



FIFTH THIRD BANK

“First Line of Defense” Testing

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Some Level Setting: Three Lines of Defense

- When discussing first line of defense (LOD) testing, it's important to understand how the three lines are organized and fit into an organization's risk management structure.
- First Line of Defense – Business process owners. Risk identification, assessment and testing, risk mitigation and management.
- Second Line of Defense – Independent control groups. Compliance and Operational Risk. Risk program development and governance, risk monitoring, verification and testing, reporting and oversight, and credible challenge of the first line.
- Third Line of Defense – Independent assessment. Audit. Independent of and drive accountability from first and second lines and provide a credible challenge of the second line.
- All three lines test.

First Line / Business Controls Role and Responsibilities

- Business Controls is a group of experienced risk managers and analysts embedded in the first line.
- Business Controls is responsible for overseeing the management of risk in the line of business
 - Owns and ensures adoption of key risk programs, such as RCSAs, BCRAs, KRIs, issues management, and third party management
 - Partners with process owners to identify, escalate, and report risks in their areas
 - Owns the inventorying, assessment, monitoring, and reporting of risks
 - Performs control testing
 - Collaborates with other lines of defense and serves as liaison with first line during their exams and testing

First Line Testing Strategies

- Quality, accuracy, and adherence to policies and procedures are key components of risk mitigation
- LOB performance in these areas is measured through testing of critical processes, quality of information and data, and control effectiveness
- Business Controls assesses the design of the control environment and determines the need for testing to test the effectiveness of the key controls
- Key controls in high-risk processes must function properly or significant errors can occur
- Business Controls performs key controls testing and opines on the quality of the control environment

First Line “Key Controls” Testing

- Some controls are more “key” than others
- A lot of controls are important, but not necessarily key or critical
- For each control, embedded into particular processes, ask the question “What could go wrong if it failed?”
- If bad things can happen to clients or the bank, that’s a key control.
- For controls determined to be “key,” targeted key-control testing is warranted.
 - It’s not regulatory compliance testing (done by the second LOD)
 - It’s not financial auditing (done by third LOD)
 - It is quality control (QC) testing - testing the quality and accuracy of the control

Coordinated Testing is Efficient Testing

- A clear first-line testing plan includes both annual scheduled testing of key controls and special, focused testing
 - Annual, regularly scheduled testing covers key-control testing of high risk processes
 - Special, focused testing is appropriate for important product or service changes or in the case of significant employee turnover
- Testing needs to be coordinated and the test results shared with the second and third lines to:
 - Ensure appropriate coverage of key controls
 - Prevent duplicative, time-consuming testing

Key Controls Testing Results

- Analysis of testing results (from any LOD) can lead to:
 - Clarifications or amendments to procedures
 - Training opportunities to ensure complete understanding of processes
 - Additional check points or more oversight and approvals
 - First LOD self-identified issues if better controls or procedures are warranted
 - Changes or enhancements to controls using lean process-automation techniques to eliminate manual processes

Proper Staffing is (Obviously) Important

- First LOD risk management and associated testing are stronger with a strong Business Controls staffing model
- First-line risk managers and analysts with relevant prior business experience are the most successful and effective
 - Deeper knowledge of the business
 - Know how to do things right the first time
 - High credibility with process owners
 - Understand that excessive or onerous controls can impact the client experience
 - Experience creates flexibility – more than one way to accomplish the goal of the control

Make Proper Staffing a Priority

- How do we attract and retain the best?
- Make Business Controls a “destination”
- Compensation must be commensurate with the level of experience that current team members and candidates bring to the team
- Staffing levels need to be adequate to prevent burn-out
- Job descriptions need to be clear so that the roles are focused on both “business” and “controls”
 - Exposure to business leaders at the highest levels
 - Not checking controls, but evaluating their adequacy
 - Testing designed to confirm quality, not challenge it
 - End-to-end point of view results in better recommendations
 - Business consulting results in improved processes – “we make good better”

Summary – pulling it all together

- A deep understanding of every process is essential
- First-line testing needs to be focused on key controls
- Identify weaknesses and address them before issues arise
- Recommendations must be impactful – “make good better”
- Coordinate testing with other LODs – try not to over (or under) test
- Build the right team of risk experts. Attract the best. Pay them well.
- Results
 - more effective and efficient, well-controlled processes
 - fewer “red” KRIs
 - more stable earnings – fewer operational losses and remediations
 - fewer second and third line and regulatory issues

Questions?

Thank you