

WOLF
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THIRD PARTY RISK MANAGEMENT EVOLUTION

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PRESENTER



Stephen King, JD

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Steve is a Principal in Wolf's Risk Advisory Group and serves on the Firm's Regulatory Compliance Team, where he is responsible for coordinating, executing, and overseeing regulatory compliance services for clients. Steve guides clients through the myriad of federal and state banking statutes from an operational and legal perspective. Steve specializes in developing and customizing regulatory compliance performance and reporting structures, customized to the entity's unique characteristics and tailored to its individual risks. He assists with the universal regulatory compliance challenges facing all entities; such as growth, asset size, and transitions; as well as specific challenges such as examinations and BaaS / SaaS relationships from both sides.

Steve joined Wolf in 1996 and has over thirty years of experience as a compliance advisor, facilitator, and resource for financial institutions, fintechs, cryptocurrency entities, mortgage lenders, and investment advisors in compliance matters. He is an avid speaker and regularly travels to events to educate members of financial industry associations throughout the country.

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AGENDA

- ☑ Third Party Relationship Risk Management
- ☑ Life Cycles & Change Management
- ☑ Risk Management Techniques
- ☑ Board / C-Suite Reporting
- ☑ Pitfalls / Best Practices



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THIRD PARTY RELATIONSHIPS



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THIRD PARTY RELATIONSHIPS

- ☉ Types of Third-Party Relationships
 - Outsourced Services
 - Fintechs
 - SaaS vs BaaS (and now LaaS)
 - Referral Arrangements



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THIRD-PARTY RISKS

- Vendor can't fulfill your Bank's needs
- Vendor does not provide services as promised
- Vendor makes performance errors
- Vendor becomes uncooperative
- Vendor violates regulatory requirements
- Vendor security breach / GLBA breach



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EVOLVING RISKS

- ☑ Increased Examiner Scrutiny
- ☑ Economic Uncertainty
- ☑ Cybersecurity Risk
- ☑ Compliance Risk / Legal Risk
- ☑ Talent Management



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POTENTIAL FALLOUT

- Reputation Damage
 - Loss of Customers
 - Legal and Regulatory Consequences
 - Monetary Losses
 - Impact on Future Growth
- Functions** can be outsourced
Responsibility can NOT



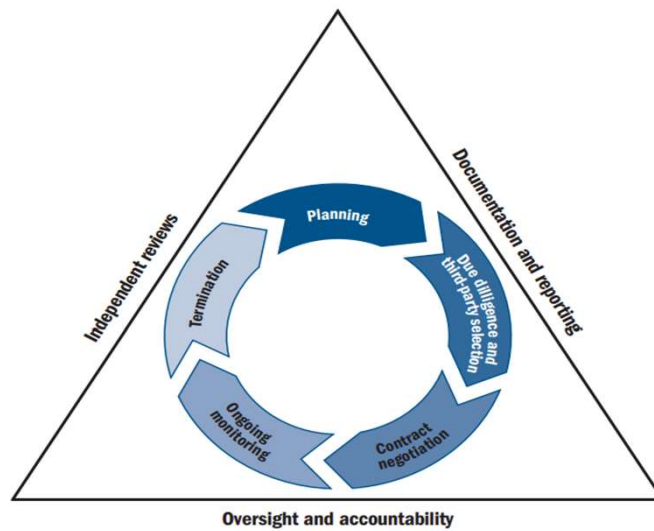
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THIRD PARTY RELATIONSHIP LIFE CYCLE



