Building Upon a Solid Foundation

ACHIEVING BEST IN CLASS REGULATORY RELATIONSHIP MANAGEMENT

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PNC BANK | ABA STONIER GRADUATE SCHOOL OF BANKING CLASS OF 2017 CAPSTONE PROJECT

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Executive Summary

"Banking has long been about relationships, but it's not only relationships with customers that are vital to a bank's long-term success. After all, customers will come and go, but regulatory relationships are forever…"[1]

The post-Great Recession regulatory environment triggered heightened examination scrutiny and expectations of financial institutions. Given today's regulatory landscape and PNC's size, it is imperative that PNC meets its responsibilities with its regulatory agencies by engaging and responding in a timely, reliable, coordinated, and transparent way. This capstone project focused on PNC's internal structure and processes that support its existing regulatory relationships including evaluating current examination fieldwork support, benchmarking with other financial institutions, and identifying potential internal organizational restructuring opportunities.

Project Goal Statement

Based on well-researched and analyzed information, recommend structural and procedural changes to ensure PNC is best positioned to interact professionally with the regulatory agencies by delivering accurate and timely information with appropriate oversight and controls to enhance PNC's reputation and achieve its strategic goals.

[1] Dawnella Johnson and Paul Osborne, "5 Building Blocks for a Healthy Relationship with Regulators", *ABA Bank Compliance* (January – February 2017), 13.

The regulatory liaison function encompasses, but is not limited to, coordination of regulatory examination support, identification of regulatory issues, monitoring management's remediation activities, and internal reporting of the supervisory process and outcomes. As such, the Mission Statement could be stated as follows:

To plan, coordinate, and implement strategies to build understanding, credibility, trust, and mutually beneficial relationships with the regulatory agencies which exam PNC's businesses and corporate functions.

In support of the Mission Statement, the Regulatory Affairs Vision Statement could read as follows:

Ensure PNC is positioned to deliver accurate information in a timely manner with appropriate controls to both internal audiences and the regulatory agencies.

PNC stands to benefit from a more disciplined approach to regulatory engagement with defined roles, enhanced policy and procedural guidance, and consistent application of best practices in the areas of examination and issue management. The key recommendations are as follows:

Future Opportunities

- Reorganization – *Creation of a centralized **Regulatory Relations** organization that uses existing resources in a more efficient, coordinated structure with Mission and Vision statements, and an appropriate level of resources.*

Today, regulatory engagement follows a decentralized approach to examination support and regulatory issue management. However, the support among the various internal groups is often uneven and lacks a common framework and oversight.

- Training Program – *Creation of a training program to educate all employees involved with the regulatory agencies*.

Similar to annual ethics training, a standardized training course for all those directly and indirectly involved in the supervisory process could outline the roles and responsibilities of various process participants as well as review current PNC regulatory-related policies and procedures.

Process Changes & Improvements

- Coordination with Peer Banks and Industry Consultants – *Participate in an established Regulatory Relations Roundtable or approach an existing organization to sponsor such professional interaction.*

Research associated with this project revealed the existence of established regulatory relations forums with a focus on the following topics:

- Importance of regulatory relations with the consideration of increased pressure from supervisory bodies
- Increased focus on engagement with variety of internal and external stakeholders
- Depth and breadth of regulatory relations in addressing key challenges

- Regulatory Orientation Session – *Annual orientation program designed to educate new regulators on PNC as well as build relationships with the leadership of all three lines of defense.*
- Website – *Creation of a Regulatory Relations intranet site*

The recommendation to move existing regulatory examination and issue support resources under an expanded and renamed centralized function, ***Regulatory Relations***, builds upon a healthy foundation in place today with the regulators. The regulatory agencies can have a tremendous impact on a financial institution's activities and strategic goals. That said, a centralized function and structure can seize the opportunity to not only exert leadership across the enterprise but also build trust and creditability with the regulatory agencies. Equally important, the centralized function allows the Lines of Business (LOB) and Shared Services management to focus on their respective primary responsibilities without unnecessarily expending time, effort, and resources to prepare for and assess the readiness of their organization for the examination.

With additional resources, a centralized Regulatory Relations function can move forward on key initiatives such as the development and continued support of an intranet site and training programs to raise awareness across the enterprise and position the institution to promote, develop, and maintain production working relationships with the regulatory agencies.

Introduction & Background

History

Headquartered in Pittsburgh, Pennsylvania, the PNC Financial Services Group, Inc. (PNC) is the product of a merger of two Pennsylvania banks in 1983: Pittsburgh National Corporation and Provident National Corporation based in Philadelphia.

Pittsburgh National Bank, the largest subsidiary of Pittsburgh National Corporation, originated in 1852 as the Pittsburgh Trust and Savings Company. The bank became the First National Bank of Pittsburgh in 1863. During the 1930s, the First National Bank of Pittsburgh partnered with Peoples-Pittsburgh Trust Company. In 1946, these two banks joined to form Peoples First National Bank and Trust Company ("Peoples First"). In 1959, Fidelity Trust Company merged with Peoples First which created Pittsburgh National Bank.

Provident National Corporation also dates back to the mid-nineteenth century. One of its predecessors, Provident Life and Trust Company, was established in 1865 as an insurance company. In 1922, the Provident Life and Trust Company split into two independent entities: Provident Mutual Life Insurance Company and Provident Trust Company. The latter company combined with Provident Tradesmens Bank and Trust Company to create Provident National Bank in 1957.

In 1982, Pennsylvania changed its laws to allow statewide banking. On April 19, 1982 Pittsburgh National Corporation became the first to act on the new legislation when it announced its intention to consolidate with Philadelphia's Provident National Corporation and create a bank with $10.3 billion in assets. It was the largest bank merger in American history at the time. Today, the initials “PNC” have no specific meaning but serve as a historical reference to both of its predecessor holding companies.

Acquisition and Growth

Between 1991 and 1996, PNC acquired nine financial institutions. Starting in early 2000’s, PNC continued its expansion through the following strategic business acquisitions:

Year	Acquired Institution	Size ($B)	Market
2003	United National Bancorp	3.1	Central New Jersey and Eastern Pennsylvania
2005	Riggs National Corp	6.0	Greater Washington DC
2007	Mercantile Bankshares Corp	17.6	Mid-Atlantic - District of Columbia, Maryland, Delaware, Virginia and Southeastern Pennsylvania
2007	Yardville National Bancorp	2.6	Central New Jersey and Eastern Pennsylvania
2008	Sterling Financial Corp	3.2	South-central Pennsylvania, Maryland and Delaware
2008	National City Corp	143.7	Midwest to the Mid-Atlantic
2011	BankAtlantic (branches and related facilities)	.33	Tampa/St. Petersburg Area
2011	Flagstar Bank (branches)	.21	Metropolitan Atlanta, Georgia
2012	RBC Bank (USA), U.S. sub of Royal Bank of Canada	25.0	Southeast - North Carolina, South Carolina, Georgia, Florida, Alabama, and Virginia

National City Corporation was the largest acquisition in PNC's history placing it among the nation's five largest banks at that time and providing access to almost a third of the total U.S. population through a presence in 33 of the most populated metropolitan areas. National City was the only one of the 25 largest U.S. banks eligible to receive Troubled Asset Relief Program (TARP) funds to be denied TARP funds with Omaha, Nebraska-based Lauritzen Corporation (ranked 37th nationally) being the next-largest bank denied funds. PNC’s acquisition of National City increased total assets from $145.6B to $279.2B as reported at September 30, 2008.

PNC Regulatory Agency Oversight

Prudential Regulators

Office of the Comptroller of the Currency (OCC) - Primary federal regulator responsible for nationally chartered commercial banks, and as of July 21, 2011, federally chartered thrifts.

Federal Reserve System (FRS) - Primary federal regulator responsible for state-chartered commercial and savings bank members of the Federal Reserve System.

Other Regulatory Agencies

Consumer Financial Protection Bureau (CFPB) – Primary federal regulator responsible for enforcing federal consumer financial laws and protecting consumers in the financial marketplace.

Federal Deposit Insurance Corporation (FDIC) - Primary federal regulator responsible for state-chartered banks not members of the Federal Reserve System, state chartered savings banks and as of July 21, 2011, state chartered thrifts.

Securities and Exchange Commission (SEC) - Primary federal regulator responsible for overseeing the nation’s securities markets and certain primary participants (e.g., brokerdealers, investment companies/advisers, credit rating agencies and securities exchanges), as well as certain organizations (e.g., Financial Industry Regulatory Authority).

Self-Regulatory Organizations (SRO)

Financial Industry Regulatory Authority (FINRA) – Independent, non-government, not-for-profit SRO responsible for regulating both the firms and professionals selling securities in the United States and the U.S. securities markets.

National Futures Association (NFA) – Independent, non-government, not-for-profit SRO responsible for the U.S. derivatives industry, including on-exchange traded futures, retail off-exchange foreign currency (forex) and OTC derivatives (swaps).

Businesses, Markets, Peer Group, and Strategy

As a "Main Street" bank (as opposed to a Wall Street bank), PNC businesses are organized around its customers and communities for strong relationships and local delivery of retail and business banking; residential mortgage banking; specialized services for corporations and government entities, including corporate banking, real estate finance and asset-based lending; and, wealth management and asset management. The reference to Main Street is not a statement of the bank's capabilities or sophistication, but rather it is philosophical statement about PNC's values, approach to risk management, and focus on long-term value.

