



# Three Lines: One Bank

MAY 12, 2021

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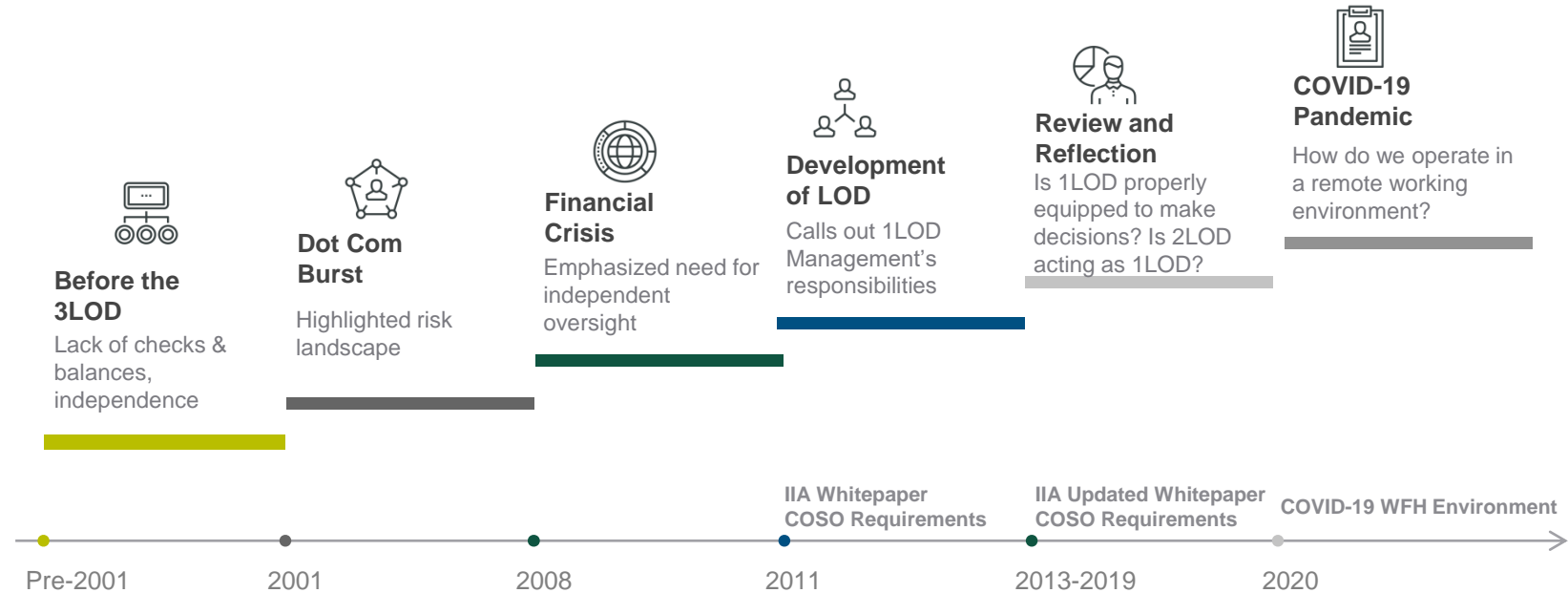
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Design Options

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# Evolution of the Three Lines of Defense

## How did we get here?



## Definition of the Three Lines of Defense



### 1LOD

- Front line units, business units or functions that create and own risk (i.e., "LOB," the "line of business" or "business unit")
- Identify, own, and manage risks in the business
- Introduction of the 1LOD Control Function in recent years – responsible for oversight and consistency (aka Line 1B)



### 2LOD

- Independent risk management functions (e.g., Fiduciary, Credit, Market, IT, or Operational Risk, Compliance, Legal, etc.)
- Provide risk management frameworks
- Guide and train on regulatory requirements and risk management processes
- Monitor and measure against risk appetite



### 3LOD

- Internal Audit – Provide assurance on the adequacy and effectiveness of:
  - Governance
  - Risk management, and
  - Internal controls

# Ultimate responsibility for the management of risks and oversight of controls has transformed and shifted over the past 20+ years

## EVOLUTION 2001 - 2021

### 1LOD



#### Then:

- Included line and executive management only
- Responsibilities regarding oversight of risk and controls may have been unclear, undefined, or unknown to line management



