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Summary of Interagency Guidance on Third Party Relationships: Risk Management

The Contents

Source: This summary is a digest of the financial risk requirements outlined in the report on 'Interagency Guidance' issued jointly on June 6, 2023, by The Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), Treasury. Specific pages where you can find full details of the guidance are referenced throughout this summary. You can access the publication in full vial the link below.

Publication: Interagency Guidance on Third-Party Relationships: Risk Management

Financial Conditions Oversight Requirements

The Interagency Guidance establishes the expectation for banking organizations of all sizes to effectively manage risks related to their third party relationships, with great scrutiny required when related to critical third parties. It covers key aspects throughout the entire life cycle of third party relationships and identifies oversight of financial condition as an important factor in bank risk management.

Key Takeaways from the Interagency Guidance

Financial Condition of Critical Third Parties
Financial condition of critical third parties is listed prominently as an important risk that banks are expected to manage.

Adopt Appropriate Risk Management Processes
Banks must identify a list of critical third parties and adopt appropriate risk management processes to mitigate risk of disruption.

Ongoing Oversight of Financial Condition
Financial oversight should be ongoing, it should occur at initial due diligence for critical third parties and during ongoing monitoring.

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RapidRatings is equipped to assist your bank in aligning with the guidance provided by the US bank regulatory agencies.

Our third party risk management solution is designed to accurately measure and manage risk and can be integrated into your processes and systems.

We provide ongoing financial risk management solutions, which meets regulatory requirements, to the top US banks.

1. Who the Guidance is for

Key Takeaway
This guidance covers all banks and helps them protect against substantial loss and disruption.

Identify, Assess, Monitor and Control
"A banking organization can be exposed to adverse impacts, including substantial financial loss and operational disruption, if it fails to appropriately manage the risks associated with third party relationships. Therefore, it is important for a banking organization to identify, assess, monitor, and control risks related to third party relationships."
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OCC clarifies that "Banks" refers collectively to national banks, federal savings associations, covered savings associations, and federal branches and agencies of foreign banking organizations.

2. Prominence of Financial Condition

Key Takeaway
Financial condition is the top referenced risk following the obvious requirements for strategic fit and legal compliance.

Financial condition is a foundational risk element which reflects likely performance across the broader range of operational risk areas. The guidance lists financial condition immediately following strategic fit/effectiveness and legal compliance in both Due Diligence and Ongoing Monitoring.

Banks need to ask:

"Does the company fit my strategic goals, is my partnership compliant and legal, and does the third party have the financial capability to meet my needs?"

Financial Condition	
Due Diligence **Pages 36-45**	**Ongoing Monitoring** **Pages 57-61**
Strategies and goals	Changes to the third party's business strategy.
Legal and regulatory compliance	The third party's ongoing compliance with applicable laws and regulations.
Financial condition	**Changes in the third party's financial condition.**
Business experience	Training provided to employees.
Qualifications and backgrounds of key personnel and other human resources	Changes in the third party's key personnel.
Risk management	The overall effectiveness of the third party relationship.
Information security	The third party's ability to maintain info security.
Management of information systems	
Operational resilience	The third party's response to incidents, business continuity and resumption plans.
Incident reporting and management processes	
Physical security	
Reliance on subcontractors	The third party's reliance on and exposure to and use of subcontractors.
Insurance coverage	Changes to or lapses in insurance coverage.
Contractual arrangements with other parties	The volume, nature and trends of customer inquiries and complaints.

3. Financial Statement Analysis

Financial Statement Analysis is Critical

An assessment of a third party's financial condition through review of available financial information, including audited financial statements, annual reports, and filings with the U.S. Securities and Exchange Commission (SEC), among others, helps a banking organization evaluate whether the third party has the financial capability and stability to perform the activity.
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Key Takeaway
Oversight of financial condition requires the analysis of financial statements.