THIRD PARTY RELATIONSHIP LIFE CYCLE



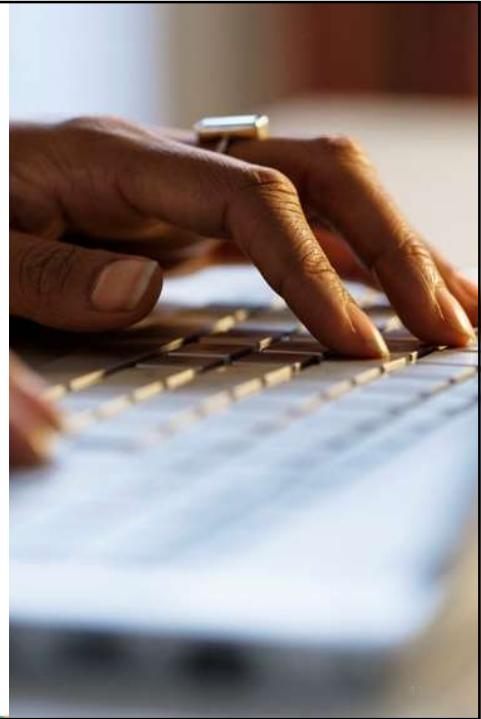
THIRD PARTY RELATIONSHIP LIFE CYCLE

☉ Planning

- Understand Business Purpose of Arrangement
- Align with Strategic Plan, Risk Appetite
- Identify Benefits, Risks, Impacts, Significance
- Perform Risk Assessment
- Establish Formal Approval Process
- Ensure Adequate Oversight Resources



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THIRD PARTY RELATIONSHIP LIFE CYCLE

☉ Due Diligence / 3rd Party Selection

- Align each party's Strategic Plan & Objectives
- Review Due Diligence, including business partners and subcontractors
- Operations, IT, Legal, Finance, Compliance Evaluations
- Maintain expertise to evaluate processes & controls for functionality and oversight
- Customized to criticality and complexity



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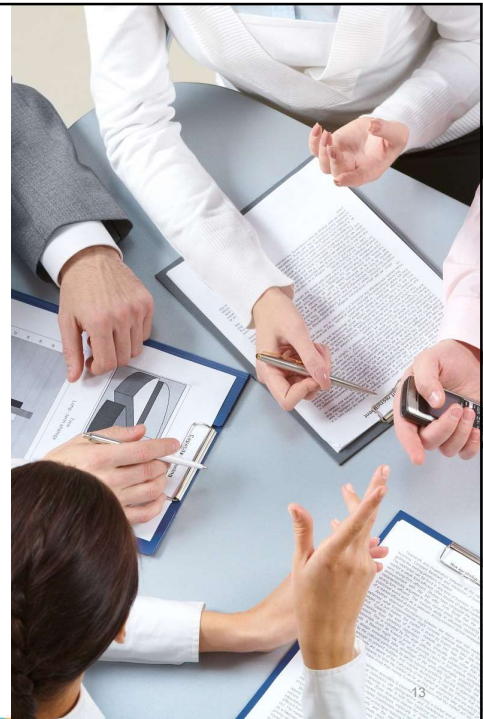
THIRD PARTY RELATIONSHIP LIFE CYCLE

☉ Contract Negotiations

- Define nature and Scope of Arrangement
- Identify Responsibilities, Performance Standards, Defaults & Liabilities
- Require Reporting Functions and Retention
- Right to Audit, Exam Results and Customer Complaints
- Contractual Warranties, Indemnifications
- Dispute Resolution / Termination Standards



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THIRD PARTY RELATIONSHIP LIFE CYCLE

☉ Ongoing Monitoring

- Confirm Control Quality and Performance
- Review Performance and Testing
- Change Management
- Reassess Relationship Against Current Environment, Risk Appetite
- Integration into Bank Processes
- Establish Acceptable Measurements of Success, Risk, Termination (Metrics)



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MONITORING ACTIVITIES

- Review relevant, applicable audit and internal controls reports
- Review regulatory examination reports (as applicable)
- Financial condition
- Review of BCP planning and testing
- Subcontracting reliance and controls/monitoring
- Contract Review
- SLA Review

