

# Recent Lessons in Risk Management



# Four Key Pillars of Risk Management

- Board and senior management oversight
- Policies, procedures, and limits
- Risk monitoring and management information systems
- Internal controls

# Board and Senior Management Oversight

- Establishes strategic direction and risk levels consistent with business objectives, capital, liquidity and other constraints.
- Approves significant policies including those related to managing risk with periodic review of risk exposure limits.
- Remains informed about risks as the business activities change and innovations occur in financial markets and risk management practices.
- Ensures risk management is in place before risk is assumed.

# Board and Senior Management Oversight

## *Red Flags*

- No identification of risk appetite.
- Either lack of strategic planning, or vaguely defined strategic plan without adequate direction.
- Implementation of business strategies without a cohesive risk management framework.
- Misalignment of business strategy with senior management knowledge and acumen.
- Policy-dominant individuals.

# Policies, Procedures and Limits

- Provide for adequate identification, measurement, monitoring, and control of the risks posed by the institution's significant risk-taking activities.
- Consistent with the institution's stated strategy and risk profile.
- Establish accountability and lines of authority across the institution's activities.
- Provide for the review and approval of new business lines, products, and activities, as well as material modifications to existing activities, services, and products.

# Policies, Procedures and Limits

## *Red Flags*

- Incomplete or outdated policies and procedures that do not capture daily implementation of business strategies and limits.
- Missing policies and procedures.
- Bank practices not aligned with policies and procedures.

# Risk Monitoring and Management Information Systems

- Must address all **material risks**.
- Key assumptions, data sources, models, and procedures used in measuring and monitoring risks are appropriate and adequately documented and tested for reliability on an on-going basis.
- Must be appropriate to monitor the complexity of risk taken.
- Must be accurate and provide timely and sufficient information to identify any adverse trends and to evaluate the level of risks faced by the institution in relation to approved policies.

# Risk Monitoring and Management Information Systems

## *Red Flags*

- Concentration exposures and appropriate limits not considered.
- Either lack of or incomplete risk assessments.
- Initial third-party risk due diligence not performed timely or incomplete.
- Inaccurate, untimely and infrequent reporting to the board for material risk areas.



# Internal Controls

- Clear lines of authority for risk management and for monitoring adherence to policies, procedures, and limits. Independence and objectivity.
- Organizational structures reflect actual operating practices and management responsibilities.
- Reports are reliable, accurate, and timely; and material exceptions are noted and promptly investigated or remediated.
- Support compliance with applicable laws, rules, regulations, and supervisory requirements.
- Scope, conclusions and remediation actions of independent reviews, audits and examinations are well documented and receive appropriate attention from the board and senior management.

# Internal Controls

## *Red Flags*

- Management and Staff
  - No adherence to internal controls
  - Absence of internal controls culture
- Audit program
  - Frequency of review not appropriately aligned with risk
  - Lack of independence
  - Reliance on third-parties to monitor and test with no additional oversight

# Guidance

- [SR 23-4 attachment: Interagency Guidance on Third-Party Relationships: Risk Management \(federalreserve.gov\)](#)
- [The Fed - SR 21-3 / CA 21-1 : Supervisory Guidance on Board of Directors' Effectiveness \(federalreserve.gov\)](#)
- [The Fed - Supervisory Letter SR 16-11 on supervisory guidance for assessing risk management at supervised institutions with total consolidated assets less than \\$100 billion -- June 8, 2016 -- Revised February 17, 2021 \(federalreserve.gov\)](#)
- [The Fed - Supervisory Letter SR 11-10 on Interagency Counterparty Credit Risk Management Guidance -- July 5, 2011 \(federalreserve.gov\)](#)
- [FRB: Supervisory Letter SR 99-3 \(SUP\) on supervisory guidance regarding counterparty credit risk management--February 1, 1999 \(federalreserve.gov\)](#)
- [Conducting Due Diligence on Financial Technology Companies - A Guide for Community Banks \(federalreserve.gov\)](#)
- [Federal Reserve Board Publication Community Bank Access to Innovation through Partnerships](#)
- [Material Loss Review of Heartland Tri-State Bank \(federalreserve.gov\)](#)
- [Federal Reserve Board - Agencies issue guide to assist community banks to develop and implement third-party risk management practices](#)

# Questions

