October 18, 2021

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley
Assistant Executive Secretary
Attention: Comments-RIN 3064-ZA26
Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, suite 3E-218
Washington, DC 20219

Re: Request for Comment on Proposed Guidance on Managing Risks Associated with Third-Party Relationships (Docket No. OP-1752; RIN 3064-ZA26)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the proposed guidance captioned above ("proposal"), issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively "the Agencies").

Better Markets considers the effort to provide a consolidated guidance, rather than three independent sets of guidance, a reasonable effort that would allow banks to more appropriately

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies— including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

meet the expectations of the Agencies and would allow supervisors to more clearly communicate expectations to banks. However, while there are aspects of the guidance that are appropriate and beneficial, the guidance should be made more specific to better delineate between the types and levels of risks that must be managed. Additionally, considering the evolving and complex nature of third-party relationships, the management of the associated risks would be best served by a minimum set of standards implemented through regulation.

Background

To provide banks with a single, consolidated set of guidance around managing the risks associated with third-party business relationships, the Agencies have issued the proposed guidance that is based on the independent guidance of each of the Agencies.[2] The Agencies state that the risk management of third-party relationships should address each part of the "life cycle" of the relationships, namely:

1. Developing a plan that outlines the banking organization's strategy, identifies the inherent risks of the activity with the third party, and details how the banking organization will identify, assess, select, and oversee the third party;
2. performing proper due diligence in selecting a third party;
3. negotiating written contracts;
4. having the board of directors and management oversee the banking organization's risk management processes, maintaining documentation and reporting for oversight accountability, and engaging in independent reviews;
5. conducting ongoing monitoring of the third party's activities and performance; and
6. developing contingency plans for terminating the relationship in an effective manner.

As acknowledged in the proposal, the proposed guidance is primarily based on the guidance of the Office of the Comptroller of the Currency and its associated set of Frequently Asked Questions.

Aspects of the Guidance Are Beneficial and Should be Maintained

The core principles of the guidance are sensible and if followed would work to lower risk in third-party relationships. Importantly, it is helpful that the Agencies emphasize the importance of ensuring the planning and due diligence phases are well-managed, thorough, and thoughtful. Considering the pace of innovation in technology related to financial products and services, these phases are critical to helping prevent a bank from engaging with a third party whose technology or processes are not aligned with the goals and business practices of the bank. Specifically, for the planning phase, the Agencies note that planning and assessment are "performed by those

[2] See Board of Governors of the Federal Reserve System (2013), *Guidance on Managing Outsourcing Risk*, https://www.federalreserve.gov/supervisionreg/srletters/sr1319a1.pdf; Federal Deposit Insurance Corporation (2008), *Guidance for Managing Third-Party Risk*, https://www.fdic.gov/news/financial-institution-letters/2008/fil08044a.html; Office of the Comptroller of the Currency (2013), *Third-Party Relationships: Risk Management Guidance*, https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html

with requisite knowledge and skills," those that are "experts across disciplines." Indeed, many third-party relationships involve multiple risk types that must be considered, and so banks must ensure they have their own staff that can opine on each specific risk with sufficient expertise or – in the case a bank has to "supplement the qualifications and technical expertise of in-house staff" – ensure that any external support can do so.

Additionally, it is beneficial that the guidance recognizes the potential need for certain banks, especially smaller banks, to conduct their due diligence with the help of "industry utilities or consortiums." Some banks may not have the level of resources or expertise necessary to perform a sufficient evaluation, particularly with new and emerging technologies. Consortiums could be very beneficial to smaller banks, allowing multiple smaller banks to pool their resources in performing their due diligence. Such an effort would be sensible considering the third party would be offering the same product or service that use the same back-end processes and procedures to each of the banks.

Finally, the guidance appropriately references and emphasizes the role of boards of directors in the process of third-party risk management. After all, boards of directors are ultimately responsible for ensuring banks have strong and effective management that works to prevent dangerous practices and to comply with existing laws and rules. As noted in the proposal "a banking organization's use of third parties does not diminish the respective responsibilities of its board of directors" and indeed should not be diminished simply because a certain product or service is being obtained from a third party rather than being developed and implemented in-house. The risk management of third-party relationships must be treated as a part of a bank's overall risk management process, not a separate process.