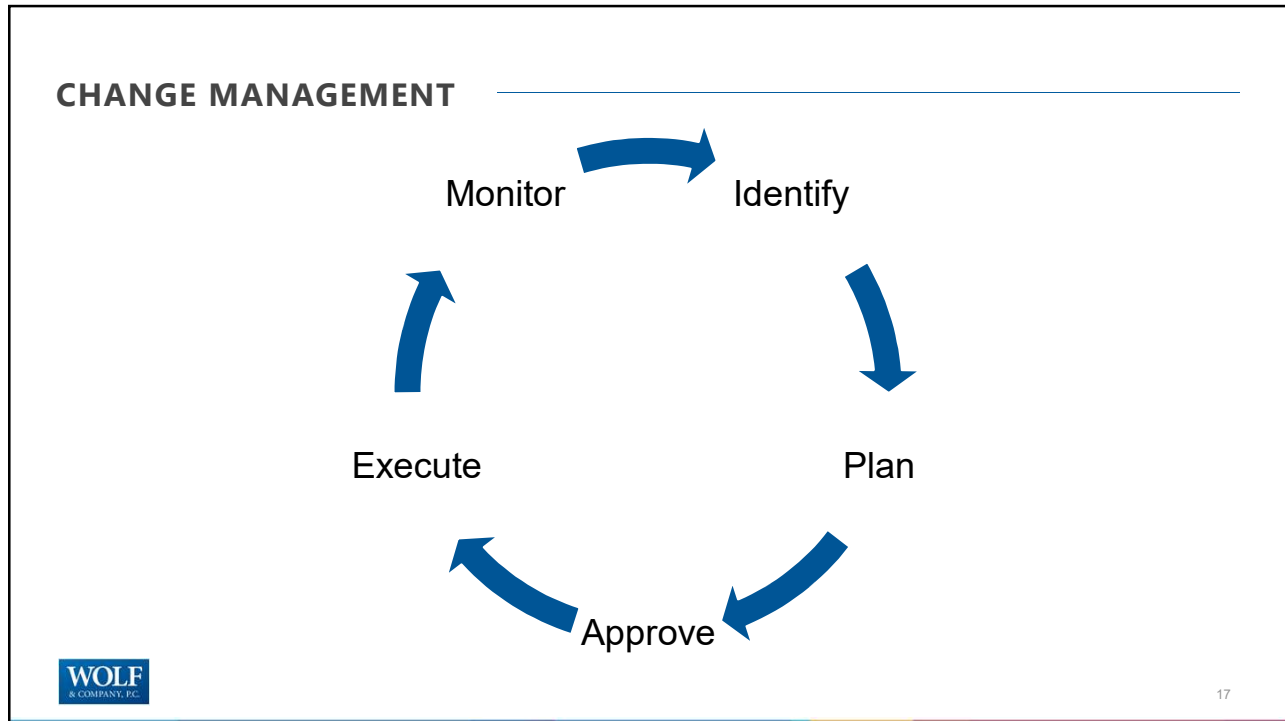
**Ensure corrective (s) are taken, as necessary,
based on the action results of monitoring**



THIRD PARTY RELATIONSHIP LIFE CYCLE

- ☑ Termination
 - Confirm Thresholds, Measurements
 - Establish Remediation, Cure, De-Risk
 - Impact to Exit vs Realign
 - Effective Transition of Services
 - Ongoing Warranties and Risks





CHANGE MANAGEMENT

- ☑ Identification of Material Changes
- ☑ Assess Impact on Bank
- ☑ Coordination of Bank Functions
- ☑ Revision of Bank Processes and Controls
- ☑ Establishment of Measurements
- ☑ Reporting Metrics

```

    graph TD
      Prepare[Prepare for Change] --> Assess[Assess for Change]
      Assess --> Sustaining[Sustaining the Change]
      Sustaining --> Success[Success]
      Sustaining --> Implement[Implement the Change]
      Implement --> Plan[Plan for Change]
      Plan --> Prepare
  
```

The diagram shows a process starting with 'Prepare for Change', moving to 'Assess for Change', then 'Sustaining the Change', which leads to 'Success'. A hand in a suit jacket is pointing towards the 'Assess for Change' and 'Prepare for Change' stages. The central text 'Change Management' is also present.

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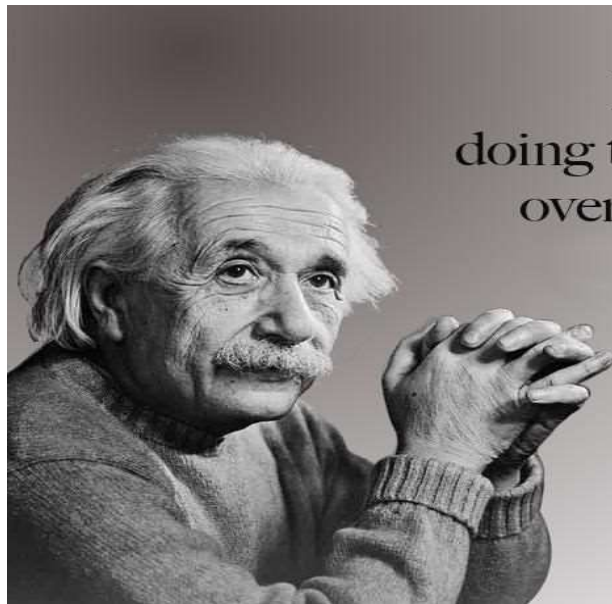
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RISK MANAGEMENT TECHNIQUES