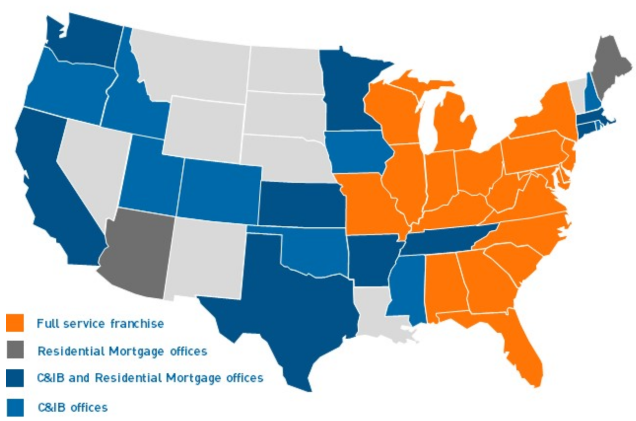
PNC's primary geographic markets are located in Pennsylvania, Ohio, New Jersey, Michigan, Illinois, Maryland, Indiana, Florida, North Carolina, Kentucky, Washington, D.C., Delaware, Virginia, Alabama, Georgia, Missouri, Wisconsin and South Carolina. PNC also provides certain products and services in Canada, China, Germany, and United Kingdom.

PNC is bank focused on adherence to the following business model:

- Strong Capital Management
- Invest in and grow high return, diverse businesses which fit its desired risk profile
- Adhere to its risk appetite
- Stay core funded and disciplined in deposit pricing
- Execute on its strategic priorities "to drive higher fee income, control expenses and create long-term value"[2]

PNC's peer group includes the following financial institutions:

- BB&T Corporation
- Bank of America Corporation
- Capital One Financial, Inc.
- Fifth Third Bancorp
- JPMorgan Chase
- KeyCorp
- M&T Bank
- Regions Financial Corporation
- SunTrust Banks, Inc.
- U.S. Bancorp
- Wells Fargo & Co.



PNC's Financial Highlights

12/31/16	PNC	U.S. Rank
Deposits	$257 billion	#7
Assets	$366 billion	#7
Branches	2,520	#5
ATMs	9,024	#5

– **Source for U.S. Rankings: SNL Financial. Assets rank excludes Morgan Stanley and Goldman Sachs.**

[2] William S. Demchak (CEO), *Barclays Global Investor Conferen*ce. New York, New York: September 14, 2016, 3.

Financial Highlights

At December 31, 2016, PNC's consolidated total assets, total loans, total deposits, and total shareholders' equity were $366.3 billion, $210.8 billion, $257.1 billion and $45.7 billion, respectively. PNC had a network of 2,520 branches and 9,024 ATMs at December 31, 2016.

On January 13, 2017, PNC reported net income of $1.047 billion, or $1.97 per diluted common share, for the fourth quarter of 2016 compared with net income of $1.022 billion, or $1.87 per diluted common share, for the fourth quarter of 2015. For the full year 2016, PNC reported net income of $3.985 billion, or $7.30 per diluted common share, compared with net income of $4.143 billion, or $7.39 per diluted common share, for the full year 2015. The Liquidity Coverage Ratio at December 31, 2016 for both PNC and PNC Bank, N.A. continued to exceed the fully phased-in requirement of 100 percent, which became effective on January 1, 2017.

Capstone Introduction

The post-Great Recession regulatory environment triggered heightened examination scrutiny and expectations of financial institutions. In 2014 alone, federal banking regulators –

that is, the FRS, FDIC, OCC, and the National Credit Union Administration (NCUA) – issued 583 Enforcement Actions (EA) of various types, with the majority of them coming from the FDIC.[3]

Given today's regulatory landscape and PNC's size, it is imperative that PNC meets its responsibilities with its regulatory agencies by engaging and responding in a timely, reliable, coordinated, and transparent way. This project will focus on PNC's internal structure and processes that support its existing regulatory relationships including evaluating current examination fieldwork support, benchmarking with other financial institutions, and identifying potential internal organizational restructuring opportunities.

To that end, this project will evaluate and propose options through the use of surveys and benchmarking with the following goals:

- Analyze the existing enterprise-wide PNC / regulatory agency interactions to ensure appropriate engagement and determine potential gaps;
- Evaluate the advantages and disadvantages of organizational structures designed to better coordinate the following related but separate corporate functions:
    - **Regulatory Affairs** – serves as relationship manager to regulatory agencies and reports on supervisory activities and associated outcomes;

[3] Val Srinivas, Daniel Byler, Richa Wadhwani, Alok Ranjan, and Vamsi Krishna, "Enforcement Actions in the Banking Industry," *Deloitte University Press*, December 9, 2015, https://dupress.deloitte.com/dup-us-en/industry/banking-securities/bank-enforcement-actions-trends-in-banking-industry.html (Accessed January 31, 2017).

- **Regulatory Support** – provides supervisory activity project management support on limited basis;
- **Regulatory Reform** – analyzes proposed regulatory changes impacting PNC's businesses and advocates on behalf of PNC's interests;
- **Regulatory Engagement** – engages regulatory agencies on regulatory policy throughout rulemaking process

- Revise and/or implement policies, procedures, and standards to formalize a regulatory relations program; and,
- Develop communication channels to inform internal audience of the regulatory affairs program.

Project Goal Statement

Based on well-researched and analyzed information, recommend structural and procedural changes to ensure PNC is best positioned to interact professionally with the regulatory agencies by delivering accurate and timely information with appropriate oversight and controls to enhance PNC's reputation and achieve its strategic goals.

Strategy & Implementation

"Banking has long been about relationships, but it's not only relationships with customers that are vital to a bank's long-term success. After all, customers will come and go, but regulatory relationships are forever…"[4]

Scope

PNC Regulatory Affairs originally reported to the Chief Risk Officer as part of a function formerly known Enterprise Risk Policy Administration, a precursor to today's Enterprise Risk Management (ERM) group. In the summer of 2009, Regulatory Affairs was realigned under the General Counsel's organization given the prevailing view at that time that supervisory interactions aligned more closely with legal review and engagement.

Until 2014, the Regulatory Affairs staff remained essentially unchanged in its staffing and its mission. In 2009, the Director of Regulatory Affairs was supported by one Program Analyst. In 2014, a deputy position was added to the organization. Today, the senior position, known as Managing Director (formerly Director), is supported by a Director (new position) and a Regulatory Risk Analyst.

As outlined in the History (Acquisition and Growth) section in Part I, PNC's increased size, complexity (i.e., addition of National City's mortgage financing and servicing business),

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[4] Dawnella Johnson and Paul Osborne, "5 Building Blocks for a Healthy Relationship with Regulators", *ABA Bank Compliance* (January – February 2017), 13.

footprint, and post-Great Recession regulatory environment, including the inception of the Consumer Financial Protection Bureau (CFPB), significantly expanded the Regulatory Affairs' mission and challenged its ability to monitor both regulatory activities and management's efforts to remediate all related findings.

The scope of the project will entail an evaluation of PNC's Regulatory Affairs' mission, organizational structure, resources, and program management approach to identify potential opportunities to enhance internal and external practices and processes.

Purpose

The purpose of this project is to evaluate PNC's current approach and governance in an effort to optimize the way PNC engages with the regulatory agencies. With supporting benchmarking, surveys, and analysis, PNC stands to benefit from a more disciplined approach to regulatory engagement with defined roles, enhanced policy and procedural guidance, and consistent application of best practices in the areas of examination and issue management.

The Director, Regulatory Affairs, will conduct the necessary research to better understand alternative approaches, assess the benefits and limitations, and recommend enhancements to better communicate, monitor, and collaborate enterprise-wide. The Regulatory Affairs group will execute certain proposed activities; however, certain recommendations will exceed the Deputy General Counsel's delegated authority and will require the review and approval of more senior level management committees. PNC's Managing Director of Regulatory Affairs will oversee implementation.

Survey results from peer financial institutions, coupled with subsequent executive and senior management engagement related to those findings, will serve as the catalyst for change to a more coordinated, centralized approach to examination support and issues management consistent with enhanced policies, procedures, and protocols. Recommendations stemming from this project will be provided to executive management and other corporate governance committees, as necessary, for review and approval of any significant initiatives.

Mission and Vision Statements

Since its inception, senior leadership has entrusted Regulatory Affairs to provide a unique and highly visible capability that enables effective communication and engagement with the regulatory agencies. The creation of a Mission Statement, however, would guide the program's efforts in contributing to the achievement of PNC's strategic objectives.

The regulatory liaison function encompasses, but is not limited to, coordination of regulatory examination support, identification of regulatory issues, monitoring management's remediation activities, and internal reporting of the supervisory process and outcomes. As such, the Mission Statement could be stated as follows:

***To plan, coordinate, and implement strategies to build understanding, credibility, trust, and mutually beneficial relationships with the regulatory agencies which exam PNC's businesses and corporate functions*.**

In support of the Mission Statement, the Regulatory Affairs Vision Statement could read as follows:

Ensure PNC is positioned to deliver accurate information in a timely manner with appropriate controls to both internal audiences and the regulatory agencies.

