

The Critical Role of Third-Party Risk Mitigation in Financial Services

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Financial institutions need robust practices to help manage the risks associated with third parties.

Third-party risk management (TPRM) has become an essential component to help ensure stability, security, and compliance. Financial institutions increasingly rely on third-party vendors and collaborators to deliver a wide range of services, from core banking operations to innovative fintech solutions. This growing dependence highlights the need for robust TPRM practices to help protect stakeholders, including institutions, collaborators, and customers.

In today's global marketplace, third-party relationships can offer significant benefits, including cost savings, operational efficiencies, and access to professionals with advanced, industry-specific skill sets. However, this is accompanied by increased operational, compliance, reputational, and cybersecurity risks. As the financial services sector continues to evolve, the role of TPRM to identify and mitigate these risks will only become more critical. This is especially key as financial institutions will seek fintech providers that increasingly work with multiple vendors and service providers, further expanding the complexity of their third-party networks. These third parties often rely on their own

subcontractors, creating a chain of fourth parties that the financial institutions also must consider in their risk assessments.

This multilayered ecosystem necessitates a tailored TPRM program that extends beyond direct associates to include fourth parties. Effective risk mitigation now requires financial institutions to monitor not only their immediate third parties but also the subcontractors and associates of those third parties, helping to enable a detailed understanding of the risk landscape as a whole. An effective TPRM program is crucial for identifying, assessing, and managing these risks to help prevent potential disruptions and safeguard the integrity of financial institutions.

The Necessity of Third-Party Risk Mitigation

The most recent regulatory guidance introduced on TPRM, the “[Third-Party Relationships: Interagency Guidance on Risk Management](https://www.occ.gov/news-issuances/bulletins/2023/bulletin-2023-17.html)

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(OCC Bulletin 2023-17), issued by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System, and the FDIC, provides an in-depth framework for managing these risks. The guidance emphasized due diligence, risk assessment, contractual agreements, and ongoing monitoring as key elements of a robust TPRM program.

Due Diligence & Risk Assessment



Due diligence is the cornerstone of a successful TPRM program. Before entering into a relationship with a third-party vendor, financial institutions must conduct thorough due diligence to assess the

vendor's financial stability, compliance history, operational capabilities, and overall risk profile. This process should include looking over the vendor's controls, policies, and procedures to confirm they align with the institution's regulatory obligations and risk appetite.

Risk assessments should be ongoing and dynamic, considering the evolving nature of risks and regulatory requirements. Institutions

Clear & Enforceable Contracts



Establishing clear and enforceable contracts is essential for defining the responsibilities and expectations of each party. Contracts should outline compliance requirements, performance metrics, data security standards, and terms for audit and review. Including provisions for regular audits and assessments helps ensure that third parties adhere to agreed-upon standards and allows for timely identification and mitigation of potential risks. Written contractual language helps

Ongoing Monitoring & Review



Continually monitoring third-party performance and compliance is critical to a strong TPRM program. Financial institutions should implement advanced monitoring tools and technologies to track vendor activities in real time. Regular monitoring and reviews help identify emerging risks and determine if the third parties continue to meet performance and compliance expectations.

Consumer Protection Measures



Consumer protection is a fundamental aspect of TPRM. Financial institutions should develop and enforce policies that prioritize consumer protection, such as transparent communication, prompt resolution of customer issues, and stringent data privacy measures. In addition, monitoring the complaints of the third party and determining the root cause is a prudent measure to help the bank timely identify any potential unfair, deceptive, or abusive acts and practices (UDAAP).

The Larger Role of TPRM in Financial Services

The increasing importance of third-party risk mitigation in financial services cannot be overstated. Financial institutions should implement robust TPRM practices to help manage the risks associated with third-party relationships effectively.

Focusing on due diligence, clear contractual agreements, ongoing monitoring, and consumer protection can help financial firms build a strong foundation for growth and innovation while maintaining the safety and security of their stakeholders.

In an industry characterized by rapid innovation and evolving regulatory landscapes, the commitment to TPRM helps safeguard stakeholders' interests and build a sustainable, trustworthy, and resilient financial future.

If you have any questions or need assistance, please reach out to a professional at Forvis Mazars.