#### Now:

- Many financial institutions are incorporating oversight functions and / or teams within the 1LOD ("1B")
- Aid management in identifying risks and address potential control concerns; allows 1LOD time needed to work with clients

### 2LOD



#### Then:

- Did not exist
- Financial Crisis in 2008 highlighted the need for independent oversight at the corporate level
- Original implementation may have morphed into risk ownership in the 2LOD



#### Now:

- Shift from risk ownership to risk oversight
- More formalized framework, risk identification, and reporting
- Emphasis on advising 1LOD and effective challenge

### 3LOD



#### Then:

- "Independent" function
- Acted as the sole oversight function

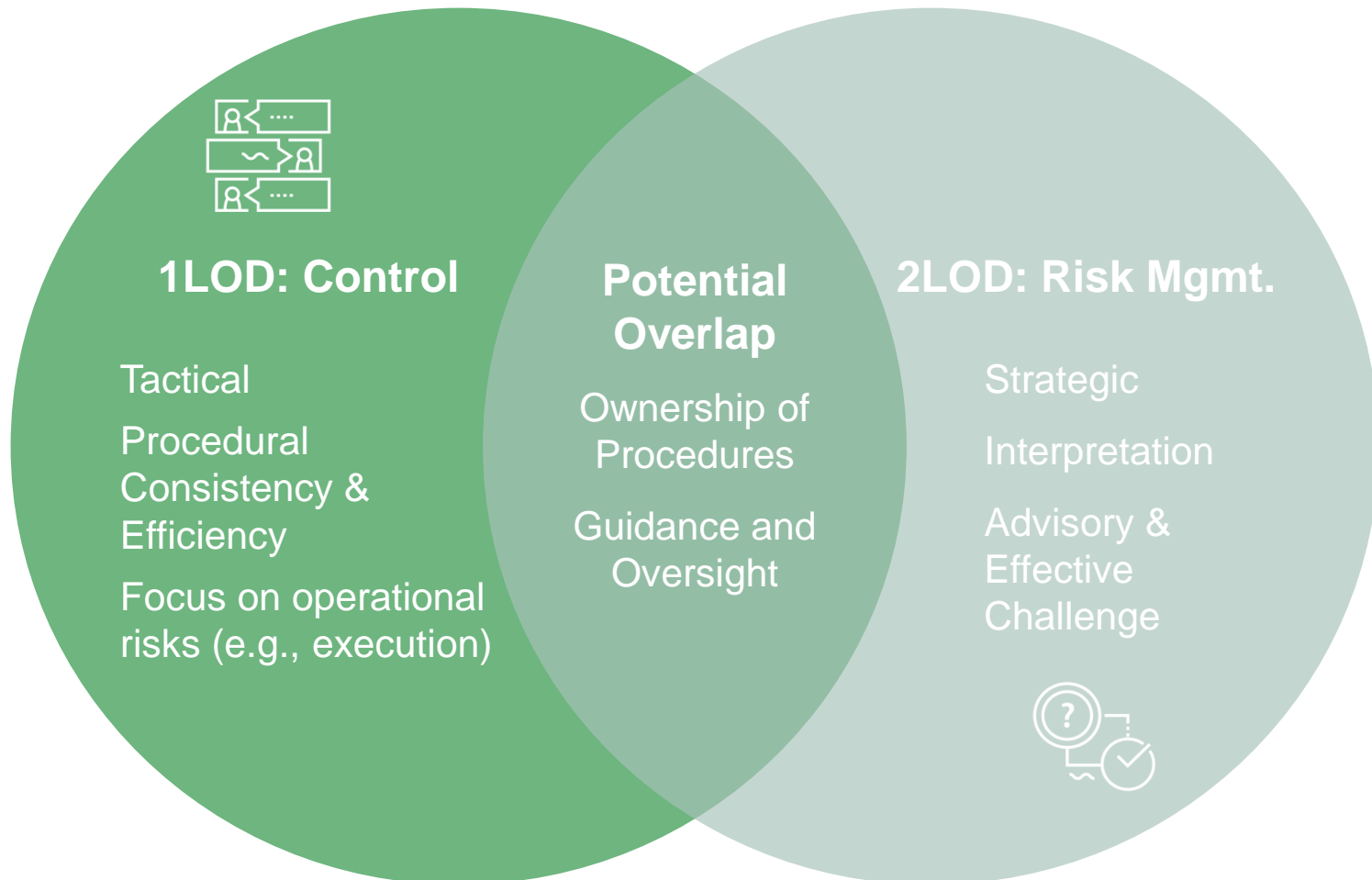


#### Now:

- Emphasizes true independence
- Assess 1LOD and 2LOD in achieving risk management and control objectives