Strategic Fit

As indicated in Part I, PNC's strategic priorities focus on driving higher fee income, controlling expenses, and creating long-term value. Executive management identified the drivers of fee income to include Treasury Management, Consumer Services (e.g., retail payments), and Asset Management (e.g., referrals from other PNC businesses). Investment in technology and infrastructure has been highlighted as the necessary foundation to grow the enterprise while generating net savings in the outyears. Regardless of the approach, each strategic initiative mentioned above will be met with heightened regulatory scrutiny.

Like risk management, regulatory engagement is an organizational and individual responsibility. Keeping lines of communication open between PNC and the regulatory agencies is a basic function of management and leadership. As the Federal Reserve observed: "A positive relationship between a bank and its regulator is a valuable asset. A bank will have close interaction with regulators in every stage of its development and will be subject to the regulator's scrutiny in examinations and certain applications for "non-objection", consent, or approval."[5]

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[5] "The Supervisory Process and Regulatory Relations", *Partnership for Progress, Board of Governors of the Federal Reserve System*, https://www.fedpartnership.gov/bank-life-cycle/start-a-bank/supervisory-process-and-regulatory-relations (Accessed February 2, 2017)

Benchmarking

The key source of information to better assess alternative approaches to managing regulatory engagement involves benchmarking with other financial institutions. While a perspective from banks of various sizes both domestic and foreign-owned provides useful information, an understanding of how similarly sized banks manage its regulatory relations program will be the most insightful. Five peer financial institutions participated in an online survey; in return, each institution was provided a summary report of the survey results for their review and consideration. Two additional institutions initially agreed to respond to the questions but ultimately did not participate in the online survey. Additionally, on a pro bono basis, external consultants provided an independent industry-wide view as well as a critique of the online survey.

Specifically, the benchmarking of other financial institutions' regulatory relations function included the following areas:

- Size of the institution
- Title of the function
- Reporting structure within the organization
- Regulatory agencies applicable to the institution
- Resourcing (i.e., Full-time Equivalents (FTE))
- Key responsibilities/mandates of the function
- Roles and responsibilities of assigned resources
- Examination and issue management reporting

See attached summary report in the Appendix.

Executive Management Engagement

After reviewing the benchmarking results, the Regulatory Affairs organization will subsequently engage certain PNC Lines of Business (LOB) and Shared Services executive leaders, such as the Chief Risk Officer and General Auditor, to recommend proposed internal process enhancements related to the regulatory liaison function in order to garner their interest and support prior to more formal review and approval.

The discussions with the executive leaders will include recommendations on the following topics as well as confirmation of the roles and responsibilities of assigned resources:

- Centralized vs. decentralized approach to examination management
- Align on current and future expectations of the function
    - Direct the preparation and submission of regulatory agency reports or correspondence.
    - Review all regulatory agency submission materials to ensure timeliness, accuracy, comprehensiveness, or compliance with regulatory standards.
    - Provide regulatory guidance to lines of business
    - Formulate or implement Regulatory Affairs policies and procedures to ensure that regulatory compliance is maintained or enhanced.
    - Communicate regulatory information to appropriate recipients and ensure that the confidential supervisory information is handled correctly.
    - Update enterprise with relevant and anticipated regulatory impacts associated with proposed rulemaking (i.e., Regulatory Reform).

Competitive Advantage

The coordination of all of the key stakeholders from Regulatory Affairs to the lines of defense will be even more critical as delays in providing the correct information to the regulators slows and, in worst case, jeopardizes PNC competitive advantage going forward. Speed to market, modernization, and security enhancements provide the engines for growth.

Regulatory awareness and concurrence will be even more crucial in a hyper-competitive, time-sensitive environment.

Corporate Governance and Approval

Any project-related activity or series of related activities that implements a strategy, product, service, process, or technology will fall under PNC's strategic initiative process regardless if the initiative is new or represents a change to something that already exists.

Future Opportunities

As a result of the research to support this project, opportunities are available to the function and PNC enterprise-wide. The following provides a synopsis of noteworthy enhancements and potential outcomes:

Internal

Reorganization – *Creation of a centralized Regulatory Relations organization that uses existing resources in a more efficient, coordinated structure with Mission and Vision Statements, and an appropriate level of resources.*

Today, regulatory engagement follows a decentralized approach to examination support and regulatory issue management. Certain Lines of Business (LOB) (e.g., PNC Mortgage) and Shared Services (e.g., Technology and Operations) provide internal resources to support the regulatory examination and ongoing supervision processes. However, the support among the various internal groups is often uneven and lacks a common framework and oversight. In some

LOBs and Shared Service functions, there are no resources in place to support regulatory engagement.

Training Program – *Creation of a training program to educate all employees involved with the regulatory agencies*.

Similar to annual ethics training, a standardized training course for all those directly and indirectly involved in the supervisory process could outline the roles and responsibilities of various process participants, as well as review current PNC regulatory-related policies and procedures. Specific training courses designed for and supported by PNC University could include guidance on the release of corporate information including legal review requirements, safeguarding of confidential supervisory information, conducting regulatory examination meetings, and responding to findings and/or inquiries from the regulatory agencies.

External

Coordination with Peer Banks and Industry Consultants – *Participate in an established Regulatory Relations Roundtable or approach an existing organization to sponsor such professional interaction.*

Research associated with this project revealed the existence of two established regulatory relations forums. In one case, Ernst & Young hosted and facilitated a *Regulatory Affairs Roundtable* with a focus on the following topics:

- Importance of regulatory relations with the consideration of increased pressure from supervisory bodies

- Increased focus on engagement with variety of internal and external stakeholders
- Depth and breadth of regulatory relations in addressing key challenges

Similarly, one financial institution located in California separately hosts a quarterly regulatory relations forum. PNC can also explore opportunities for host organizations, such as The Clearing House, to provide the advocacy among the large banks to engage in discussions focused on supporting effective and efficient regulatory engagement.

Process Changes & Improvements

<u>Regulatory Orientation Session</u> – *Annual orientation program designed to educate new regulators on PNC as well as build relationships with the leadership of all three lines of defense.*

Given personnel changes within the OCC, FRB, and FDIC assigned examination teams, PNC provides an orientation session to new examination team members. The goals of the program are:

- Provide a high-level overview of PNC's organization; and,
- Introduce management from all three lines of defense who present information and engage in follow-up discussions.

The program is well-received by the attending agency representatives. An annual program is now in place with the attendees, agenda and subject matter discussed openly with the attending regulatory agencies.

<u>Website</u> – *Creation of a Regulatory Relations intranet site*

A dedicated website would maximize awareness and deepen the understanding of today's regulatory environment. Content that is relevant to those involved with regulatory engagement would be updated on a regular basis. Types of content include, but are not limited to:

- Secure portal to a limited, defined audience for access to certain confidential supervisory information (e.g., regulatory agency organization charts, examination schedules)
- Links to regulatory agencies, annual supervisory agendas, and examination guides
- Policies and procedures
- Contact list for regulatory-related inquiries
- Templates for management response letters, meeting invitations and presentations
- Frequently asked questions

Executive management notionally approved the recommendation to create a website. The project remains an action item until resources are identified to focus on the concept, design, content, and functionality.

Implementation Schedule

Regulatory Affairs will develop an implementation action plan identifying high level milestones for the successful execution of certain initiatives. The plan will identify i) major activities, dates, and responsible parties, ii) performance indicators or targets to measure success, and iii) review milestones with triggers for an actionable exit strategy in the event a proposal or activity does not meet expectations. Additionally, Regulatory Affairs will establish a monitoring plan to report project status back to the appropriate committee throughout the implementation and the life of the project.

Financial Impact

Investment

A reorganization to create a centralized approach to regulatory relations would primarily involve the transfer of existing personnel costs resulting in higher overhead to the Legal Department. However, since the full time equivalent (FTE) positions already exist within the organization, a budget reallocation would need to occur between the current organizations such as Technology and Operations (T&O) and Legal. Since the FTE would shift from one cost center to another, there are no revenue estimates associated with this efficiency opportunity. Restructuring existing FTE will result in clearer employee job descriptions, improved integration and collaboration by bringing specialists to work in specific areas, and more accountability and greater focus on the timely completion of tasks. If the proposal results in a decision to reduce the number of positions, the investment will include certain costs with the reduction such as severance as well as incentives to keep best qualified employees from leaving the new organization. However, the purpose of the proposal is directed toward optimizing current resources for the future, not implementing a cost savings or downsizing initiative.

The development of certain technological enhancements, such as a Regulatory Affairs intranet site and a training course in PNC University, create functional and useful sources of information at no additional cost but will result in providing timely guidance to the enterprise as commonly requested information will be readily available.

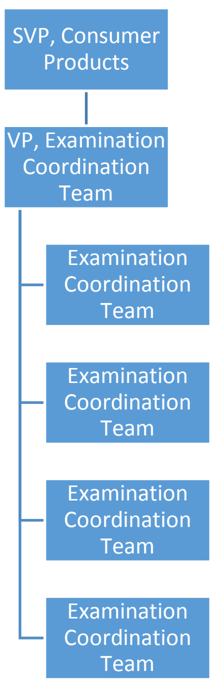
An actual expense may include any consulting costs associated with the review and evaluation of any proposed reorganization, functional redesign, and/or implementation plan.