Significance of financial statement analysis

Financial statement analysis allows banks to identify third parties which present a disruption risk due to their incapacity to deliver the agreed services at the required quality. Additionally, the guidance explicitly states that contracts can specify access to relevant risk information, which "may include performance reports, financial reports, security reports, and control assessments."
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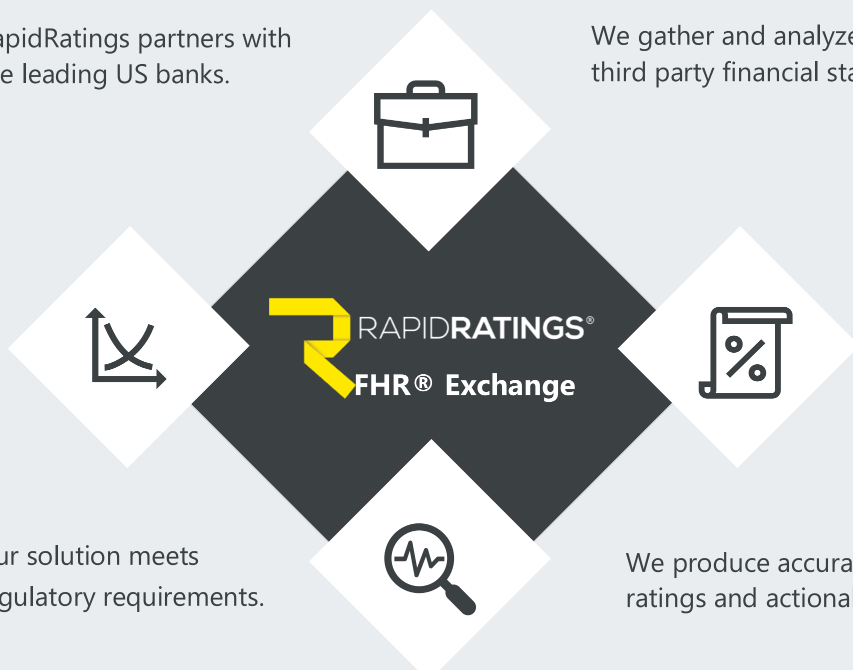
RapidRatings partners with the leading US banks.

We gather and analyze their third party financial statements.



Our solution meets regulatory requirements.

We produce accurate risk ratings and actionable reports.

4. Critical Third Parties

Key Takeaway
All banks have critical third parties and require comprehensive oversight of their ongoing financial condition.

The guidance recognizes, repeatedly, that *"Not all relationships present the same level of risk, and therefore not all relationships require the same level or type of oversight or risk management"*.
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However, higher levels of scrutiny are warranted and expected for critical third parties.

Risk Management & Documentation and Reporting

Risk Management

As part of sound risk management, banking organizations engage in more comprehensive and rigorous oversight and management of third party relationships that support higher-risk activities, including critical activities. Characteristics of critical activities may include those activities that could:

- Cause a banking organization to face significant risk if the third party fails to meet expectations.
- Have significant customer impacts; or
- Have a significant impact on a banking organization's financial condition or operations.

It is up to each banking organization to identify its critical activities and third party relationships that support these critical activities.
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Documentation and Reporting

A current inventory of all third party relationships (and, as appropriate to the risk presented, related subcontractors) that clearly identifies those relationships associated with higher-risk activities, including critical activities.
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A RapidRatings report listing critical third parties segmented by financial condition risk is a meaningful first step towards robust risk management and frequency included in regulatory documentation.

5. Managing Risk Across the Life Cycle

The level of due diligence during vendor selection should be commensurate with the significance of the third party relationship. *"More comprehensive due diligence is particularly important when a third party supports higher-risk activities, including critical activities."*
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It is inconceivable that due diligence for a critical third party could be considered comprehensive without the bank reviewing financial statements.

Key Takeaway
Financial condition oversight is required in up front due diligence and on an ongoing basis.

Ongoing Monitoring

Ongoing monitoring enables a banking organization to:

1. Confirm the quality and sustainability of a third party's controls and ability to meet contractual obligations.
2. Escalate significant issues or concerns, such as material or repeat audit findings, deterioration in financial condition, security breaches, data loss, service interruptions, compliance lapses, or other indicators of increased risk.
3. Respond to such significant issues or concerns when identified.

Effective third party risk management includes ongoing monitoring throughout the duration of a third party relationship, commensurate with the level of risk and complexity of the relationship and the activity performed by the third party. Ongoing monitoring may be conducted on a periodic or continuous basis, and more comprehensive or frequent monitoring is appropriate when a third party relationship supports higher-risk activities, including critical activities.
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How we help financial institutions

RapidRatings partners with banks and financial institutions to enable them to:

- Assess and manage third party or vendor risk.
- Create a resilient third party ecosystem.
- Achieve regulatory compliance around third party risk.

What we do

RapidRatings provide third party financial health assessments which are:

- Based on their financial statements.
- Accurate and detailed foundations for decisions.
- Clear indicators of their potential to disrupt your operations.
- Accepted as meeting regulatory compliance standards.

Can we help you?

If you are interested in discussing your third party risk or regulatory compliance requirements with **RapidRatings** please email solutions@rapidratings.com indicating your availability to connect and discuss your needs.

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