## 1LOD vs 2LOD

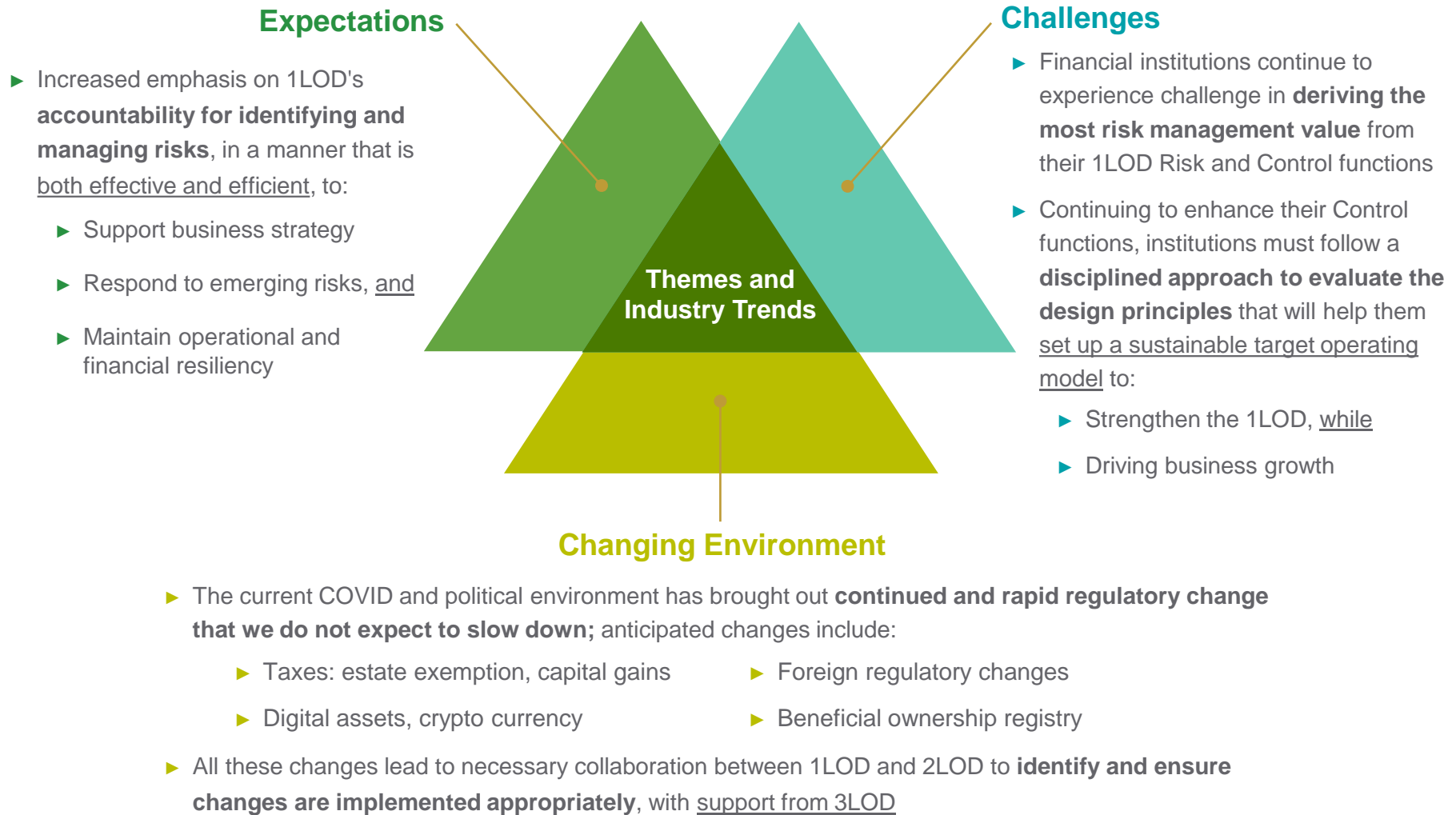
Where we are now?