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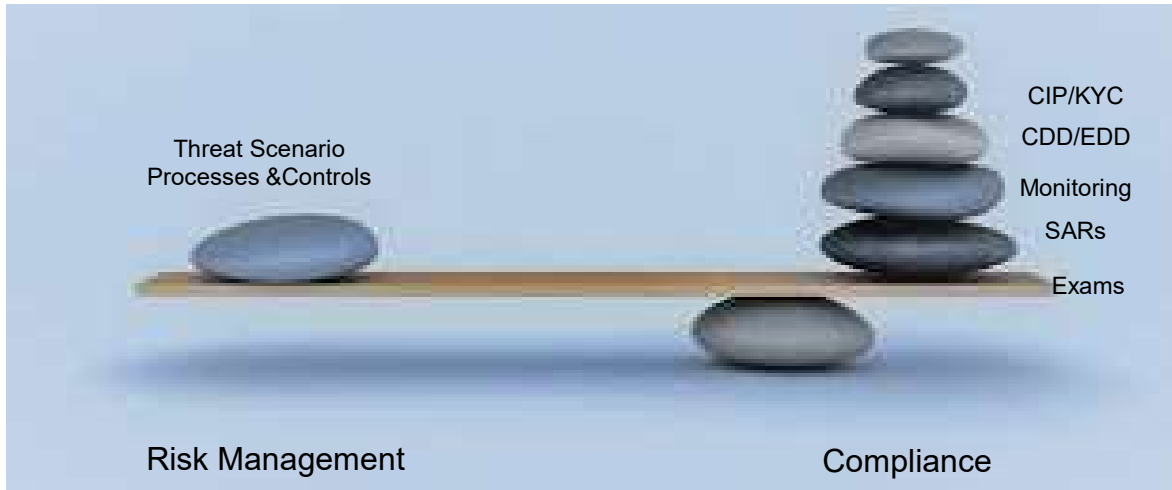
INSANITY:
doing the same thing over and
over again and expecting
different results.

~ Albert Einstein

WWW.SEVENQUOTES.COM



RISK VS. COMPLIANCE



Governance Factors

- Financial Impact (Originate & Maintain)
- Performance Cost/Risks vs Benefits
- Benchmarks for Measuring Performance
- Integration vs Augmentation (Physical & IT)
- Customer Interaction
- Management & Oversight Resources
- Exit Strategy



RISK MANAGEMENT – LAYING THE FOUNDATION

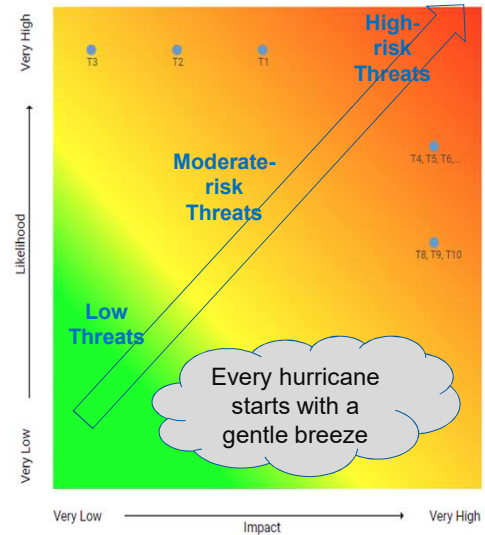
1. SAMPLE THREAT TOPOLOGY FOR SCENARIOS

Dashboard

Product/Service: Functional Risk Area:

Select options Select options

Threat ID	Threat Name	Product/Service	Risk Area
T1	Reputation / Material changes in customer relations and perceptions	Audit Services	Liquidity
T2	Reputation / Material changes in customer relations and perceptions	IT Assurance (RMS)	Liquidity
T3	Reputation / Material changes in customer relations and perceptions	Internal Audit (RMS), WolfPAC (RMS), Compliance ...	Liquidity
T4	Risk to strategic objectives	IT Assurance (RMS), Audit Services, Internal Audit ...	Strategic
T5	Economic environment (Strategic)	Audit Services	Strategic



RISK MANAGEMENT – LAYING THE FOUNDATION

2. RISK APPETITE

The degree of risk that will be acceptable in pursuit of business objectives
 What are the risks we are both Willing and Unwilling to take?

Category	No Appetite	Lesser Appetite	Balanced Appetite	High Appetite
Compliance	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Liquidity	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Strategic	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Int Rate	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Credit	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>



RISK MANAGEMENT – LAYING THE FOUNDATION

2. RISK APPETITE - EXAMPLE

Qualitative Statements

- ☑ We will strive to offer value to our customer while maintaining a viable 3rd party assisted lending program in accordance with the Bank’s policy.
- ☑ We will maintain the quality of the loan portfolio and minimize the losses associated with high-risk loans by establishing parameters to govern the risk thresholds loans to be held in the Institution’s loan portfolio.
- ☑ Automation of loan sourcing and underwriting to reduce loan origination time to less than 3 business days.
- ☑ Automation of loan sourcing and underwriting to reduce delinquency rates to less than X%.
- ☑ Automation of loan sourcing and underwriting to reduce charge-offs to less than X%.



RISK MANAGEMENT – LAYING THE FOUNDATION

2. RISK APPETITE - EXAMPLE

Policy

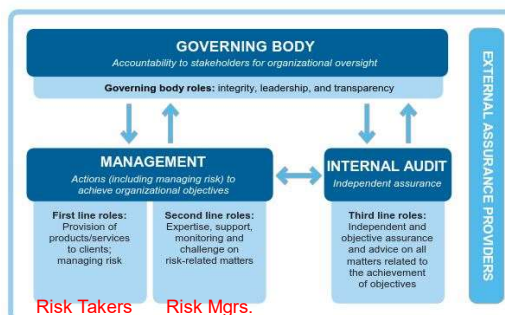


- ERM or Risk Mgmt. Policy:
1. Purpose
 2. People
 3. Committee(s)
 4. Processes
 5. Reporting



Risk Management Framework

The IIA’s Three Lines Model



- ☑ First Line are the “Risk Takers”
- ☑ Second Line are the “Risk Managers”
- ☑ Third Line is Independent Audit

Oversight



- ☑ Direct Board Reporting (tradition of Exec. Session)
- ☑ Required Exec. Mgr. Role (or designated role)
- ☑ Training Resources and Succession Planning

BOARD / C-SUITE REPORTING



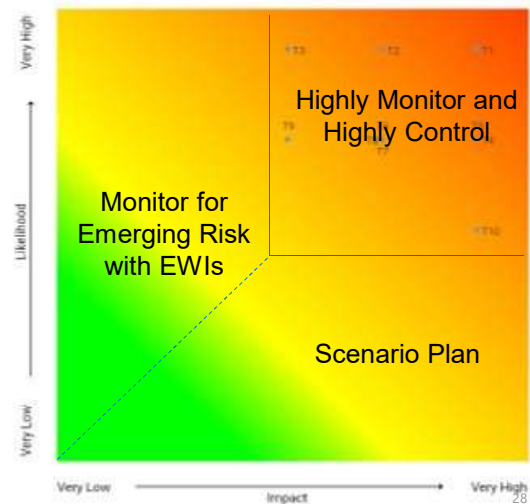
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ADD BOARD RISK SCENARIO DISCUSSIONS

RESULTS FROM: A) HIGH IMPACT LOW LIKELIHOOD THREATS, AND
B) EMERGING RISKS

- ☑ Scenario Planning Techniques
 - Can utilize models and table-top exercises
 - Keep it simple (at first)
 - Assemble the right people
 - Work with the right data
 - Develop comprehensive strategies
 - Refresh scenarios frequently
- ☑ Emerging Risk Monitoring Techniques
 - Top down, By Line of Service, and By Department (engage other people)
 - Report over time, and monitor direction of risk
 - Develop indicators to alert for small changes



