

THE EMERGING IMPORTANCE OF OPERATIONAL RISK MANAGEMENT ©

Ellen McCarthy, CEO & Founder
Sustainable Compliance Strategies, LLC™



TOPICS

- ❖ The Regulatory Landscape for Risk
- ❖ Categories of Operational Risk
- ❖ Operational Risk Event Reporting
- ❖ The Three Lines of Defense
- ❖ Reporting to and Challenges by Executive Management and the Board



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THE REGULATORY LANDSCAPE FOR RISK

- ❖ Focus on Risk Culture
 - ❑ SEC Examination Priorities
 - ❑ FINRA Examination Priorities
 - ❑ Federal Bank Regulators
 - ❑ State Regulators, e.g. NYDFS Risk Culture
 - ❑ OSFI (Canada) Operational Risk Reviews



THE REGULATORY LANDSCAPE FOR RISK

- ❖ SEC Examination Priorities 2017
 - Investment Advisers, Investment Companies, Broker-Dealers, Transfer Agents, Clearing Agencies, Private Fund Advisers, National Securities Exchanges, Municipal Advisors
 - Assessment of Market-wide Risks, e.g.
 - Redemption Risks in Money Market Funds
 - Enterprise Risk Management, including whether Regulation Systems Compliance and Integrity (SCI) programs cover appropriate business units/infrastructure
 - Cybersecurity
 - Anti-Money Laundering (AML)

THE REGULATORY LANDSCAPE FOR RISK

- ❖ FINRA Examination Priorities 2017
 - Considering Firm's:
 - Business Model,
 - Size and Complexity of Operations,
 - Nature and Extent of Activities
 - Cybersecurity
 - Supervisory Controls Testing
 - Transaction Processing: Segregation/Reg SHO
 - AML/Suspicious Activity Monitoring
 - Fraud (e.g. Microcap)
 - Municipal Advisor Registration

THE REGULATORY LANDSCAPE FOR RISK

❖ Federal Bank Regulators

□ Board of Governors of the Federal Reserve System

- Information Technology/Security Risk
- Outsourcing Risk
- Business Continuity/Disaster Recovery Risk
- Pandemic Preparedness
- Environmental Liability
- Fraud – e.g. Unlawful Internet Gambling, Elevated Risk Complex Structured Finance Activities

THE REGULATORY LANDSCAPE FOR RISK

❖ State Regulators

- ❑ e.g. New York State Department of Financial Services (NYDFS) Risk Culture
- ❑ “Culture of Compliance in the Age of Risk” (December 2016/January 2017 Consent Orders)
- ❑ Cybersecurity
- ❑ AML
- ❑ Transaction Monitoring
- ❑ Corporate Governance: Avoidance of Commingled Compliance and Operational Responsibilities

THE REGULATORY LANDSCAPE FOR RISK

- ❖ Office of the Superintendent of Financial Institutions Canada (OSFI) Operational Risk Reviews
 - Guideline E-21
 - Appropriate to the Financial Institution's Size, Nature, Scope and Complexity of Operations, Corporate Strategy, and Risk Profile
 - Operational Risk Management Framework
 - Operational Risk Appetite Statement
 - Three Lines of Defense
 - Identification and Assessment of Operational Risk

CATEGORIES OF RISK

- ❖ Financial Risk
 - The risk of economic loss.
- ❖ Operational Risk (Non-Financial Risk)
 - The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.



SUB-CATEGORIES OF FINANCIAL RISK

- ❖ Credit Risk
 - ❑ Receivables Risk
 - ❑ Concentration Risk
 - ❑ Investment Loss Risk

- ❖ Market Risk
 - ❑ Liquidity and Funding Risk
 - ❑ Balance Sheet Risk
 - ❑ Foreign Exchange Risk



SUB-CATEGORIES OF OPERATIONAL RISK

- ❖ Operations Risk
 - ❑ Outsourcing Risk
 - ❑ Fraud Risk
 - ❑ Transaction Processing Risk
 - ❑ Physical Security Risk
 - ❑ Data/Information Security Risk
 - ❑ Operations Control Risk
 - ❑ Technology/Systems Risk



SUB-CATEGORIES OF OPERATIONAL RISK

- ❖ Business Event Risk
 - ❑ Disaster/Business Continuity Risk
 - ❑ Human Resources Risk
 - ❑ Financial Reporting Risk
 - ❑ Geopolitical Risk
 - ❑ Environmental Risk



SUB-CATEGORIES OF OPERATIONAL RISK

- ❖ Legal and Regulatory Risk
 - ❑ Legal Risk
 - ❑ Regulatory and Compliance Risk
 - ❑ Fiduciary Risk
 - ❑ Money Laundering Risk
 - ❑ Taxation Risk



SUB-CATEGORIES OF OPERATIONAL RISK

- ❖ Reputation Risk – inherent in all activities.
- ❖ Strategic Risk
- ❖ Other Operational Risk, e.g.:
 - ❑ Industry and Marketplace Risk
 - ❑ Catastrophic Loss of Customer Risk