Consolidation of Regulatory Examination Support Resources

Current Organizational Charts & Associated Costs

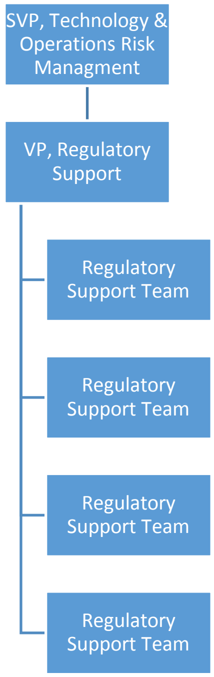
Organizational charts represents filled positions as of February 1, 2017. Full year costs represent 2016 data as prepared by Corporate Finance.

Examination Coordination Team (formerly, PNC Mortgage Examination Coordination Team)



COST TYPE	FULL YEAR
Per Headcount	

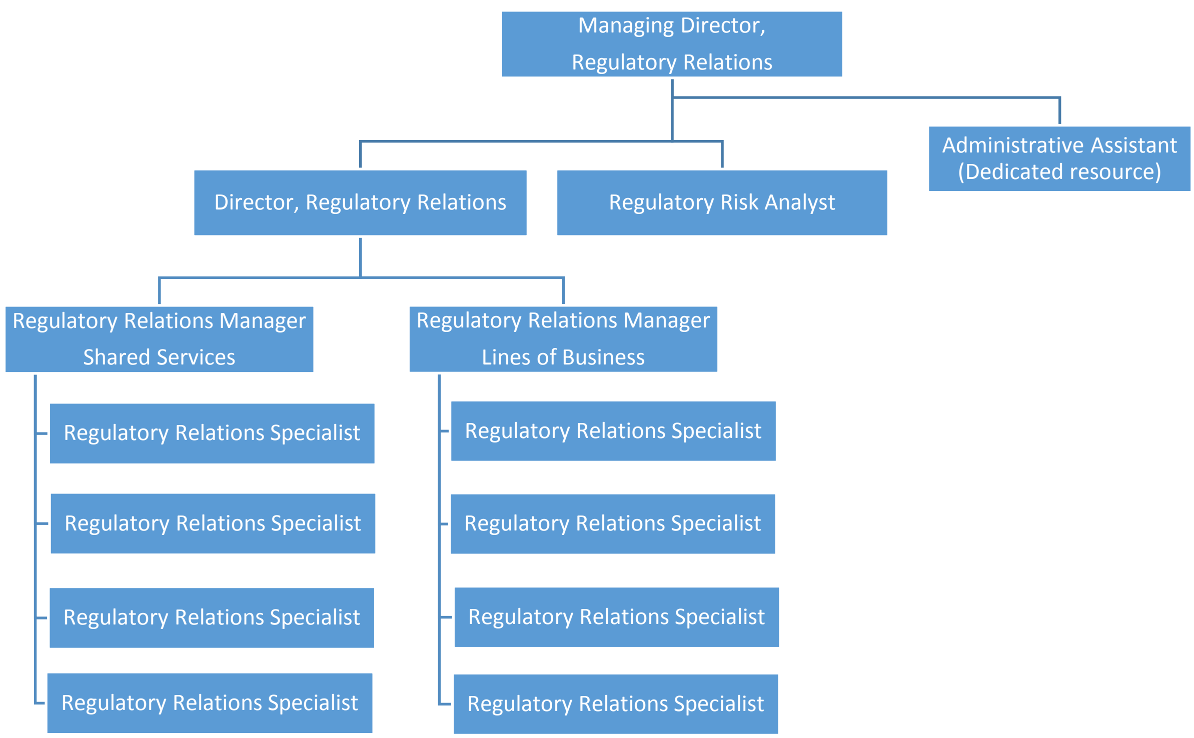
Technology & Operations Risk Management Regulatory Support Team



COST TYPE FULL YEAR

Per Headcount

Proposed "Regulatory Relations" Consolidated Organizational Chart



Investment Risks

While there are some upfront, minimal implementation costs associated with the reorganization of existing resources, the potential investment risks are considered to be low and include the following:

Employee-related Costs

- Severance / Incentive Pay
  - Should the outcome involve a reduction in staffing to meet the new mandate of the regulatory liaison function, there will be severance costs associated with the displacements. Additionally, if certain individuals are considered critical to the success of the future organization, there may be the need for incentive pay to avoid losing the employees.
- Relocation / Travel
  - Should the project result in not only a centrally managed function but also require a centrally located staff, then relocation costs will need to be considered for those impacted staff who are currently located outside of Pittsburgh. Additionally, if the function is better supported by the in-person availability of remote employees, then there may be increased travel costs associated with bringing the employees to the examination site on an as-needed basis.
- Professional Development & Training

- If the expansion of the liaison function entails a broader scope of responsibilities, then employees may need additional training related to regulatory compliance issue, regulatory indoctrination, and/or program management.

Risk Mitigation / Project Support Rationale

As outlined above, there are potential investment risks associated with the realignment and expansion of the ***Regulatory Relations*** function. This section describes the mitigation strategies to address each potential risk. It is important to note that any proposed significant initiative requires approval via the Strategic Initiative Approval (SIA) process. The Corporate Financial Planning & Analysis group reviews all SIAs to prepare an independent comprehensive financial review and Net Present Value analysis to create uniform and identifiable financial summary to assist management with its decision making.

Employee-related Costs

- Severance / Incentive Pay
    - While the possibility of a cost savings exists for any proposed significant initiative, the recurring savings would outweigh the one-time severance costs. No turnover is expected from a potential reorganization minimizing the likelihood that severance or incentive pay would be an unexpected cost.
- Relocation / Travel
    - Today, many examination support resources are remotely located. Based on the experience of existing resources as well as the experiences shared from another

large financial institution, remotely-located program managers are equally effective at managing the responsibilities associated with examination fieldwork coordination and support.

- Professional Development & Training
    - As part of day-to-day leadership, the talents and capabilities of the staff should be assessed against the requirements of the function. It's not expected that any training and/or professional development costs would be significant to the budget of the Legal Department.

Non-Financial Impact

Logistical and Organizational Risks

***"Companies always underestimate how difficult this process is largely because it means creating a customer-centric view,"* Galbraith notes. *"That is, if you are going to combine products and services for the benefit of the customer, you have to know a lot about who that customer is."*[6]**

In association with PNC's Strategic Initiative Approval (SIA) process, PNC will complete an assessment to analyze the initiative's potential impact on critical risk components and

[6] Jay R. Galbraith, "Organizing to Deliver Solutions", *Center for Effective Organizations*, Marshall School of Business, May 2002.

control environment, and clear identify the approval requirements necessary for the initiative.

A reorganization includes the following potential risks:

<u>Operational Risk (Line of Business (LOB) or Shared Services Management)</u>

- Loss of Control over Process
  - A reorganization will relieve management of the role of primary regulatory engagement coordinator, thereby potentially losing subject matter expertise overseeing the examination interaction and issues management processes.
- Reliance on Centralized Function
  - Management would rely on a centralized regulatory function to track all exams, regulatory findings, remediation progress, and reporting.
  - If management does not see the benefits of a centralized function, there is a risk of duplication of effort and inconsistent engagement practices if LOB or Shared Services management operate independently.
- Loss of Resources
  - A transfer of FTE to a centralized function would mean less management flexibility to reassign resources to other projects and potentially disrupt existing roles & responsibilities such as engagements with other outside interests such as Investor Relations (e.g., Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), and other institutional investors).

Strategic Risk

- Absence of Doctrine
  - There is no policy expressing how regulatory relations contributes to or supports PNC's strategies, functions, or activities.
  - A realigned regulatory liaison function could offer a customer-centric, value-added solution to meet the needs of management and the regulatory agencies.
- Misalignment with Mission & Vision
  - A clear understanding of the combined resources' capabilities and any development requirements should strategically align with the mission and vision of the ***Regulatory Relations*** function.

Operational Risk (Employees)

- Morale
  - Employees will lose their current identities which could cause a degree of confusion, apprehension, and uncertainty.
- Employees / Knowledge
  - If the reorganization is not accepted by an existing employee, then the departure of an individual results in a loss of knowledge in a key and visible area.
- Training
  - To ensure consistency in the engagement process, a centralized team will need to critically evaluate existing processes, policies, and procedures to ensure that best practices identified, shared, and implemented across the centralized team.

Risk Mitigation

As previously outlined, there are several identified risks associated with the realignment and expansion of a regulatory relations function. This section will describe the mitigation strategies to address each potential risk.

<u>Operational Risk (Line of Business (LOB) or Shared Services Management)</u>

- Loss of Control over Process
    - In an effort to minimize concerns with this risk, the centralized function will need to develop close regular interactions with the LOB or corporate function by assigning a centralized team member (e.g., Regulatory Relations Manager) to be in regular contact with executive management.
    - Equally important, management will no longer need to dedicate existing resources or establish a program for regulatory engagement, examination interaction, and issues management.
- Reliance on Centralized Function
    - The Regulatory Relations Manager would take responsibility for the deployment of resources to manage an existing engagement and ensure LOB or Shared Services executive management receive a consolidated view of the regulatory landscape to include status of ongoing examinations, outstanding issue remediation, and, potentially, upcoming regulatory activities (i.e., rulemakings).
- Loss of Employees

- With a centralized function, management can focus its resources on pressing issues such as normal daily requirements associated with the function such as employing resources to remediate regulatory concerns versus tracking and reporting. No reprogramming of FTE would occur without an internal impact analysis to avoid unintended consequences of reduced resources.