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RISK MANAGEMENT – LAYING THE FOUNDATION

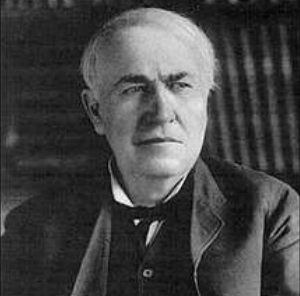
IN SUMMARY – KNOW WHERE YOU ARE, AND WHERE YOU ASPIRE TO BE

- ☉ Compliance Risk Management (“Check-the-box”)
 - “I will do what I am required to keep the regulators happy.”
- ☉ Integrated Risk Management
 - “I wish to break down silos and see threats across the organization.”
- ☉ Strategic Risk Management
 - “RM is a strategic initiative and should provide a competitive advantage.”



PITFALLS / BEST PRACTICES






I have not failed 10,000 times. I have succeeded in proving that those 10,000 ways will not work.

~ Thomas A. Edison

AZ QUOTES



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COMMON PITFALLS

- Risk Assessment missing key components of relationship service risks
- Evaluation of Third Party strengths at weaknesses, but not upon material changes (Personnel, Processes/Controls, Regulatory)
- Not evaluating ongoing performance / reports against metrics
- No identification or evaluation of subcontractors

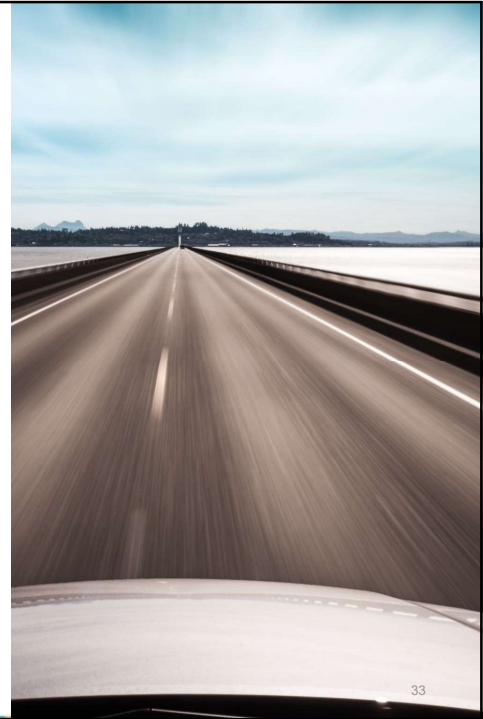


BEST PRACTICES

- ⊙ Understand and evaluate Risk Appetite against specific outsourced service and its unique risks, threats, exposures
- ⊙ Compliance and Risk standards/requirements should **NOT** be reduced for third party service performance
- ⊙ Be proactive in requesting plans for revision regarding regulatory changes impacting deliverable service
- ⊙ Identify and review third party gaps and deficiencies as data points
- ⊙ Establish communication points (changes, customer complaints, reports)
- ⊙ Directly audit them yourself or be involved in selection of independent audit



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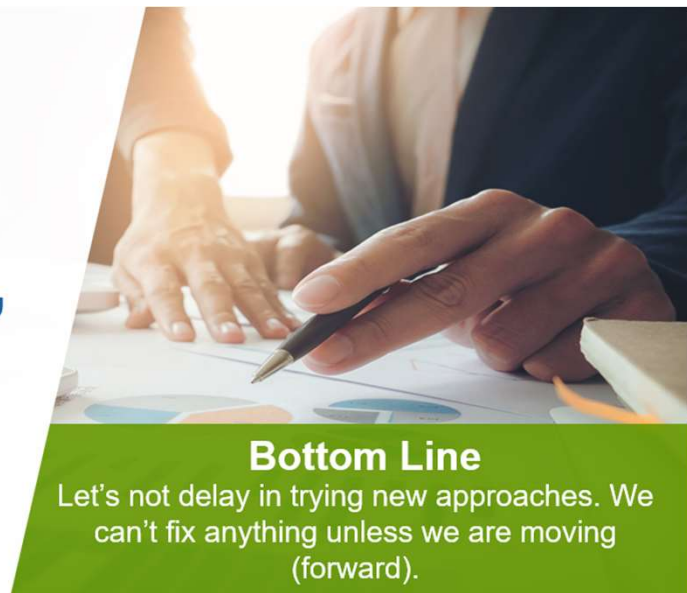