# Key Considerations



## Key Themes and Industry Trends



### So how do we handle this?

## Key Drivers

### *Why do you need a Control Function?*

Development of a Control Function may be triggered by a particular event or regulatory feedback. Recurring drivers shared across firms include the growing strategic importance of the function.



#### 1LOD ACCOUNTABILITY

Increased emphasis on 1LOD ownership of risk management

Requires strong control leadership, evidence of control activities, and ongoing risk identification



#### NON-FINANCIAL RISK TOLERANCE

Greater need for transparency and effectiveness of 1LOD risk and control activities

Avoidance of losses and fines, resolution of open regulatory issues



#### BREADTH AND DEPTH OF RISK

Evolving business activities and market structure require evolution of the Control function

Rapid transformation, need to respond to new risk areas or business model changes

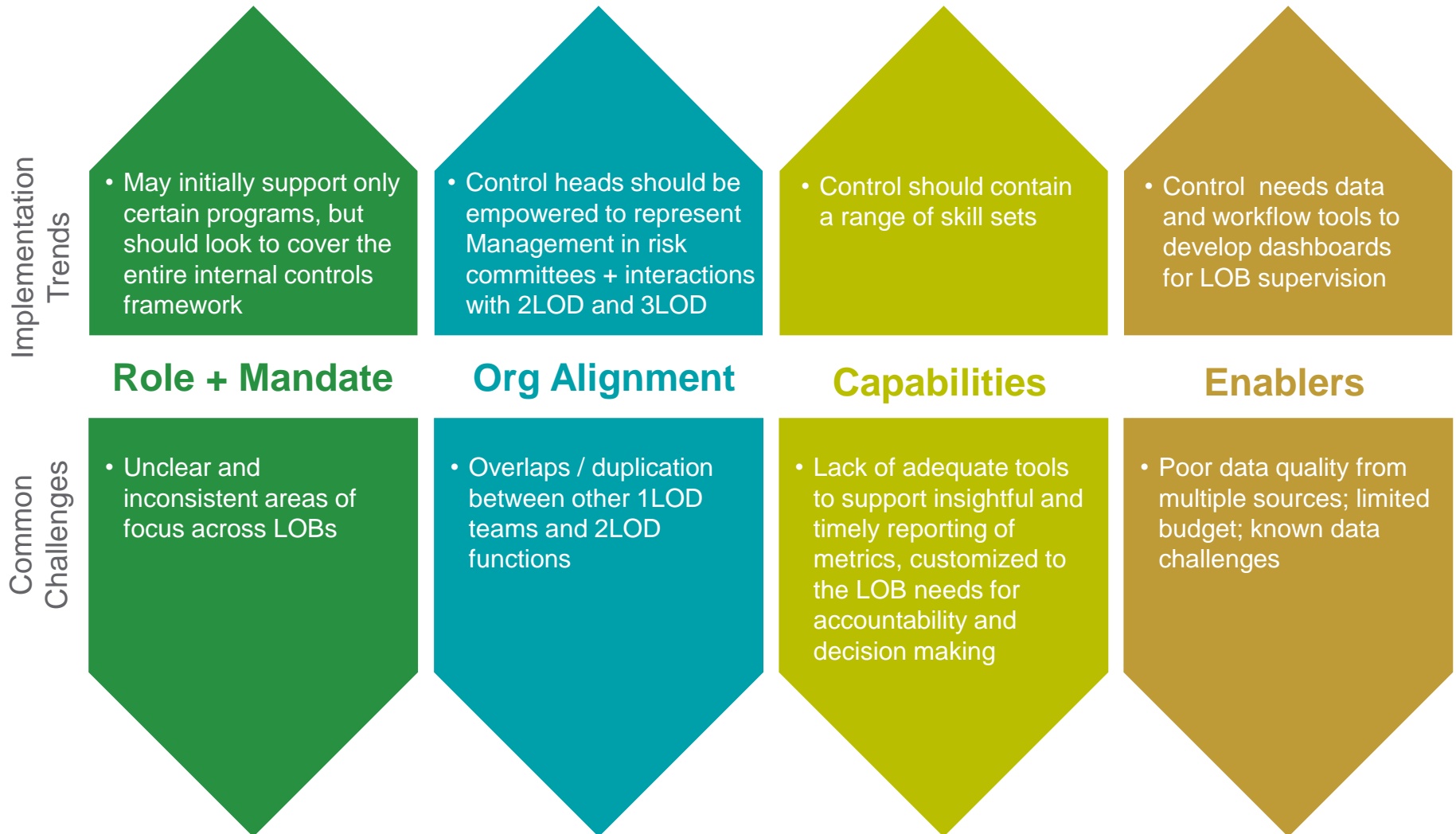


#### PROCESS OPTIMIZATION AND COST EFFICIENCIES

Optimization of processes and controls are a key business initiative

Leadership across LOBs and LODs promote alignment within the risk and control environment