Strategic Risk

- Absence of Doctrine
  - The development of key policies and procedures will help ensure that regulatory relations provides leadership to the institution. A coordinated set of guidance documents would ensure internal and external engagement meets regulatory expectations.
- Misalignment with Mission & Vision
  - The development of Mission and Vision Statements would be fundamental to the success of a centralized function as it would describe to all key stakeholders how a coordinated approach contributes to achievement of strategic objectives.

Operational Risk (Employees)

- Morale
  - A centralized function will provide employees with other knowledgeable professionals to engage, discuss challenges, and seek opportunities to

collectively improve the ***Regulatory Relations*** program which instills a sense of purpose, accountability, and job satisfaction.

- Employees / Knowledge
    - While turnover is a managerial challenge, the development of doctrine and the establishment of an appropriately-sized central staff will overcome the absence of an individual and help to avoid a single point of failure possibility.
- Training
    - A centralized team can share processes, policies, and procedures to ensure that best practices identified, shared, and implemented across the centralized team.
    - A more informed workforce will help establish strong regulatory relationships built upon a solid foundation of trust and mutual respect.

Measures – Effectiveness and Efficiency

In an effort to assess the non-financial impact of a reorganization to a centralized approach, the following metrics will assist in recognizing whether the change is effective and enhances PNC's ***Regulatory Relations*** efforts.

1) Internal Process Measure - Percentage of Past Due Regulatory Identified Issues (RII)

The measure will identify the number of RII formally reported as past due by the regulatory agencies as a percentage of the total population of RII. This measure essentially reflects how well management understands the RII, develops an appropriate remediation plan, and successfully implements the corrective actions in the agreed-upon timelines.

Improvements in this metric would indicate that management is not only adhering to a well-conceived remediation timeline and action plan but also applying appropriate resources in an effort to resolving regulatory matters of concern on a timely basis.

2) Learning and Growth Measure - Number of Civil Money Penalties (CMP), Violations of Law, and/or Agency-required look-back exercises and amount of fines associated with CMP

While no such metric exists at this time, a count of these critical findings will allow management the ability to assess the impact of the centralized function with regards to maintaining transparent and open engagements with the regulatory agencies.

On February 26, 2016, the OCC adopted new civil money penalty matrices and rescinded the matrix that it used since 1993. A recent Deloitte study found that while the number of OCC enforcement actions is stabilizing at historic levels, "the associated fines have increased markedly since 2010…banks and IAPs [institution affiliated parties like directors and officers] have spent $4 billion on restitutions and $1.5 billion on CMPs since 2010."[7]

Improvements in these metrics would indicate that management is adhering to regulatory expectations and avoiding any financial impact to profitability that would result from the financial penalties as well as lost business resulting from a negative reputational risk event.

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[7] "OCC Civil Money Penalty Matrix Changes: Is an Uptick in CMP Frequency and Amounts in the Offing?" *The American Association of Bank Directors* (May 20, 2016), http://aabd.org/occ-civil-money-penalty-matrix-changes-is-an-uptick-in-cmp-frequency-and-amounts-in-the-offing (accessed January 31, 2017)

3) Customer Measure – Satisfactory Survey – OCC/FRB/CFPB

While no such survey exists at this time, a satisfaction survey of the prudential regulatory agencies along with the CFPB will allow the agency leadership an opportunity to note areas of concern. Regulatory Relations would deploy a survey on a periodic basis with specific questions as well as space for open feedback related to the centralized function and approach.

Improvements in the survey metrics would not only indicate that issues are understood and actions are taken but also reassures the LOBs and Shared Services function that the requirements and expectations of a centralized regulatory relations function are being met.

Expectations

Organization

Similar to other financial institutions which provide centralized exam management support, this reorganization will afford LOB and Shared Services functions an opportunity to focus time and energy on their primary responsibilities rather than build their own regulatory relations program. A Regulatory Relations Manager assigned to the LOBs and Shared Services areas would be expected to develop extremely close partnerships in an effort execute a consistent approach to examination and RII management. Today, the organization's approach is uneven with some areas providing internal project managers for regulatory engagements.

The purpose of the centralized function is to standardize the engagement process; however, the role is not intended to answer for or speak on behalf of the LOB or Shared Service. A centralized structure is an attempt to ensure that certain engagement functions, such as scheduling meeting during fieldwork, organizing management's response to exam findings, delivering necessary documents that are secured and accessible, and ensuring internal coordination throughout the lifecycle of RII, are consistently delivered across the enterprise.

People

On a regular basis, individuals within the organization are placed into the position of managing the regulatory engagement process with limited guidance and resources. In certain cases, individuals are not regularly in contact with the regulatory agencies and are not sensitive to the unique nature of the relationship. To that end, there are often misunderstandings are to how meetings should be conducted, how staff should engage with the regulators, and who should represent management and the lines of defense in such meetings. Further, the examiners tend to engage directly with individuals who they know *get the job done* but who, in turn, may not understand the importance of escalating certain regulatory requests or potential regulatory findings noted during fieldwork.

Initiatives such as a ***Regulatory Relations*** website or in-house training course (e.g., PNC University) related to regulatory agencies' oversight should prove to be valuable resources for increased understanding and consistent engagement.

Customers

Internal

While not part of the proposed reorganization, a future phase could incorporate an enterprise-wide view of the impact of new rules and regulations on current practices across PNC which, in turn, provides a more holistic and current view of the regulatory landscape. Reporting could be expanded to provide an assessment of today's environment, including on-going and near-term examinations and RII resolution activities as well as a tie into targeted federal, state, and local laws, and regulatory guidance.

External (Regulatory Agencies)

A centralized team will not only become more familiar with the LOB or Shared Services area it supports, but it also will also better understand the regulatory agencies' areas of focus, including the examination teams responsible for those areas. "Effective regulatory relationship management requires those who interface with regulators to become knowledgeable about the laws and regulations applicable to their operations; this requires research, training and self-study appropriate to the industry and the extent to which it is regulated."[8] Recognizing that a centralized regulatory function can serve as one-stop for the agencies lessens the opportunity for regulatory requests to be handled internally without proper oversight. To the extent that ***Regulatory Relations*** is the primary point of contact, the Regulatory Relations Manager

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[8] Jo Ann Barefoot and Lori J. Sommerfield, "Regulatory Relationship Management: Building Trust, Creditability with Regulators," *The Bureau of National Affairs Banking Report* (May 2, 2011): 1.

becomes the focal point of the regulators experience, providing a level of service to meets or exceeds their expectations.

Conclusion

According to the Federal Reserve, "Maintaining a positive relationship with regulators at all times is critical, but a positive relationship is most beneficial during times when a bank is in distress. A strong, positive relationship may significantly help maintain bank stability and avoid distress."[9]

The recommendation to move existing regulatory examination and issue support resources under an expanded and renamed centralized function, ***Regulatory Relations***, builds upon a healthy foundation in place today with the regulators. The FRB's observation provides further support to identify ways to improve the organizational approach to regulatory engagement. The regulatory agencies can have a tremendous impact on a financial institution's activities and strategic goals. That said, a centralized function and structure can seize the opportunity to not only exert leadership across the enterprise but also build trust and creditability with the regulatory agencies. Equally important, the centralized function allows the LOBs and Shared Services management to focus on their respective primary responsibilities

[9] "The Supervisory Process and Regulatory Relations", *Partnership for Progress, Board of Governors of the Federal Reserve System*, https://www.fedpartnership.gov/bank-life-cycle/start-a-bank/supervisory-process-and-regulatory-relations (Accessed February 2, 2017)

without unnecessarily expending time, effort, and resources to prepare for and assess the readiness of their organization for the examination.

With additional resources, a centralized ***Regulatory Relations*** function can move forward on key initiatives such as the development and continued support of an intranet site and training programs to raise awareness across the enterprise and position the institution to promote, develop, and maintain production working relationships with the regulatory agencies. With time, other functions, such as Regulatory Reform and Regulatory Financial Reporting can be examined to see if additional process efficiencies are available and worth consideration.

In the end, an enhanced ***Regulatory Relations*** program should seek all opportunities to utilize resources effectively for value-added activities such as constructive interactions with the examiners, and appropriate and timely resolution of regulatory findings.

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Appendix

Appendix
Regulatory Relations/Affairs Practices Survey Results

Appendix
Regulatory Relations/Affairs Practices Survey Results

Other: Head of Regulatory Relationships

FTE	PTE	Managers
22	0	3
1	0	1
8	0	3 (FTEs have direct reports)
16	0	N/A
8	1	1

Appendix
Regulatory Relations/Affairs Practices Survey Results

If not already included in your organization chart or an organization chart was not provided, please provide each staff member's title (e.g., "Director", "Relationship Manager"), location, responsibility, and/or regulatory process control (e.g., examination support, issue management).

