Holes To Fill In Vendor Risk Management

by Steve Brown

Swiss is the holiest of cheeses, but few people outside of cheese inspectors really know how the gaps get there in the first place. It certainly isn't from hungry mice, so put that one to rest. No, it is caused instead by carbon dioxide given off by bacteria in the cheese's milk. More specifically, Swiss scientists have now decided that tiny bits of hay were causing the holes.

We were thinking of holes as we contemplated community banker reaction to the various directives from regulators about managing vendor risks. Regulators have all updated their guidance on third-party risks in the last 3Ys and as examiners hit the ground and observe banks' procedures, things are getting tougher. This makes sense when you consider one key driver has been data breaches at vendors and other non-regulated third parties that have led to increased exposures for regulated banks.

For its part, the OCC for example, has said "A third-party relationship is any business arrangement between a bank and another entity, by contract or otherwise." If any of those entities have flaws in their own systems bankers must be ready but unfortunately that's a lot of holes to keep track of.

To begin, bankers should conduct a risk assessment of each vendor. It should take a look at what sort of risk they pose for the bank and any potential impact.

Next, it is critical to take a close look at and document the vendor's capabilities and financial standing. One of the easiest ways to evaluate a vendor is to determine whether your loan team would offer them a loan. Conduct a thorough financial analysis and have the lending team answer under what terms and conditions would they lend this company money. The thornier this gets the more the bank will need to be protected and the less risky the vendor's tasks should be (including even eliminating the relationship if needed).

Third, take a close look at the contracts and be prepared to make changes to them. Your bank needs to minimize its risk when a vendor does not perform and you should have a detailed explanation of what you do and do not get under each contract. Taking the time to clearly spell out terms and conditions, along with rights and remedies is critical.

Fourth, you are never truly done when it comes to vendor management as it is an ongoing process. Understand contract maturity dates and at least annually update the financial condition of key vendors to make sure you are dealing with solid counterparties not just at origination but on an ongoing basis.

Another key area to monitor closely relates to consumer or other sensitive information. Here, take the approach of the CIA and the military and determine who needs to know the information and only give it to those individuals. Take additional steps to highly protect such information and make sure your contracts require vendors to notify you and destroy such information if and when it is received by error.

Finally, you will need to track all of this. Many community banks use Excel and that is fine for the most part, but be sure the information collected and tracked on all key vendors does what it is supposed to do and is updated as needed.

Know that regulatory guidance makes clear that risk assessment is an ongoing task, not a one-time-only occurrence. A robust vendor-management process should help properly assess the risk of any vendor of any size and do so throughout the relationship lifecycle.

You don't have to get crazy when doing vendor management, but the regulations do require you to make sure the process isn't full of holes, so be sure to inspect it now and again.

BANK NEWS

Cyber Risk

Research by the National Small Business Association finds cybercriminals stole an average of $32,000 from small business accounts that were hacked last year.

EMV Compliance

A survey by the National Retail Federation finds only 8.5% of respondents said they were EMV compliant (had implemented chip enabled payment card terminals in stores) while 14% said they were not prepared at all.

Lending Opportunity

Fed research on small businesses with less than 500 employees finds: 63% of employer firms have outstanding debt. By major category debt levels are: less than $25k (22%); $25k to $50k (14%); $50k to $100k (18%); $100k to $250k (19%); more than $250k (27%).

Not Difficult

A survey by Deloitte finds only 10% of company executive surveyed say the availability and cost of credit is a constraint to their business.

Capital Change

Global regulators (through Basel) agreed they will no longer allow banks to use internal models to calculate operations risk. Basel will release new standardized rules to handle such risks industry wide.

Economic Growth

JPMorgan now estimates the GDP growth rate has slowed to 1.4%

Wealth Transfer

Research by Boston College projects an estimated $59T will be transferred from American estates from 2007 to 2061. This is the greatest transfer of wealth in US history.

Borrower Satisfaction

Fed research on small businesses with less than 500 employees finds applicants that were approved for loan financing reported the following satisfaction levels by lender type: small bank (75%), credit union (56%), large bank (51%) and online lender (15%). The main reasons online lenders ranked lowest: high interest rate (70%), unfavorable repayment terms (51%), lack of transparency (32%), long wait for credit decision (22%) and difficult application process (21%).

Debt Rising

Research by CardHub finds outstanding credit card debt climbed to $917.7B at the end of 2015, a 24% jump vs. 2014. The increase pushes average debt loans to the highest levels since 2008.