## Key Trends & Common Challenges 1LOD Control Implementation





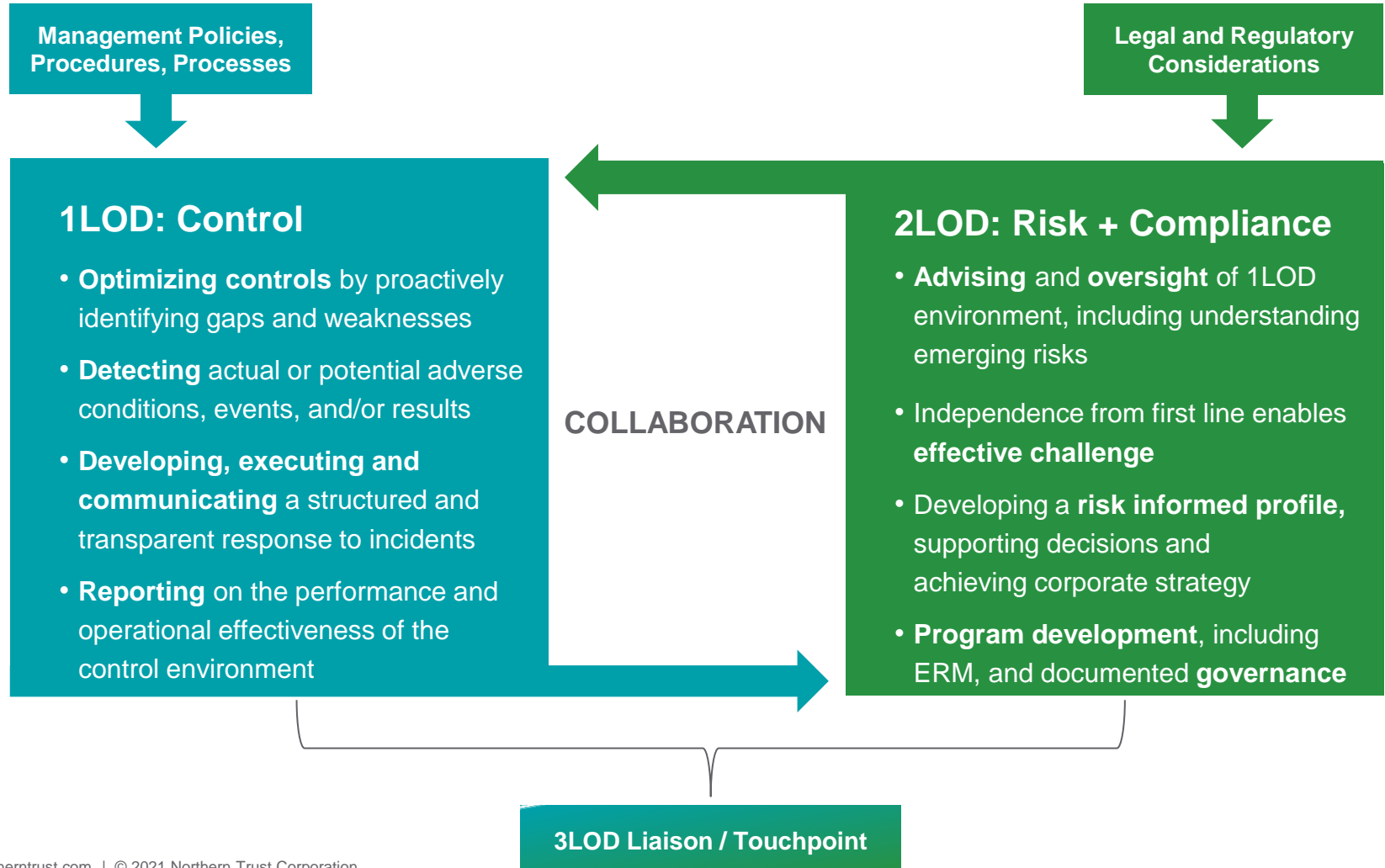
# Design Considerations

“By working together, pooling our resources  
and building on our strengths, we can  
accomplish great things.”

- RONALD REAGAN

## Commonly identified mandates, functions, and frameworks

Successful implementation is dependent upon constant collaboration between all lines of defense.