- *"Chief Regulatory Relations Officer (Manages 21 FTE) / Head of FRB/FDIC Regulatory Coordination - Exam Management and Reporting (Manages 4 FTE) / Head of OCC/CFPB Regulatory Coordination - Exam Management and Reporting (Manages 4 FTE) / Head of Enforcement Action Management (Manages 10 FTE)"*

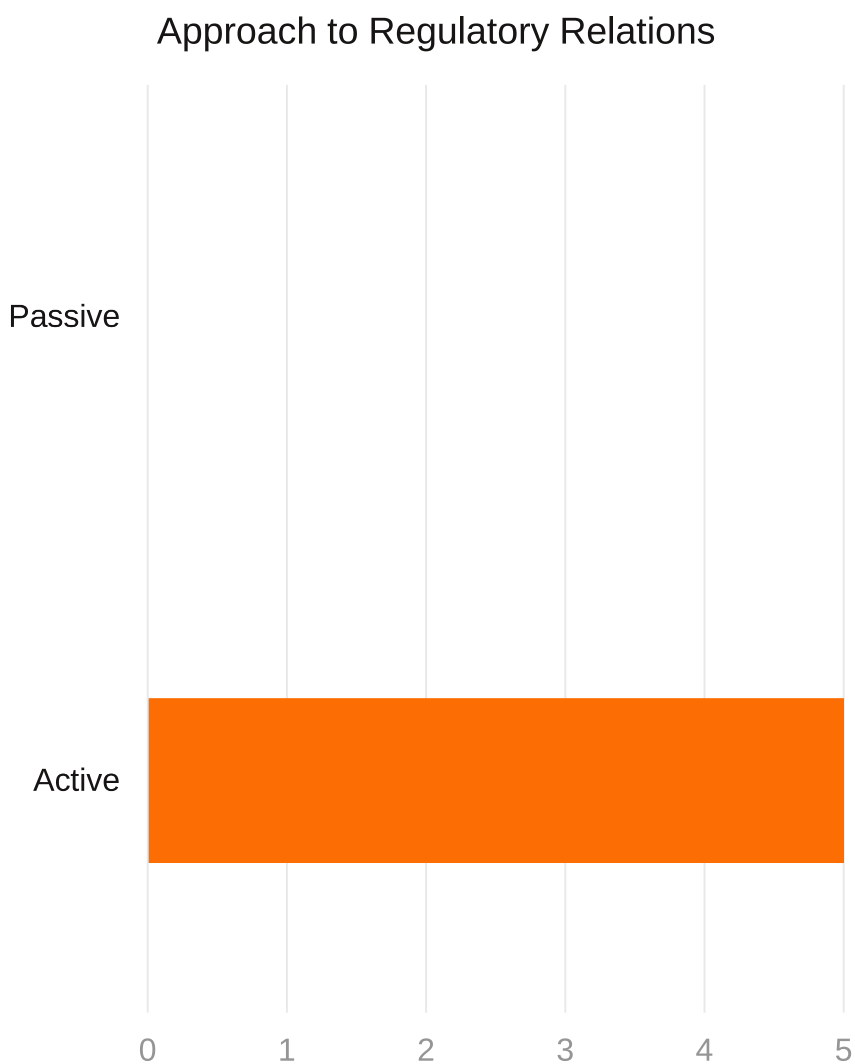
- *"Regulatory Relations Director / Regulatory Relations Manager"*

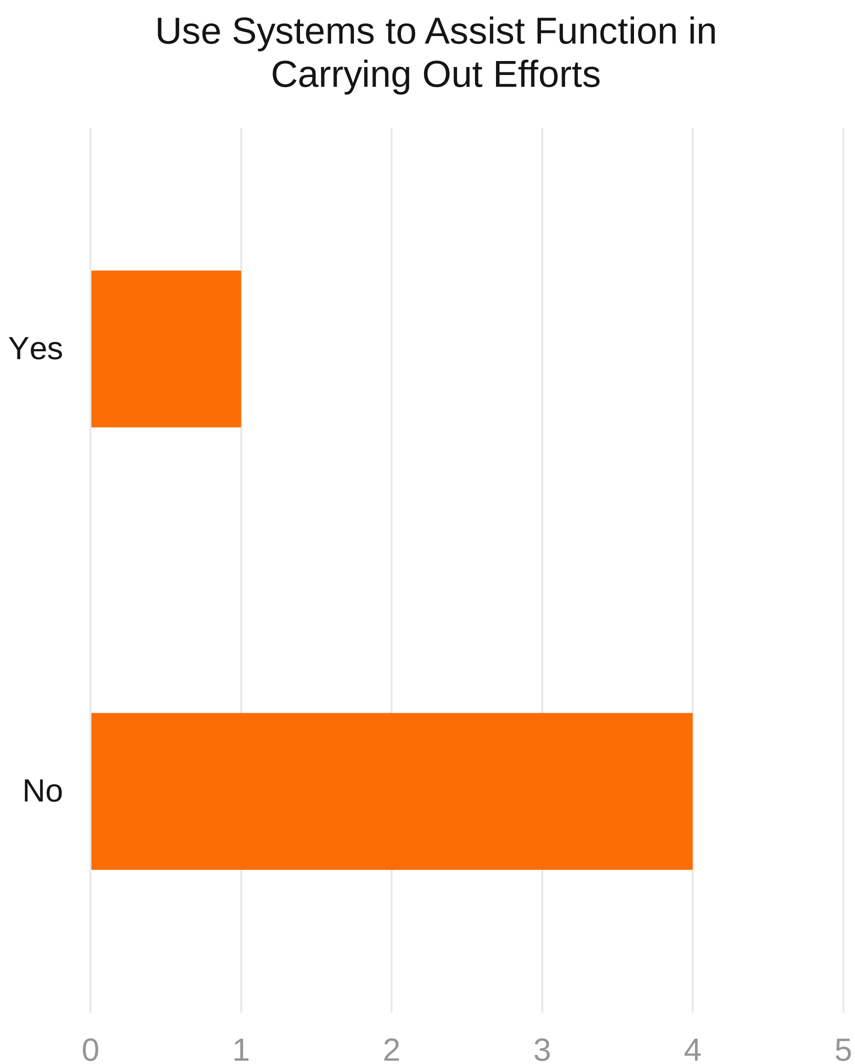
- *"Director of Regulatory Affairs / Regulatory Affairs Senior Manager - (3) business partners/exam managers with line of business/support groups across the bank / Regulatory Affairs Manager / Senior Regulatory Affairs Specialist / Regulatory Affairs Program Development Manager - (1) P&Ps, reporting, info request submissions, ad hoc research, exam support, etc. / Executive Assistant"*

- *"The regulatory relations function has one department head (equivalent of a Managing Director); 8 Director-level associates that manage mostly all facets of line of business / department regulatory matters, including examinations and; 4 support staff that provide general exam support to the directors and also do reporting; 3 administrative assistants that handle all calendaring, travel, etc. for regulatory team."*

- *"The Relationship Managers are the liaisons between the Agencies and business lines of our US operations for ALL activity, exams, ongoing supervision or adhoc requests. The Information Analysts manage our database which tracks all exams and regulatory findings, remediation progress and status. They do all of the reporting of status of exams and findings to our board, senior management and parent company."*

