



Risk Powers Performance

Integrity Risk Appetite: A key pillar in the strategy of financial institutions

The Dutch Central Bank (DNB) is increasingly focusing on integrity risk management methodologies applied by financial institutions. DNB published a guidance document on Systematic Integrity Risk Analysis (SIRA) in 2015 which outlined best practices on how to assess and manage integrity risks. The concept of an integrity risk appetite was already introduced in this guidance as an important baseline of the SIRA. On the 24th of May 2017 DNB published a concept of its guidance document on integrity risk appetite for financial institutions. It concludes that many financial institutions are not yet able to explicitly state how they have configured their risk appetite and/or for what purpose the statement is used within the organization.

Integrity risk appetite in context

Financial institutions are exposed to many forms of integrity risk, ranging from money laundering to cybercrime and socially unacceptable behavior.

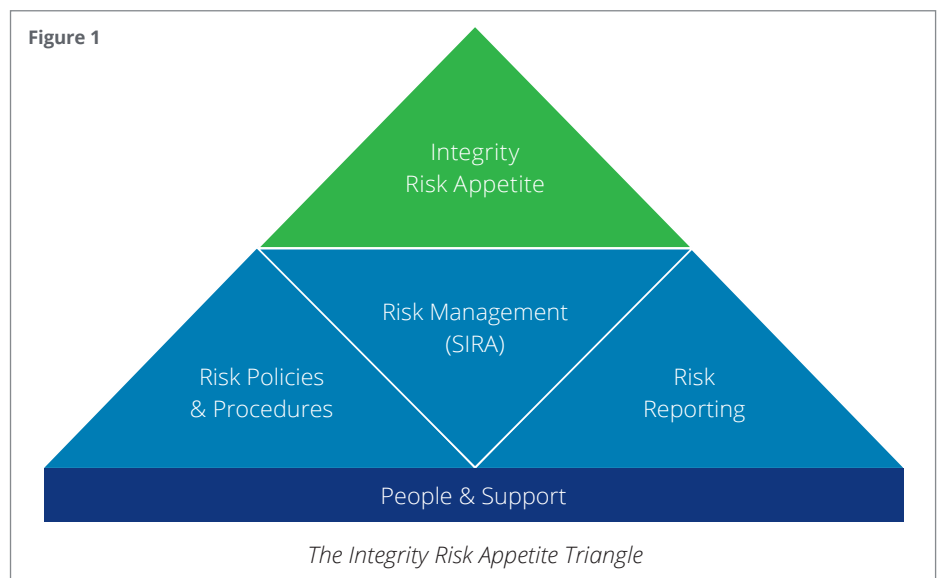
Examples of integrity risks

- Money laundering
- Terrorist financing
- Circumvention of sanctions legislation
- Corruption (bribery)
- Conflicts of interest
- Fraud within or outside the organization
- Evasion or avoidance of tax regulation
- Market manipulation
- Cybercrime
- Socially unacceptable behavior

DNB recommends that financial institutions define those integrity risks that are relevant for the activities or products they offer, as well as the integrity risk appetite for it. The first line of defense is ultimately responsible for integrity risks related decision making, such as:

1. Harmonization of the integrity risk appetite with strategic objectives;
2. Periodical reviews of the integrity risk appetite;
3. Testing and monitoring the effectiveness of measures;
4. Implementation of the integrity risk appetite throughout the entire institution including internal and external communication structures.

As is shown in the triangle below, the integrity risk appetite should directly link to risk management, policies & procedures and risk reporting. It is also the baseline for the SIRA as part of risk management. SIRA results should be compared to the integrity risk appetite in order to determine whether the business is operating within the integrity risk appetite limits. If the SIRA results indicate that the financial institution is taking more risks than desired, mitigating action is required. Mitigating integrity risks can be realized by improving the control environment and optimizing processes, but also by de-risking operations and/or the client portfolio.



De-risking

De-risking is the categorical exclusion of specific client groups. By not accepting- or exiting particular high risks clients from the portfolio, exceptions can be kept to a minimum. As a result, certain complex processes and controls can be limited. Lower cost of control will be realized as controls and processes can be standardized and consequently, costly integrity risk management is limited.

From a supervisory perspective, this also has a downside. When no individual risk assessment on these particular clients within these risk categories is performed, de-risking may adversely lead to unfair exclusion of (potential) clients. To avoid

these potential consequences of de-risking, the DNB urges financial institutions to assess individually whether certain integrity risks related to clients and/or activities can be mitigated or reduced. If not, refusing new or exit existing clients is acceptable.

