• Optimize supervisory controls to ensure appropriate calibrations and breach thresholds • Reevaluate alerting methodology to improve the quality and reduce the volume requiring resolution • Retune and recalibrate preventative and detective controls to limit "noise" in the system
Burdensome and distracting administrative requirements Overlapping responsibilities across three lines of defense; lack of transparency into requirement origin	• Modernize or develop a centralized hub/dashboard of supervisors' controls, tasks, and reports • Simplify and/or eliminate redundant, expired, or ineffective tasks and controls • Rationalize first versus second line activity and responsibility

[1] KPMG | Balance cost, efficiency, and effectiveness (January 2023)

[2] KPMG.com | "Top 10 Regulatory Challenges of 2023" (January 2023)

With the return to a new new normal, a right-sizing of responsibility is paramount to optimize accountability with respect to supervisory frameworks, including the operational risks and supervisory controls they manage.

KPMG LLP is supporting our clients' reevaluation of the supervisory operating model to empower first line of defense supervisors to effectively manage risk, execute controls, and identify red-flag trends in conduct and behavior of their team(s). By clarifying responsibilities and improving tooling and technology, we promote a simplification and streamlining of activities, saving time (and therefore cost) while preserving the essential accountabilities of all parties involved.

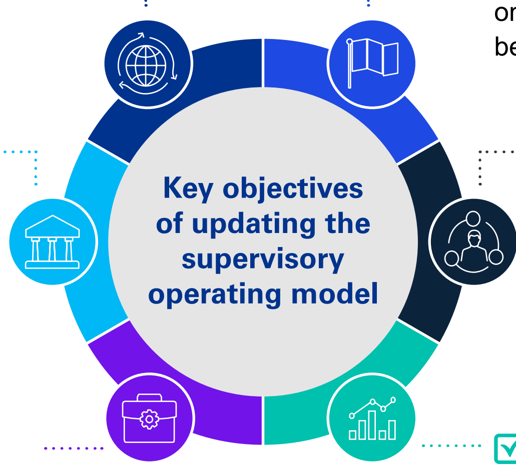
> **Now is the time to revisit the supervisory operating model to gain efficiencies through optimization, without sacrificing capabilities.**

Example: Failure to supervise

In December 2021, the SEC fined a major U.S. financial institution $125 million for poor recordkeeping practices[3]. On the heels of this fine, 16 financial institutions were **fined an additional $1.1 billion** in 2022[4] for recordkeeping and supervision failures related to the use of unapproved and off-channel communication methods.

Each institution faced recordkeeping violations in addition to "failing reasonably to supervise with a view to preventing and detecting those violations." The CFTC also announced settlements for related conduct. Most recently, a top tier U.S. financial institution has reportedly imposed penalties on its individual employees of up to $1 million for infractions.

Key objectives of updating the supervisory operating model:



Simplified environment

Clarify and coordinate activities owned by first versus second line to reduce redundancies and eliminate overlaps in responsibilities.

Improved focus on "red flags"

Reduce distracting administrative tasks to improve supervisors' focus on true misconduct concerns and behavioral trends.

Revisited requirements

Ensure supervisory controls reflect current requirements and stale controls are retired or converged.

Transparent control "center"

Improve supervisory oversight via central risk and control tooling/ dashboarding for real-time reporting and single-view risk.

Reduced "noise"

Leverage cloud-based capabilities and tools to automate and/or recalibrate manual controls to reduce false positives.

Recalibrated alert backlogs

Address alerting backlog data using NLP/AI/offshore review to reduce costly manual reviews.

[3] SEC.gov | JPMorgan Admits to Widespread Recordkeeping Failures and Agrees to Pay $125 Million Penalty to Resolve SEC Charges (December 17, 2021)

[4] SEC.gov | SEC Charges 16 Wall Street Firms with Widespread Recordkeeping Failures (September 27, 2022)

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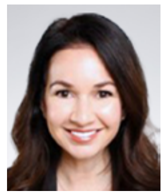

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