Appendix
Regulatory Relations/Affairs Practices Survey Results

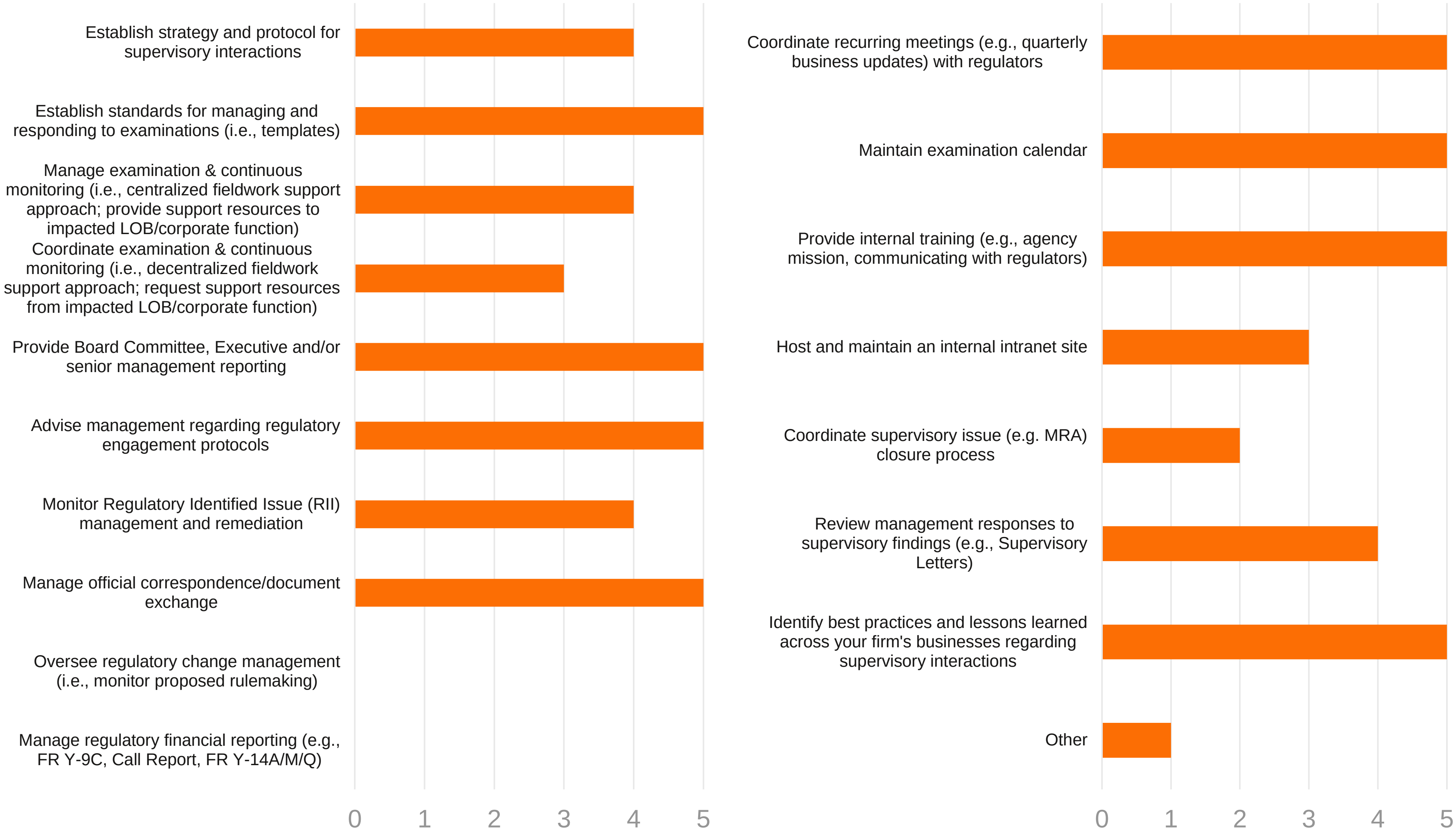




Yes: Proprietary Issue Management System SharePoint

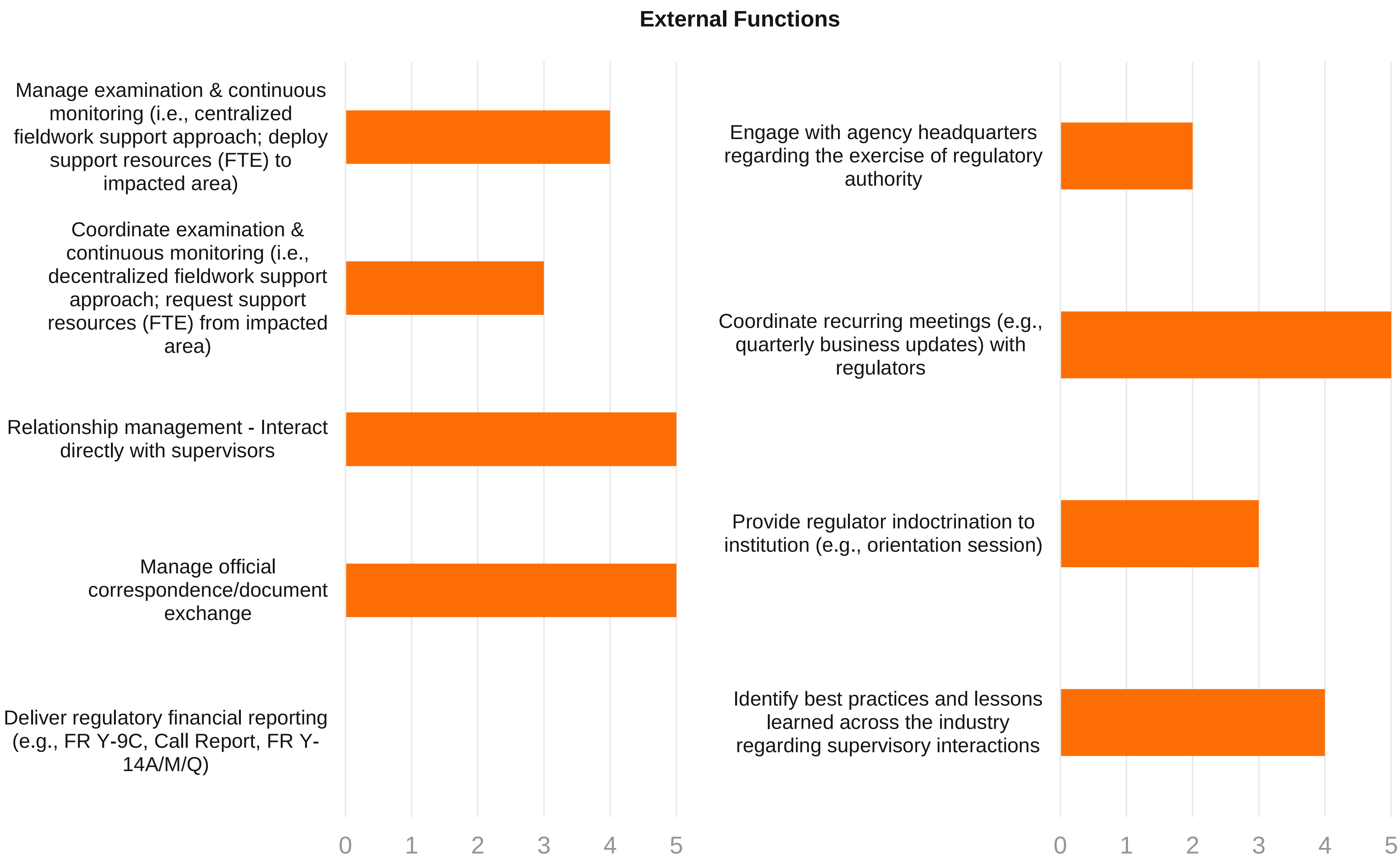
Appendix
Regulatory Relations/Affairs Practices Survey Results

Internal Functions

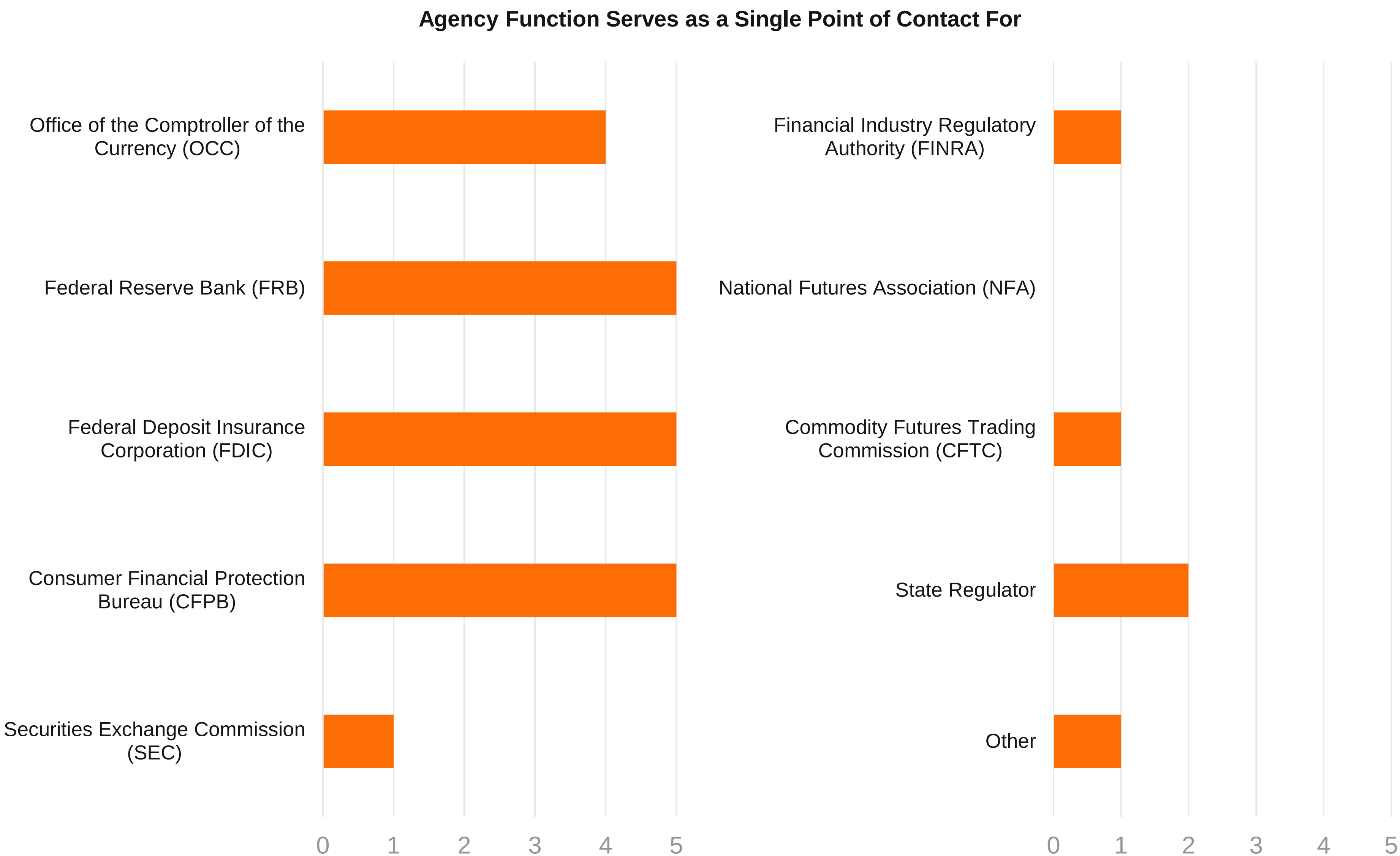


Other: Engage in industry advocacy on NPRs, etc.