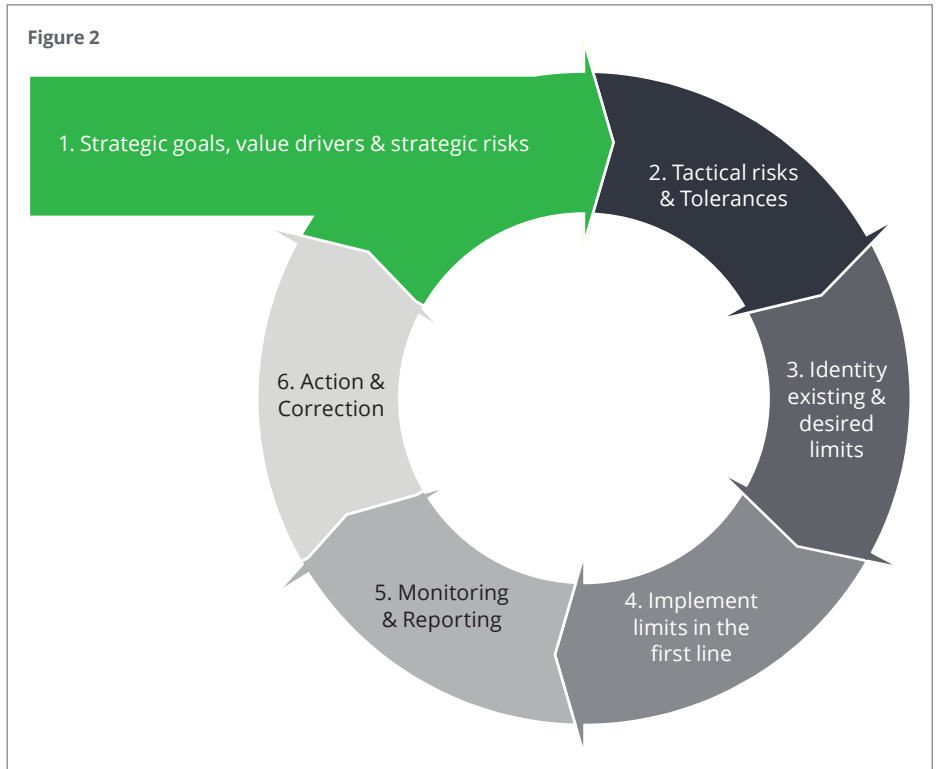
Deloitte approach

Deloitte uses a 6 step approach that has proven to be successful in developing, implementing and monitoring the integrity risk appetite, enabling further optimization of our client's integrity risk management. Embedding the integrity risk appetite throughout the entire organisation is key in this approach. Not only will the financial institution become compliant with applicable laws and regulations, also

several advantages in the market place can be achieved by this approach such as: lower (compliance) costs, less complexity of operational processes and the quality of service offerings can be improved

1. Key to an integrity risk appetite is the alignment with the strategic objectives. Articulation of value drivers and strategic risks are part of this.
2. The second step is the definition of tactical risks and tolerances. These two first steps will set a benchmark for the actual risks.
3. To measure if actual risks remain within the risk appetite, limits must be determined. These limits provide actionable input for risk and business managers.
4. Identified limits must be implemented within the business processes of the first line. Through the implementation of limits, the risk appetite is used on an operational level in the organization.
5. Hierarchical structures may filter and delay information sent up to the management chain. New and innovative ways of presenting information to the board should remove the disparity between the risks that the financial institutions takes and those that the board perceives to be taking.
6. The organizations risk appetite should foster board level debate on actionable elements that clearly articulate the organizations intended responses to (reputational) losses caused by integrity risks and breaches in integrity risk limits.

Figure 2



Challenges

Essential and often the most challenging step in the process is the implementation of risk appetite limits in the business line. Processes, controls and policies have to be adjusted in line with the new integrity risk appetite. Furthermore, it can be necessary to ‘clean’ the past by remediating current operations. Successfully dealing with these challenges is the main driver for the approach as developed by Deloitte.

Information

This article contains a general approach that needs to be further fine-tuned to (a.o.) your financial institution’s strategy, clients and products.

Deloitte has extensive experience and can support you with implementing an integrity risk appetite. We can also support you by developing accompanied policies & procedures, governance and training & awareness.

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