<u>The Increased Presence and Evolution of Technology in Banking Necessitates More Specificity in the Guidance</u>

The pace and scale with which financial technology firms are being utilized in the banking industry are substantial and continually increasing, and many of the relationships between banks and financial technology firms are very complex. This can make the processes of planning, due diligence, and ongoing evaluation difficult and at times unclear, especially for small and medium-sized banks that may not have the technical knowledge to sufficiently perform these processes and distinguish the level of risk management to be "commensurate with the identified level of risk and complexity." Without sufficient detail in the guidance, that distinction can ultimately be in some part – or in certain cases, in large part – subjective and potentially vary greatly from bank to bank. This in turn could put a significant burden on the supervisory process to ensure consistency, which would require very frequent and wide-ranging examinations.

Additionally, this guidance is intended for each bank to manage its own risk, but financial technology firms offer the same products and services across many banks using the exact same processes and procedures. This is as opposed to individual banks, whose processes and procedures will differ from bank to bank. While each bank may be managing its risks in a way that both the bank and supervisory examination teams consider to be effective, each bank and each examination team will have its own subjective determinations that may differ from other banks or other examination teams, despite those subjective determinations being applied to the same exact processes and procedures. This could be particularly problematic in certain cases such as with new and emerging technologies or where a third-party company partners with numerous small or mid-sized banks in various parts of the country.

Furthermore, some of these third-party companies may be offering products and services whose processes and procedures are unfamiliar to the bank that is utilizing them. This could leave a bank in the position that it would not have appropriate expertise to evaluate the risks associated with the product or service, even though they may be under the impression that they are indeed able to. For example, a third party may use a technology or methods that are wholly unfamiliar to a smaller bank, or in some cases even a larger bank. As noted, the use of "industry utilities or consortiums" may help the bank in their evaluation and risk management, but this too could leave knowledge gaps if most or all of the banks in the consortium are ill-informed or there is a technology that is not well understood.

In consideration of these potential issues, the guidance should more explicitly set out expectations for each of the components of the life cycle, with a particular focus on planning, due diligence, and ongoing monitoring. The specificity should be added around third-party products and services that the Agencies consider having the greatest potential to pose systemic risks to the banking system. It should provide more detail around the types of risks that such products and services offered by third parties and the utilization of a third party for those products and services may pose as well as considerations banks should follow around those risks. This expansion of the guidance would better inform banks of all size around managing these risks and would help to prevent systemic risks from building.

Management of Third-Party Risk Would Benefit from Regulations

Even if the guidance included more detail and information, a rule passed by the Agencies this year[3] – along with the National Credit Union Administration and the Bureau of Consumer Financial Protection – minimizes the effect of supervisory guidance and diminishes its role in supervisory criticisms. Considering this rule along with the points highlighted above, supervisors' ability to hold banks accountable for insufficient or ineffective risk management practices with regard to third-party relationships is diminished. This is problematic, especially since more systemic risks can build from third-party relationships, particularly in cases where a single third party's product or service is utilized across numerous banking institutions.

Therefore, the Agencies must consider setting minimum standards for risk management of third-party relationships through regulation – either independent regulations or modifications

[3] 86 FR 18173

to existing regulations. Standards that are set through regulation and not guidance would ensure that a minimum level of risk management practices are followed by all banks and that certain processes and procedures are in place to appropriately manage the risks of third-party relationships and integrate that risk management with a banking institution's overall risk management. Additionally, third-party providers of products and services are not directly regulated by the Agencies, but their activities affect the banking system, and so minimum standards set through regulations would be helpful to both banks and third parties.

Minimum standards specific to third-party relationships that are defined through regulations would also enable supervisors to hold banks accountable to those standards and work to prevent risk from building at any individual bank or across the system. That is, rather than relying on the supervisory process to promote such standards over time, supervisors could focus on enforcing the regulations that are already in place. That is not to say that the regulation would eliminate the need for guidance, but rather would be the foundation on which future guidance is derived that would seek to clarify the standards that are in place, including as risks evolve – the case with other regulations and associated guidance.

The standards should cover each component of the life cycle, but should be the most robust for planning, due diligence, and ongoing monitoring. These phases of the life cycle are critically important to ensuring a banking institution is sufficiently considering and managing the full set of risks it faces from each relationship. The standards should also explicitly include the accountability of the board of directors in their role of ensuring sufficient risk management is in place. As with the expanded guidance, the standards should focus on the products and services that the Agencies assess to potentially pose the greatest risks to the banking system.

Conclusion

Better Markets encourages the Agencies to provide additional clarity and specificity in the guidance and to follow the guidance with new regulations or modifications to existing regulations that set minimum standards.

Sincerely,

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