Appendix
Regulatory Relations/Affairs Practices Survey Results



Appendix
Regulatory Relations/Affairs Practices Survey Results



Other: Though not "regulatory", one FI serves as point of contact for GSE and other similar agency exams

Appendix
Regulatory Relations/Affairs Practices Survey Results

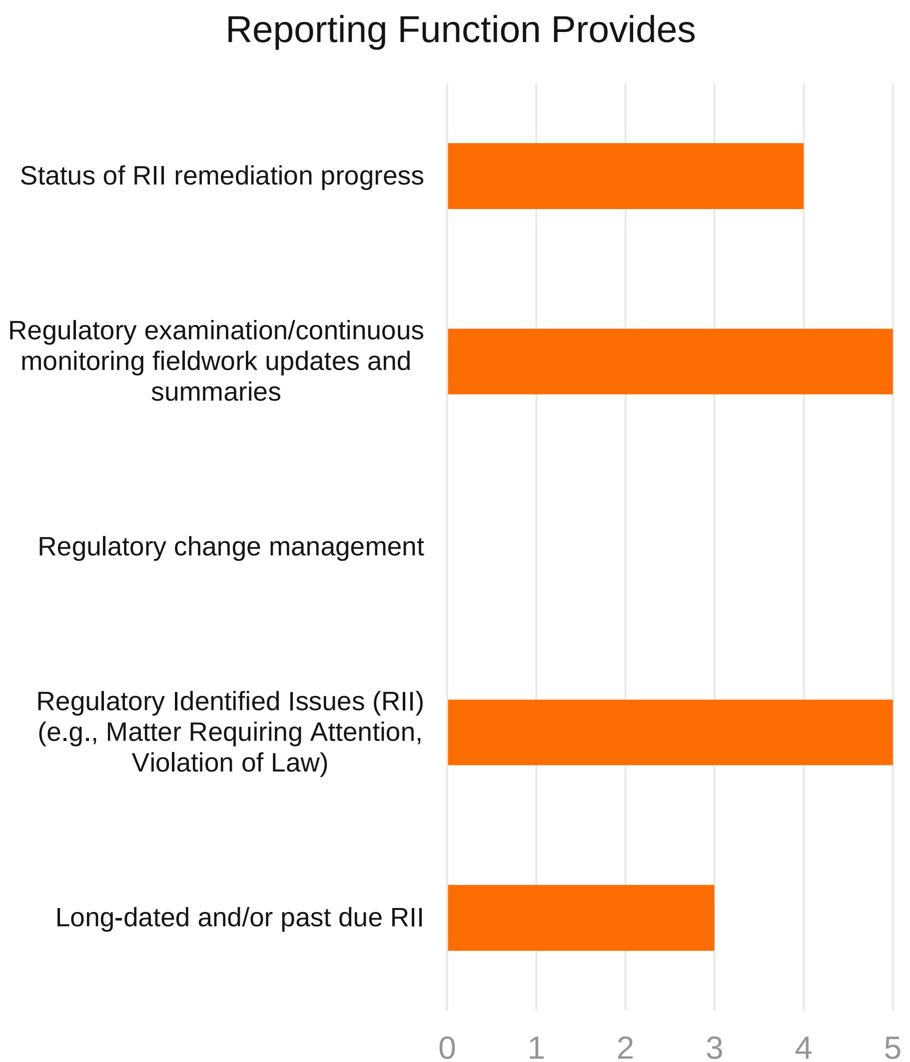
Average training or experience of the regulatory relations team.

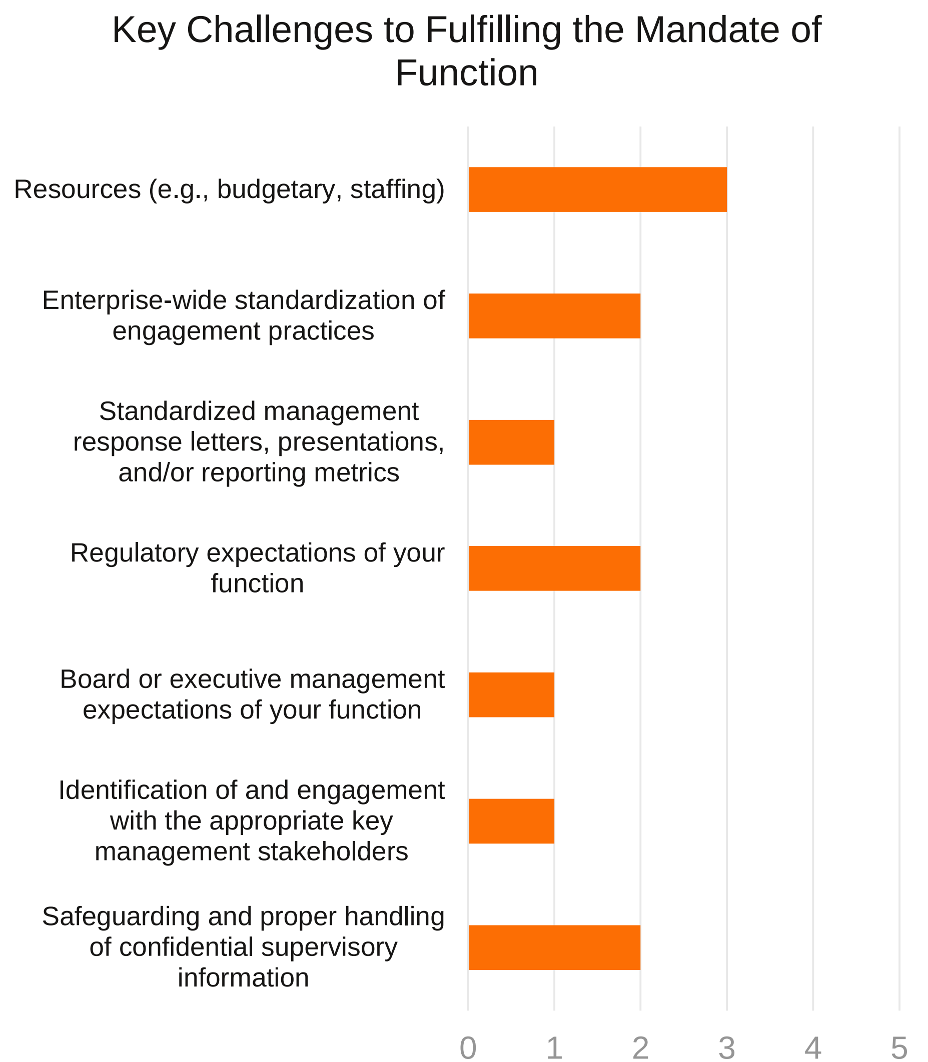
- *"15 years"*
- *"15 years"*
- *"Top 4 have 15-30 years of experience in combination of accounting, audit, risk, legal, and/or capital markets."*
- *"Most of our regulatory relations staff have been hired internally from various business line and staff risk functions, including enterprise risk, finance, and legal. We have had limited success hiring former examiners into these roles due to lack of cultural fit. The tenure in role ranges from 6 months to 9 years. We generally do a fair amount of staff rotation as part of deliberate talent management, so the notion of having someone come into the regulatory relations team and then rotate back into a line of business risk management role is encouraged."*
- *"Team was built from internal transfers from areas such as Internal Audit, Compliance, IT, Finance. They have a range of experience from 5 - 15 years. We have been in existence for 6 years and most of the folks on the team had experience working with Regulators or on exams from prior roles in the company."*

Appendix
Regulatory Relations/Affairs Practices Survey Results

Other: Risk Council

Appendix
Regulatory Relations/Affairs Practices Survey Results





Appendix
Regulatory Relations/Affairs Practices Survey Results

Advantages/Disadvantages to Current Approach

Advantages

- *“Defines accountability for our four primary banking regulators / Strong connectivity with our line of business exam managers / Centralized corporate-level reporting.”*

- *“Broad view of the organization.”*

- *“Small group of experienced SMEs, with the expertise to assist in critical exams as much as 6 - 12 months prior, and attending all meetings to report out on common themes.”*

- *“The advantage of a centralized approach is that my team has a tremendous amount of trust and credibility with internal management, including the highest levels of the executive management (executive committee). A centralized model also facilitates a consolidated view of the regulatory landscape as reported to the Board and EC. A central point of contact also facilitates efficient examination management.*

- *The regulatory agencies love the fact that our function exists. They know they can utilize us to ensure consistency across all exams and regulatory activity. Also, we see all exams and findings so our team is able to advise internal management of themes, trends, issues, etc. across the company.”*

Appendix
Regulatory Relations/Affairs Practices Survey Results

Advantages/Disadvantages to Current Approach

Disadvantages

- *"Less visibility into state regulators. Less visibility into FINRA, SEC, CFTC, NFA“*
- *“Limited resources”*
- *“Regulatory change out of scope - in other areas of the bank.”*
- *"Because the regulatory relations function is NOT the actual business being examined, this central model requires extremely close partnerships with the line of business risk offices to coordinate exam preparation and execution. Fortunately, we have strong partnership models in place with the LOBs and staff functions to execute in this manner. We have traditionally received extremely positive feedback from our examiners on our model. In the last year, however, we were assigned a new EIC from the OCC that prefers direct interaction with the business on substantive matters. This requires the central regulatory relations team to operate with zen-like senses as to its role and place in the process (i.e.., don't answer for the business).“*
- *“We struggle with internal areas (Legal and Compliance) wanting to take over the exam / regulatory ownership. With the interaction with the CFPB being so litigious, our Legal team is pushing to be more involved with non-CFPB exams, thus causing duplication of efforts and frustrations across the company.”*