Non-Financial Risk (NFR)

**KEY QUESTIONS**

1. Do the organizational culture and risk structures cover all risks including NFRs?
2. Does the framework provide the data and transparency to understand the risk profile of the organization and does it improve the decision-making process related to risk?
3. Does the framework provide complete evidence for internal and external parties that risk is properly identified and managed?

**COMPONENTS AND GOALS**

Deloitte’s Non-Financial Risk Management Framework will allow Financial Institutions to:

- Link NFRs to the bank’s Risk Appetite Framework (“RAF”) and articulate a more detailed Risk Appetite Statement (“RAS”)
- Articulate and communicate the NFR approach and resulting impact and benefits on risk culture and conduct
- Quantify relevant NFRs, define related limits, thresholds and triggers
- Assign clear roles and responsibilities
- Strengthen top-down communication, bottom-up reporting and external disclosure
- Extend NFR to all supporting policies, processes and controls and identify required technologies

**PERFORMANCE DRIVERS AND METRICS**

- Supervisory expectations
- Understanding of the bank’s NFR profile
- Capital requirements

Meet or even surpass evolving supervisory expectations

Demonstrate a comprehensive understanding and enhanced control of the bank’s NFR profile

Translate understanding of the NFR and risk management capability improvements into reduced cost of compliance and economic capital

**POTENTIAL ECONOMIC CAPITAL IMPLICATIONS**

<table>
<thead>
<tr>
<th>Pillar I</th>
<th>Pillar II</th>
<th>Pillar III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Requirements</td>
<td>Stress testing (e.g. CCAR-US, SREP-EU)</td>
<td>Disclosure</td>
</tr>
<tr>
<td>Regulatory Calculation</td>
<td>Capital adequacy level</td>
<td>Transparency</td>
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</tbody>
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Implications of non-financial risk management

- Tentatively, the regulatory calculation would not be affected by the proactive management of the NFR
- Management improvements increases alignment with real capital needs
- Improved internal control & capital scores
- Avoid or reduce add-on
- Improvement in the image and reputation
- Potential for increased investor and stakeholder confidence

**NFR TAXONOMY (Extract)**

<table>
<thead>
<tr>
<th>Risk Class</th>
<th>Category</th>
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</table>
| Financial Risk | • Credit Risk  
|              | • Market Risk  
|              | • Interest rate Risk in the Banking Book  
|              | • Liquidity Risk |
| Non-Financial Risk | • Operational Risk  
|                   | • Compliance Risk  
|                   | • Conduct Risk  
|                   | • IT Risk  
|                   | • Cyber Risk  
|                   | • Model Risk  
|                   | • Third-party Risk |
| External Market Risk | • Strategic Risk  
|                     | • Systemic Risk  
|                     | • Reputational Risk |

**Holistic approach:** “An end-to-end and common approach to managing risk, starting with a link to the risk appetite framework, an inventory of risks and relevant controls, a consistent quantitative and qualitative assessment approach, and concluding with the ability to provide feedback and enhance the process.”

Source: Deloitte Banking Risk Intelligence Map®-extract; Draft as of July 2017, subject to change.
Non-Financial Risk (NFR)

MEASURING AND MONITORING NFR

1. Measurement and monitoring of NFR
   - Risk Assessment System
   - Processes
     - Quantitative measurement (level of control)
   - Risks
     - Qualitative measurement (questionnaires)
   - Controls
   - Score obtained
     - Control level gap analysis
   - Score obtained
     - Qualitative gap analysis (integration into management)

2. Target model and action plan
   - Target model and definition of action plan

Combination of quantitative and qualitative approaches to reach a score:

Quantitative assessment
- Considers different KRIs for each eligible Risk Category and Sub-Category
- Aims to avoid subjectivity through a frequency and impact quantification

Qualitative assessment
- Combines results from the processes and control map quantification with management questionnaires

The Three Lines of Defense have an integrated role in the framework; results can be used as inputs for capital calculations, with potential substantial benefits.

COMPONENTS OF AN INTEGRATED NFR IMPLEMENTATION FRAMEWORK

- Reporting
  - Common reporting framework, where risks are monitored and communicated consistently across all lines of defense
- Technology
  - Firms should consider using innovative tools and techniques to monitor and control risks
- Governance
  - Entities should adapt the governance to include NFRs
- Risk Appetite
  - The entity should identify its potential NFRs and decide how much it is capable and willing to assume

QUALIFICATIONS

- International team and global network
  - Bring best practices for international banks based on Deloitte’s understanding of the varying local requirements and data delivery approaches resulting from the scope changes as adopted by local Competent Authorities
- Interpret and implement the legislation in banking context
  - Efficient interpretation and translation of legislation into bank-specific terminology and data sourcing
- BUCF
  - Collaboration on an international level through the Banking Union Center in Frankfurt (BUCF) and the EMEA Center for Regulatory Strategy (ECRS) providing fundamental views on regulatory changes and issues
- Expert knowledge of Operational Risk
  - In-depth knowledge and understanding of Basel regulations
- Experienced professionals
  - Senior professionals with broad-based and relevant experiences in regulation, audit and advisory

Europe’s most ambitious integration project since the Euro. The Banking Union initiative represents a fundamental innovation in supervision of financial services with significant consequences for the structure of the banking sector in the Eurozone and beyond, affecting business models and strategies.