## Development: Maturity Scale

How do you develop and right-size 1LOD Control and 2LOD RM + Compliance to complement each other?

### Ad Hoc

- Roles not well defined
- Reactive and 'fire-drill' driven
- Work gets completed, but may be delayed

### Defined

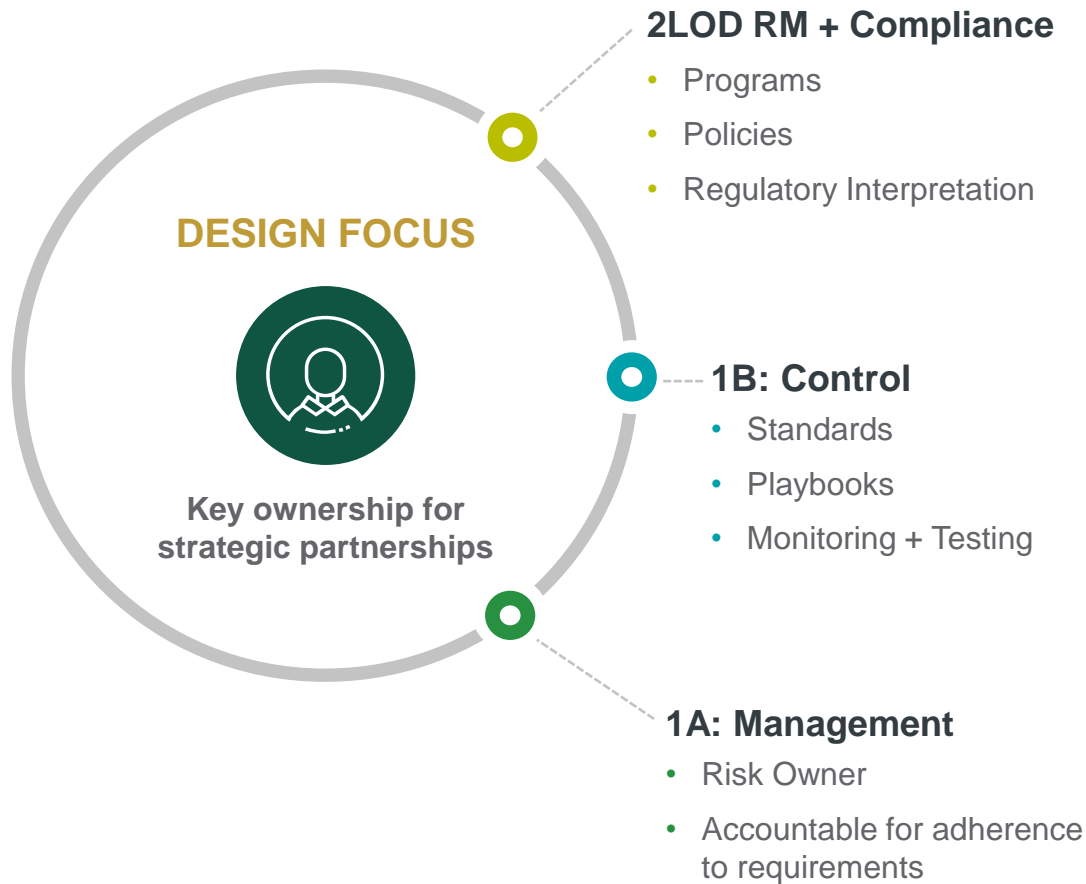
- Clear roles but ambiguity remains
- Prioritization remains highly subjective and reactive
- Key programs + frameworks identified or refined, but not fully implemented

