

## ATLANTIC TRUST

PRIVATE WEALTH MANAGEMENT



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### **Operational Risk Management: New Products and Offerings**

**Presented by:**

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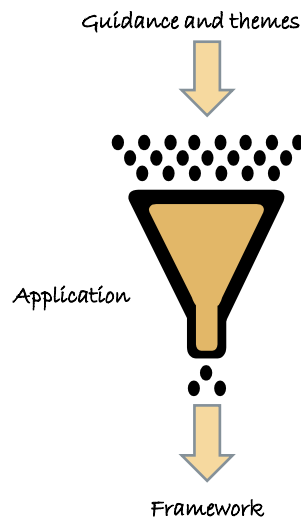
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## Operational Risk Management: New Products and Offerings

- Introduction
- Regulatory guidance and themes
- Oversight and governance
- Framework
- Ongoing monitoring and assessment
- Summary
- Common practices - discussion
- Q&A



## Operational Risk Management: New Products and Offerings

### ■ Introduction

- New products and offerings are necessary for growth, maintaining a competitive edge and responding to customer needs
- Risks associated with new product offerings should be managed, so that while creating value for our clients and growth for our organizations, unnecessary risks may be avoided or mitigated

### – Risks

Operational / Transactional	Reputational	Compliance	Strategic	Credit
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### – Risk Management

- Clients expect it
- Regulators require it
- Today's business environment demands it

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## Operational Risk Management: New Products and Offerings

### ■ Regulatory guidance and themes

- **Office of the Comptroller of the Currency (OCC)**
  - Bulletin 2004-20 – Risk Management Process
- **NASD**
  - Notice to Members (NTM) April 2005
- **Security and Exchange Commission (SEC)**
  - Conflicts of Interest and Risk Governance – October 2012 (Speech Details)
- **Office of the Comptroller of the Currency (OCC)**
  - Heightened Standards ("Heightened Expectations") January 2014

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## Regulatory Guidance

### ■ OCC Bulletin 2004-20 – Risk Management Process

- Applies to:
  - Traditional and non-traditional bank products and services
  - Modifications to existing products and services that significantly alter the underlying risk characteristics of the product or service
- Up-front analysis necessary: risk v. return; consistency with strategic direction, approval
- Effective Risk Management process includes:
  - Due diligence
    - Assess risks, involve stakeholders, new legal and regulatory requirements, required expertise, 3<sup>rd</sup> party oversight, financial plan and impact, exit strategies
  - Controls and processes to measure, monitor and control risks
    - Review and expand current controls, formal approval processes, policies and procedures, accountability, MIS, audit and compliance oversight
  - Performance monitoring and review systems
    - Centralized tracking and oversight, monitoring risk limits, KRIs, actual v. projected results, benchmarks, triggers
- Post-product launch analysis

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## Regulatory Guidance

### ■ OCC Bulletin 2004-20 – Risk Management Process (continued)

- Risk Management of Third Parties (see OCC Bulletin 2013-29)
    - Offerings acquired from 3<sup>rd</sup> parties, “turn-key” arrangements, due diligence
  - Associated Risks
    - Strategic Risk
    - Reputation Risk
    - Credit Risk
    - Transaction Risk
    - Compliance Risk
  - Supervisory Monitoring
- Also, see **Comptroller’s Handbook, Asset Management**, Unique and Hard-to-Value Assets, 8/12

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## Regulatory Guidance

### ■ NASD Notice to Members (NTM) April 2005

- Conflicts and suitability
- Written procedures for vetting new products
  - Definitional: What is a new product? Is it a material modification?
  - New class of investors? What are the investment objectives?
  - Are there material modifications to existing products?
  - Are operational or system changes required?
  - New customer base or geographic region?
  - Changes to sales practices?
  - Conflicts?



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## Regulatory Themes

### ■ Securities and Exchange Commission

- Conflicts of Interest and Risk Governance – October 2012  
*(Details of speech by Carlo V. di Florio, [then] Director, Office of Compliance Inspections and Examinations)*
  - Interest in conflicts of interest
    - Compensation-related
    - Incentives
    - Portfolio management / suitability
    - Affiliations
    - Valuation
    - Other conflicts
  - Federal securities laws
  - Standards and procedures
  - Oversight
  - Leadership consistent with effective ethics and compliance programs
  - Education and training
  - Auditing and monitoring
  - Incentives and discipline
  - Response and prevention

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## Regulatory Guidance

- **OCC Heightened Standards (“Heightened Expectations”) January 2014**
  - Minimum standards for the design and implementation of a risk governance framework
  - Generally, apply to large banks (total consolidated assets of \$50 billion or more), however, OCC reserves authority for application to smaller banks, based on complexity
  - Observation: Good business practices
    - Increased board oversight, challenge when appropriate
    - Risk Governance Framework
      - Roles and responsibilities
        - » Three lines of defense
          - 1<sup>st</sup> Line – Front line / line of business
          - 2<sup>nd</sup> Line – Risk, Control and Compliance
          - 3<sup>rd</sup> Line – Internal Audit
      - Risk Appetite
      - Concentrations
      - Risk data aggregation and reporting
      - Compensation and performance management programs
      - Three Year Strategic Plan
    - Board of Directors – oversight role

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## What is the trend of the regulatory landscape?