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Final Thought

“ Amateurs built the ark;
professionals built the Titanic. ”

Unknown

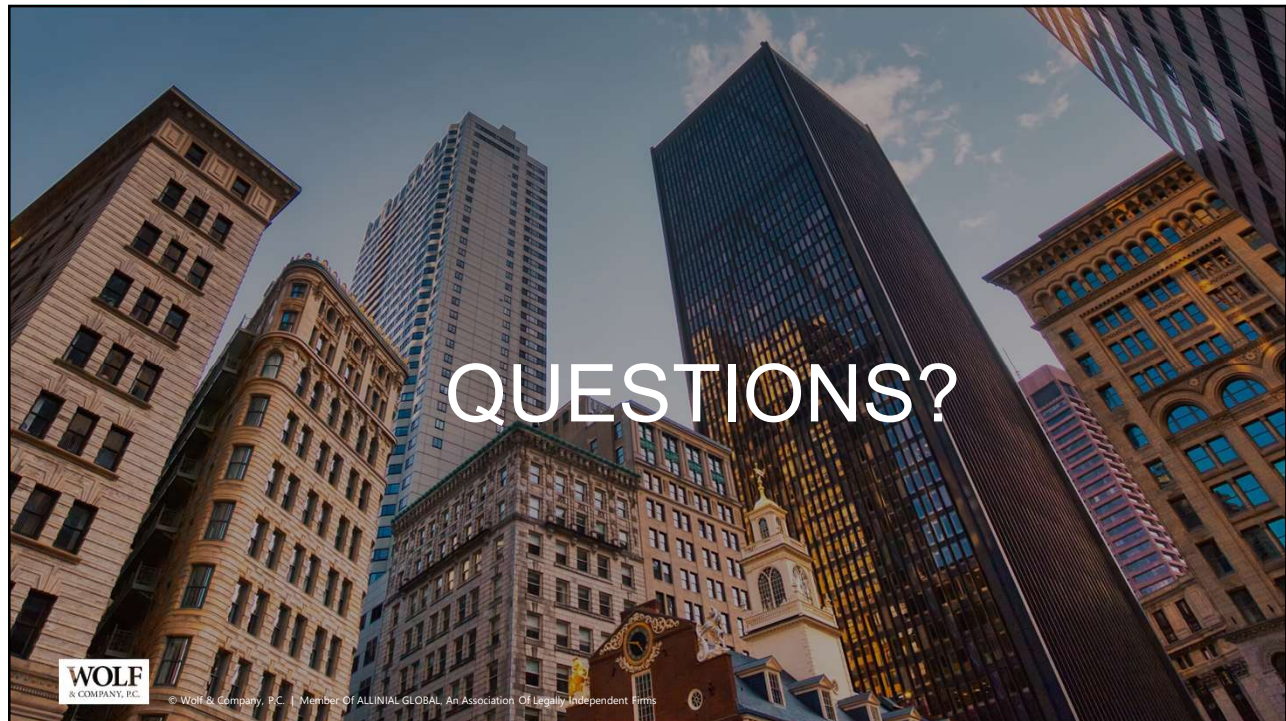


Bottom Line

Let's not delay in trying new approaches. We can't fix anything unless we are moving (forward).



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RESOURCES

Third Party Risk Management: A Guide for Community Banks

<https://www.occ.gov/news-issuances/news-releases/2024/pub-third-party-risk-management-guide-for-community-banks.pdf>

Interagency Guidance on Third-Party Relationships: Risk Management

<https://www.federalregister.gov/documents/2023/06/09/2023-12340/interagency-guidance-on-third-party-relationships-risk-management>

Joint Statement on Banks' Arrangements with Third parties to Deliver Bank Deposit Products and Services

<https://www.occ.treas.gov/news-issuances/news-releases/2024/nr-ja-2024-85a.pdf>

Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks

<https://www.fdic.gov/sites/default/files/2024-03/pr21075a.pdf>

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