### Optimized

- Most work proactive in nature
- Quantitative, data driven approach to priorities
- Role and decision-making clarity
- Key programs + frameworks clearly established and continue to evolve

**Rome wasn't built in a day.**

## Who does what?



## FRAUD PREVENTION EXAMPLE

### 2LOD: RM + COMPLIANCE

- Development of a Fraud Program

### 1B: CONTROL

- Ownership of a Fraud Playbook
- Monitoring to adherence of controls

### 1A: MANAGEMENT

- Adherence to existing fraud prevention controls



## Design of 1LOD / 1B Control Function



### Design of the Function

1. **Clear scope and mandate** enables accountability and strengthens coverage of control framework (this is a constant evolution!)
2. **Alignment of 1B Control and business and technology strategies** supports business growth and resiliency

### Core Program Design

1. **Enhance consistency and efficiency**
2. **Improve communication** across the LOB

### Build Team Appropriate to LOB

1. Organizational Alignment
2. Proper stature and **coordination between teams** empowers 1B Control managers and drives effectiveness of 1LOD risk and control activities
3. **Diverse skill sets and team structures** are required to respond to potential control gaps, new process requirements, and 2LOD program expectations

### Implementation and Evolution

1. **Prioritization** of key activities and programs
2. **Right-sized resourcing**

## Design of 2LOD Functions



### Define Function

1. **Clear scope and mandate** enables accountability and strengthens coverage of frameworks (risk management, compliance, legal, etc.)
2. **Advisory and Oversight** based on risk appetite, while still supporting business growth and resilience

### Core Framework Design

1. **Clear Framework** support consistent expectation and measurement across the enterprise
2. Framework must remain **proactive** and **nimble**

### Build Team Appropriate to LOB and Enterprise

1. Proper stature and **coordination between teams** remains critical and ensures that 2LOD functions are included from the beginning
2. **Diverse skill sets** are required to identify and assess new and emerging risks
3. Appropriate LOB alignment and oversight responsibility

### Implementation and Evolution

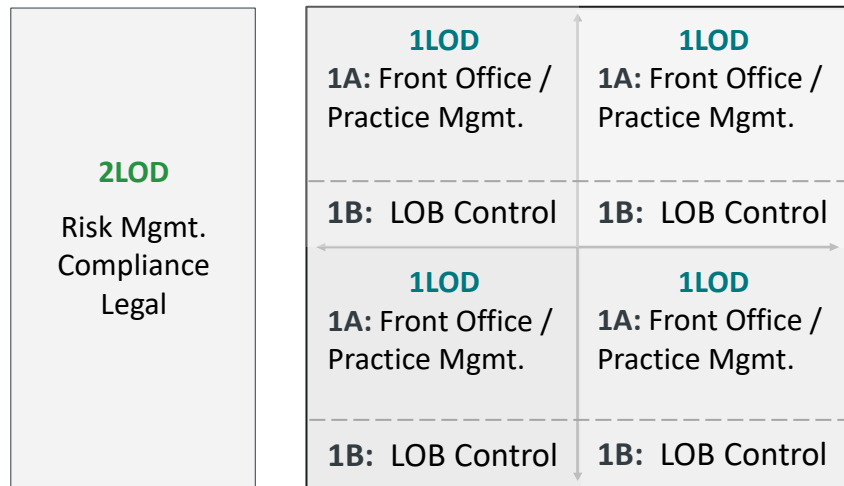
1. **Oversight** of existing risk appetite and **identification** of new and emerging risks
2. **Right-sized resourcing**



# Design Options

## LOB Specific Model

1LOD Line of Business (LOB) Specific Team(s)  
Reports to Head or COO of the LOB or Function