- **“Tone at the Top”** and accountability
- Written procedures and effective controls are required for new products and offerings
- Implement an appropriate framework
- Cross-functional participation in the review, approval and ongoing oversight
- Risk identification and limits
- Avoiding conflicts
- Suitability
- Awareness of and compliance with laws and regulations
- Expertise, training and oversight
- Unique assets
- Valuations
- MIS: Data aggregation and reporting
- Third party / vendor management
- Board oversight

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## Operational Risk Management: New Products and Offerings

### ■ Oversight and governance

- Tone from the Top
  - What is a “new” offering? Consider modifications to existing offerings, as well.
  - What is the motivation?
  - Is the new product or offering consistent with business plans and organizational key strengths?
  - Who is accountable?
  - What defines success?
- Processes and Controls
  - Cross-functional committee structure for review and approval of new products and offerings
  - Senior and business management level participation; legal, compliance and risk approval
  - Process **must** be followed; communication is **critical**
- Institute a Framework
  - Evaluation and approval
  - Pre-launch
  - Go / no-go criteria
  - Launch
  - Post launch review, trouble shooting
  - Ongoing monitoring; client complaints

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## Operational Risk Management: New Products and Offerings

### ■ Framework

- Evaluation and Approval – Policies and procedures for new products and services
  - Assessment, questionnaire, survey of new product or offering
    - Who is the sponsor or owner of the proposed product or offering?
    - What is being proposed?
    - Why is this product or offering being proposed?
    - Who will benefit from it? Who will support it? Who are our competitors?
    - What expertise is required? Is that expertise already available?
    - What are the training requirements?
    - Where will this offering be located? Are multiple currencies involved or cross-border activity?
    - When is the proposed launch date?
    - What costs are involved? How will we price it? How will we support it? Who will monitor it?
    - Due diligence
    - **What are the risks?**



Bus Interruption	Financial / Rptg	Info Sec	Legal/Tax/ Regulatory	Tech / Transaction
Reputational	People	Privacy	Theft / Fraud	Model

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## Operational Risk Management: New Products and Offerings

### ■ Framework (continued)

- Evaluation and Approval – Policies and procedures for new products and services (continued)
  - Committee should review and provide an effective challenge to the Assessment / Survey
    - Are expectations reasonable?
    - Is the offering overly complex? Are there transparency concerns?
    - What are the assumptions being used?
    - What are the measures for success?
    - What are the costs for launching the product or offering?
    - What are the qualifications of business leads to support the product or offering?
    - Is 3<sup>rd</sup> party support necessary?
    - Will it be profitable? What are compensation structures?
    - Is there a measurable demand for the product or offering?
    - Are there new legal or regulatory requirements?
    - Are disclosures required?
    - What are the risks involved (for customers and firm) and how will we mitigate them?
  - Formal, documented approval
    - Cross-functional sign-off



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## Operational Risk Management: New Products and Offerings

### – Framework (continued)

- Pre-launch
  - Scheduled meetings / review
  - Establish and monitor milestones
  - Monitor and determine cause for delays
- Go / no-go criteria
  - Cross-functional sign-off
- Launch
  - Action plans, monitoring, testing
- Post-launch review, trouble shooting
  - Test scripts, funding levels
- Ongoing monitoring and assessment



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## Operational Risk Management: New Products and Offerings

- Ongoing monitoring and assessment

- Cross-functional participation
- Performance monitoring
- Client complaints
- Communication
- Funding levels
- Periodic assessments of the effectiveness of policies, procedures and controls
- Reassess training needs
- Reassess framework




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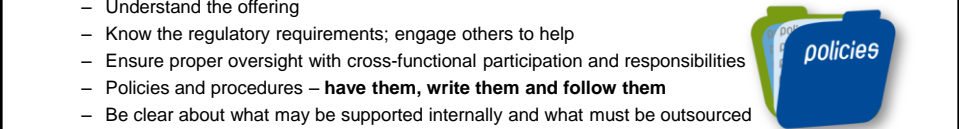
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## Operational Risk Management: New Products and Offerings

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- **Summary**
    - Avoid the pitfalls
    - ASK QUESTIONS
    - Understand the offering
    - Know the regulatory requirements; engage others to help
    - Ensure proper oversight with cross-functional participation and responsibilities
    - Policies and procedures – **have them, write them and follow them**
    - Be clear about what may be supported internally and what must be outsourced
    - Be mindful of pricing and compensation; avoid conflicts
    - Benchmark where possible
    - Evaluate service providers and have a backup plan
    - Set a timeline for assessing the success of a new product or offering
    - Ongoing monitoring and assessment
    - Terminating an existing product or offering can be as important as launching a new one
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## Operational Risk Management: New Products and Offerings

- Examples
- Common Practices - discussion
- Q&A

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