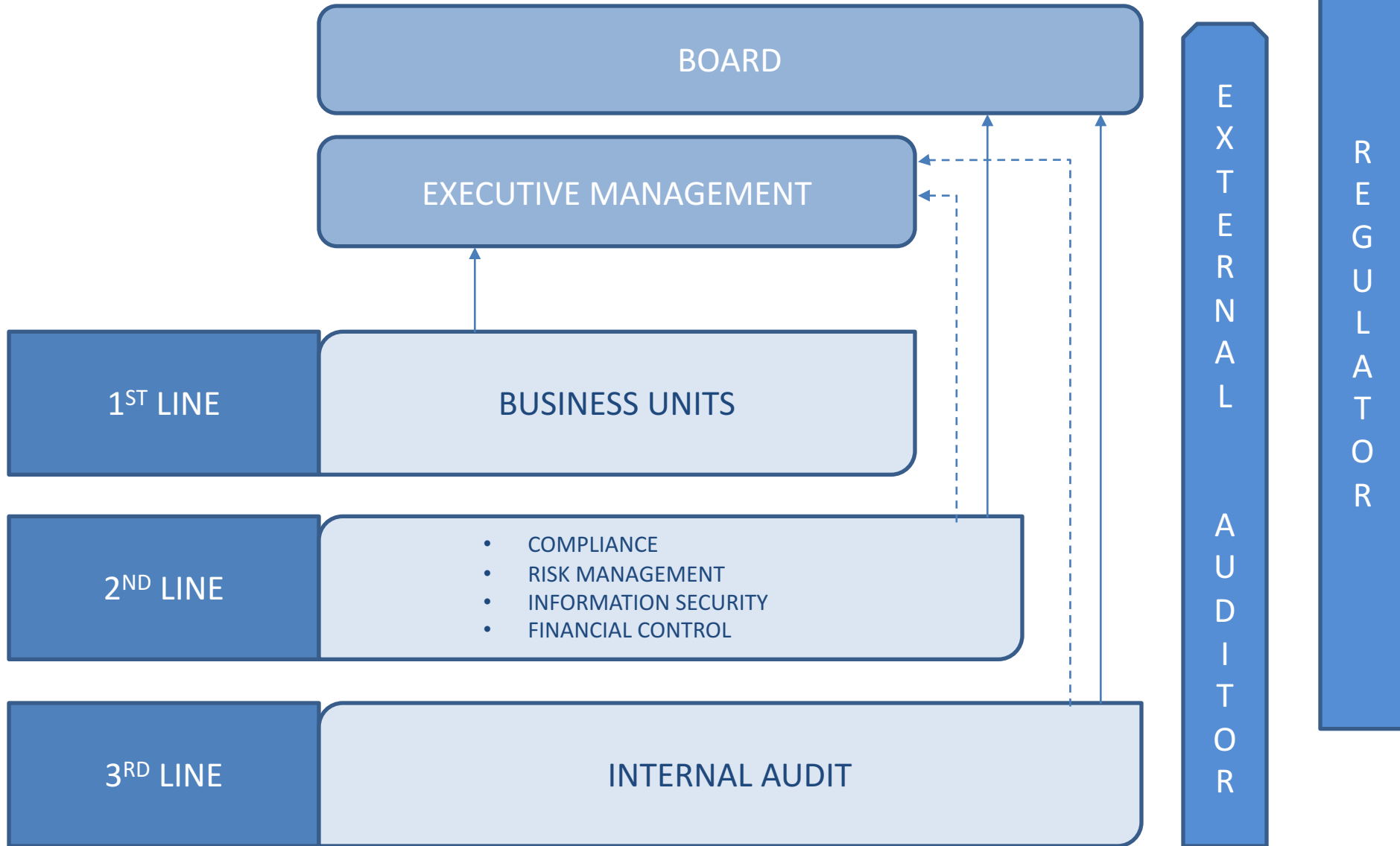


OPERATIONAL RISK EVENT REPORTING

- ❖ Incident Management and Operational Risk Event Reporting
 - ❑ Protocols to ensure that inadequate or failed internal processes, human errors, system failures or deficiencies or external events that result in direct or indirect gains or losses are appropriately reported to management and the board.



THE THREE LINES OF DEFENSE



REPORTING TO AND CHALLENGES BY EXECUTIVE MANAGEMENT AND THE BOARD



- ❖ Independent Challenge
- ❖ Frequent Reviews and Updates
- ❖ Tied to Organization's Key Strategic Elements as they Emerge and Evolve

Any Questions?

What

How

Where

Why

When

Who

CONTACT US

- PHONE
- EMAIL
- WEBSITE



Sustainable Compliance Strategies, LLC™

917-608-8020

emccarthy@strategiccompliance.com



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