### PROS

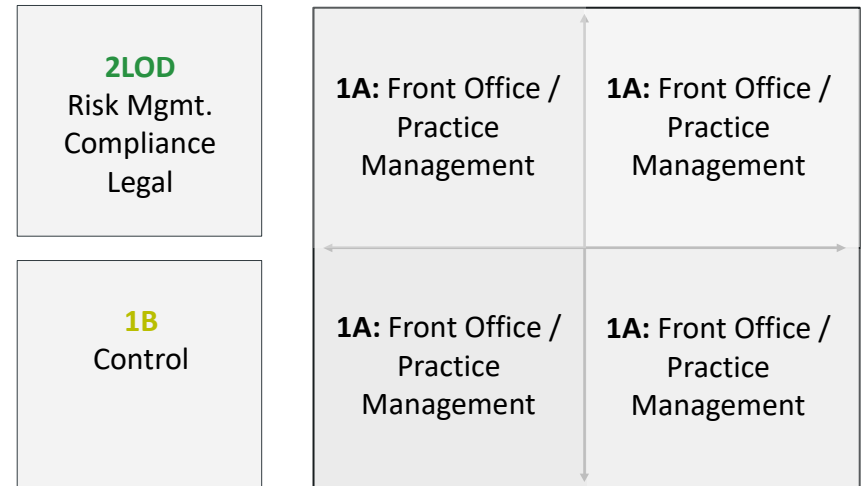
- Embedded in the LOB
- Enhances partnership between Management and Control

### CONS

- Potential differences in mandate, maturity, and resourcing between LOBs

## Centralized Model

Independent Control Team  
Spans multiple LOBs or functions, may be organized by risk area/activity



### PROS

- Standard model, scope and approach across LOBs

### CONS

- Blurred lines between 2LOD Risk + 1B Control
- May reduce partnership between Mgmt. + Control



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## BIOGRAPHIES

# Shannon Vidmont, CFIRS

SVP, Wealth Management Control Manager

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Shannon Vidmont is the Wealth Management Control Manager in the First Line of Defense at Northern Trust and is a Certified Fiduciary and Investment Risk Specialist.

Shannon re-joined Northern Trust in 2019 and has 17 years experience in various audit, risk management, and control positions at financial institutions, including 14 years of fiduciary risk management experience.

In her current role, Shannon oversees operations and execution throughout the Wealth Management Business Unit. Shannon's team focuses on enabling and supporting the business in proactively identifying risks and addressing control gaps or weaknesses while increasing clarity and consistency across practices and regions.

## BIOGRAPHIES

# Holly A. Bailey

SVP, Global Fiduciary Risk Management

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Chicago, IL



Holly A. Bailey is a Senior Vice President and currently manages the Global Fiduciary Risk Management Team for Northern Trust. Holly and her team are responsible for the identification and resolution of fiduciary risk issues as well as oversight of fiduciary risk management programs. Holly also serves as the Risk Advisor for Northern Trust Cayman International, Ltd.

Prior to joining Northern Trust, Holly was at BMO Harris Bank N.A., where she held the roles of Senior Counsel in the U.S. Wealth Management Legal Department, Chief Trust Officer for BMO Private Bank, and National Director, Trust Fiduciary Risk for BMO Private Bank. The duties of her roles at BMO Harris Bank ranged from providing oversight, analysis, and guidance on business and fiduciary risk matters, to overseeing the development and delivery of personal trust and estate administration services in the United States. Earlier in her career, Holly practiced law for over 10 years, where she focused on estate planning, trust law, estate administration, family office services, business and real estate transactions, and tax compliance.

Holly received her Bachelor of Arts degree from Alma College in Alma, Michigan in 1998, and received her J.D. from Chicago-Kent College of Law, Illinois Institute of Technology, in 2002.

Holly is a member of the Chicago Estate Planning Council and is a past president of the Corporate Fiduciaries Association of Illinois. Holly is also a member and Peer Group Leader of the Fiduciary and Investment Risk Management Association (FIRMA) and has been a speaker at FIRMA's annual national training conference. Holly is a member of the bar in the State of Illinois, the United States Court for the Northern District of Illinois, and the United States Tax Court.