

Today's Risk Management Challenges for Wealth Management: The Need for Multi-Dimensional Risk Assessment and Risk Management

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Bank regulators are applying heightened standards for risk management across all lines of business – wealth management is no exception

Sources of Heightened Regulatory Expectations

OCC: Heightened standards

Fed: Enhanced Prudential Standards

CFPB: Intensified focus on customer interests

Multi-agency attention to “culture” and how it impacts risk management

Understanding how these expectations can affect the wealth management business – and how to meet them – requires a **multi-dimensional risk assessment and risk management approach**

The building blocks of this approach are described in the slides that follow; areas of emphasis for implementation will vary depending on the size, complexity, and size of the particular business of a firm

Identify and dimension the risks associated with the firm's wealth management business

Risk identification and dimension process

Risk
Identification

Roles of the
3LOD

Risk Appetite
Alignment

Risk Data

Culture

Lines of
Business

Product or
Customer
Relationship
Life Cycle

Types of Risks

What are the **lines of business** (“LOBs”) within wealth management?

Within each LOB, what are the **stages of the life cycle of the product or customer relationship**?

At each stage, what **types of risks** arise?

Credit

Liquidity

Market

Compliance

Legal

Operational

Reputation

Strategic

With respect to Compliance/Legal risk, have applicable standards been mapped to the relevant stages of the customer relationship?

Customer relationship lifecycle

Reg R

Reg 9

State trust and estate law

Apply the “Three Lines of Defense” perspective to each of those risks

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1st Line
Business Line

2nd Line
Independent Risk Management

3rd Line
Internal Audit

Mapping of risk management activities relative to risk areas within each LOB

- ❖ For each LOB, what are the activities of the 1st line (business line); 2nd line (independent risk management); and 3rd line (internal audit) relative to each of the risk areas relevant to the LOB, to monitor, manage, and control those risks?
- ❖ Specifically, who is accountable in the 1st line and 2nd line?

Identifying functions that are missing, misplaced, or duplicated

- ❖ Are risk functions missing from the 1st line? 2nd line?
- ❖ Is the 2nd line performing a 1st line role?
- ❖ Are the same functions being performed in two places? Does this present **opportunities for efficiencies** without compromising sound risk management?

Verify that the risks being undertaken are consistent with a risk framework and risk tolerances for conducting the business endorsed by the board of directors

Risk Identification

Roles of 3LOD

Risk Appetite Alignment

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- ❖ Is there a **risk appetite statement** applicable to the wealth management business?
- ❖ Does the risk appetite statement contain **qualitative goals and quantitative tolerances** with respect to the types of risk that arise in the business?

Examples

Risk Type	Issue	Potential Metric/KRI
Operational	Vendor failure to perform	Service-Level Agreements monitoring results
Operational	Transaction processing errors	% of manual systems used for transaction processing
Compliance	Non-compliance with laws and regulations	Timely completion of Reg reviews
Reputation	Complaints regarding poor service quality	Complaints reported and trends
Reputation	Poor investment performance	Investment performance trends relative to other comparable investments
Reputation	Conflicts of interest	% of fiduciary assets invested in proprietary funds
Strategic	Unpredicted business trends	% variance (+ or -) from plan

Determine whether risk data is captured, aggregated, and escalated appropriately to enable three lines of defense and the board of directors to perform their roles

Risk
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Roles of the
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- ❖ How is risk data regarding the wealth management business captured and escalated in the company?
- ❖ Is the board getting the information it wants and needs?
- ❖ Does the board receive reporting on performance relative to a board-established risk appetite for the wealth management business?
- ❖ Do independent risk management and internal audit report on adherence to a risk appetite statement or risk limits?
- ❖ Do MIS systems have the capacity to produce the risk information needed with confidence that the information is accurate and complete?

Consider “cultural” factors that could affect risk and customer treatment decisions in the wealth management businesses

Risk Identification

Roles of the 3LOD

Risk Appetite Alignment

Risk Data

Culture

Tone

- ❖ Do Board and senior management have a clear view of risk culture to which they aspire?
- ❖ How do Board and senior management lead by example?
- ❖ How is adherence to espoused values assessed?
- ❖ How do communications support common understanding and awareness of risk?
- ❖ Do Board and senior management endorse openness to learning from risk culture failures?

Effective Challenge

- ❖ How is open communication and challenge about risk issues encouraged?
- ❖ Do risk management and CRO have stature relative to LOB heads?
- ❖ How is self-identification of risk issues encouraged?

Accountability

- ❖ Is accountability clear regarding roles between business lines, risk management, and audit?
- ❖ How do LOBs demonstrate ownership of risk?
- ❖ Are escalation processes for limit breaches and threats effective?
- ❖ How are quantitative and qualitative risk standards enforced?

Incentives

- ❖ How do remuneration and performance management standards incorporate risk and risk management elements?
- ❖ Do talent development and succession planning take into account risk management skills?

