



The 7 Rs of Risk Management Strategy for CFIs

📌 OCC regulatory risk management

Summary: The OCC recently published its autumn statement on key risks facing the federal banking system. We summarize these risks and suggest ways CFIs can mitigate them to improve their institution's resilience.

Ants are well known for being small and mighty. They've had to develop a range of defense mechanisms to protect themselves from danger — including stinging, biting, and working together in huge numbers to overcome threats. Some species have gone even further to deal with risk and protect their colony: [known as "exploding ants"](#), when threatened, they blow themselves up to coat their enemies in a sticky poison.

On the subject of protecting themselves, how can community financial institutions (CFIs) mitigate the risks facing them, including those recently identified by The Office of the Comptroller of the Currency (OCC) — without going to such extremes?

Key Risk Areas for CFIs

The OCC's most recent [Semiannual Risk Perspective, published in December 2023](#), looks at some of the key issues and threats facing the financial industry. The report highlights that although recessionary pressures have eased, economic headwinds associated with high interest rates, elevated inflation, a slowing labor market, and declining savings persist. Despite this, the OCC reports that the overall strength of the federal banking system remains sound. That said, it continues to require diligent risk management practices across all areas.

Here are a few key risk areas to watch:

- **Credit risk.** With continued high interest rates, a prolonged period of inflation, increased risk in commercial real estate lending, and declining corporate profitability and cash flow, the OCC's report suggests that key performance indicators are showing signs of borrower stress across various asset classes. The potential for a further economic slowdown will likely create further headwinds for credit quality, increasing risk in this area.
- **Market risks.** High interest rates have resulted in greater competition for deposits, and at higher rates. Alongside reduced market liquidity, this is putting pressure on financial institutions' (FIs') net interest margins (NIM).
- **Operational risks.** As FIs seek to leverage the huge advances in technology to offer innovative products and services and further their digitization efforts, they are also facing increased threats of cyberattacks and fraud.
- **Compliance risk.** Operating in a dynamic environment, FIs need to ensure equal access to credit and fair and consistent treatment of their customers. These factors, combined with the increased use of new and innovative technologies and increased partnerships with third parties and fintechs, result in increased compliance risk, including risks linked to the Bank Secrecy Act and anti-money laundering.

Risk Mitigation Strategies for CFIs

The OCC report underlines the importance of having the right plans and processes in place for a CFI’s ability to adapt to and manage existing and evolving risks. Here are **seven Rs of risk management** that can act as a useful reminder of what institutions should consider when reviewing and updating their risk management strategies.

- 1. **Risk ratings.** Risk management should be preemptive, proactive, and adaptive. CFIs should ensure that they have robust strategies, tools, and processes in place to anticipate, predict, and identify emerging market risks. These can be supported by automated AI-powered solutions that detect risks and opportunities linked with trends in the data. Accurate and timely risk ratings are a key factor in successful credit risk management and are critical for problem loan mitigation.
- 2. **Regular stress testing.** This provides insights into the impact of adverse events. Given recent trends in deposit movement and rates, as well as uncertainty about the economy, [conducting stress tests](#) and sensitivity analyses of deposit assumptions are key to helping decision-makers plan for different eventualities.
- 3. **Robust contingency planning.** If identified risks exceed tolerances, contingency plans can help improve capital and liquidity resiliency and mitigate the financial distress caused by unforeseen events. This should include capital planning and strong liquidity management that identify triggers for action and ensure a proactive and comprehensive response.
- 4. **Review cybersecurity measures regularly.** CFIs should be testing and reviewing their cybersecurity and multi-factor authentication practices and procedures regularly. Recruiting and maintaining the right technical expertise and sufficient resources to implement the right cybersecurity processes and controls is essential.
- 5. **Relationships with third parties.** CFIs should ensure rigorous oversight of any third-party relationships, and enhance their due diligence frameworks to understand and manage any additional risk exposure through these relationships, particularly where they support higher-risk or critical activities.
- 6. **Report suspicious activity.** CFIs must ensure they have effective processes in place to prevent and identify any suspicious or fraudulent activity. What’s more, the regulatory requirement to report this activity in a timely manner is important to protect customers, other FIs, and the wider financial system.
- 7. **Regulatory requirements.** Communication with regulators and keeping ahead of the development of new policies and regulatory frameworks is an important component of an institution’s risk management strategy.

A robust risk management framework that enables a CFI to identify and respond appropriately to threats in a way that ensures ongoing business resiliency is key to an institution’s ability to continue to navigate dynamic market conditions and the associated risks.

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ECONOMY & RATES

Rates As Of: 02/21/2024 10:15AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.44	0.02	0.04
6M	5.32	0.14	0.06
1Y	4.98	0.28	0.22
2Y	4.65	0.44	0.40

5Y	4.31	0.47	0.46
10Y	4.33	0.41	0.45
30Y	4.49	0.32	0.46
FF Market		FF Disc	IORB
5.33		5.50	5.40
SOFR		Prime	ORER
5.30		8.50	5.31

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