

# Regulatory Alert

## Regulatory Insights for Financial Services

February 2024

### Heightened Risk Standards: Focus on Internal Controls & Operational Risk

#### **KPMG Insights:**

- **Risk Framework:** Heightened regulatory scrutiny built on established prudential risk frameworks and comparisons to 'peers'.
- **Risk Governance:** Expanded internal controls and non-financial risk management breadth/depth of supervisory and enforcement actions.
- **Issues Management:** Expectation for enterprise-wide review/application of identified risks to risk assessments/RCSAs, expansion of mitigating controls, and robustness of end-to-end processes.
- **Sustainability and Continuous Improvement:** Need to demonstrate continuous improvement and sustainability of processes in such areas as internal controls, data management, change management, issues management.

As part of the current focus on heightened risk governance and risk management practices, the financial services sector is experiencing high regulatory intensity in the area of non-financial risk management, inclusive of a focus specifically on Internal Controls and Operational Risk.

#### **Supervision and Enforcement**

In keeping with established prudential regulatory frameworks, financial services regulators expect a

company's risk governance framework to fully incorporate policies and standards, credible challenge, and demonstrable evidence of dynamic risk assessment in support of the design, effectiveness, and sustainability of the internal controls and operational risk environment. Key regulatory areas include (see table on the following page):

Regulatory Area	Key Areas of Focus	KPMG Regulatory Insights
<b>Governance</b>	<ul style="list-style-type: none"> <li>— Roles and responsibilities for all three lines of defense.</li> <li>— Talent management, covering development, recruitment, succession planning, and compensation/performance programs.</li> </ul>	<a href="#">Key Ten Regulatory Challenges of 2024</a> <ul style="list-style-type: none"> <li>— Risk Standards</li> <li>— Risk Sustainability</li> <li>— Data</li> </ul>
<b>Risk Framework</b>	<ul style="list-style-type: none"> <li>— Risk appetite statement approved by the Board, including expectations for the company's risk culture and quantitative statements for risks that can be measured against earnings or capital.</li> <li>— Risk limits, set at enterprise, concentration, and front-line unit levels, to provide early warning of elevated risk along with related reporting and escalation processes.</li> <li>— Communication, and periodic review and monitoring, of the risk appetite and the enterprise, concentration, and front-line unit risk limits.</li> </ul>	
<b>Internal Controls</b>	<ul style="list-style-type: none"> <li>— Consistent and accurate identification, measurement, control, monitoring, and reporting of aggregate risks as well as disaggregated risks, where possible.</li> <li>— Demonstration of actions taken (e.g., enhancements) based on risk assessments.</li> <li>— Documentation of controls testing and effectiveness.</li> </ul>	
<b>Data Management</b>	<ul style="list-style-type: none"> <li>— Deficiencies in data, data outputs, or reporting (e.g., data quality, timeliness, accuracy, traceability, metrics, models).</li> <li>— Data management, including access controls; practices related to collection, retention, disposal; third-party governance/agreements; and reporting capabilities at the lines of business and enterprise levels.</li> <li>— Ability to train, recruit, and retain, skilled talent resources to identify, measure, manage data risk management processes.</li> </ul>	
<b>Issues Management</b>	<ul style="list-style-type: none"> <li>— Self-identification of issues (across the three lines) and associated time to size, mitigate and resolve enterprise wide.</li> <li>— Mitigation and resolution of previously identified deficiencies.</li> <li>— Link between issues management and risk assessment to evidence effective challenge.</li> </ul>	
<b>Change Management</b>	<ul style="list-style-type: none"> <li>— Processes for identifying, managing, challenging, approving, and monitoring changes due to new products, activities, processes, and technologies.</li> <li>— Evidence of sustainable processes and effective risk coverage, including metrics.</li> <li>— Periodic review and changes in the risk management framework to reflect industry developments and changes to the company's risk profile as a result of internal and external factors (e.g., new products, M&amp;A, negative news, systems changes, regulatory changes).</li> </ul>	

**Regulatory Issuances.** The financial service regulators have stated that outstanding supervisory findings are increasing across entities of all sizes and that operational risk issues – including governance, internal controls, IT and cybersecurity, and third parties – are among the most cited supervisory issues. The agencies have

further identified these operational risk areas as part of their top supervisory priorities for 2024 along with companies' efforts to remediate previous supervisory findings, including:

Agency	Activity	Description	KPMG Regulatory Insights
FRB	<a href="#">Supervision and Regulation Report</a>	Operational risk identified as a supervisory priority for 2024 for banking entities of all sizes; specific areas include governance and controls, third party management, novel activities, and fintechs.	<a href="#">FRB Reports: Supervision and Regulation; Financial Stability</a>
OCC	<a href="#">2024 Bank Supervision Operating Plan</a>	Risk-based supervision will focus on: <ul style="list-style-type: none"> <li>— Change management, where change to leadership/staffing, operations, risk management frameworks, and business activities are “significant”.</li> <li>— Operations, including products, services, third-party relationships with unique, innovative, or complex structures (e.g., AI, fintechs).</li> <li>— Incident response, data recovery, threat detection/remediation, third-party controls, and maintenance of IT assets inventory related to cybersecurity.</li> </ul>	<a href="#">Fall 2023 Regulatory Agendas: Key Federal Banking Agencies</a>
	<a href="#">Semiannual Risk Perspective</a>	One of four key risk themes, operational risk is deemed to be “elevated”; highlighted risks include: <ul style="list-style-type: none"> <li>— Innovative technologies and new products/services that change the operating environment as well as the relationship with legacy technologies.</li> <li>— Management of third parties and other risks commensurate with size, complexity, and risk profile – more rigor to higher risk and critical activities – talent management for sufficient resourcing and subject matter expertise.</li> <li>— Strong threat and vulnerability monitoring, and effective security controls, given increasing sophistication of cyber attacks and geopolitical tensions.</li> </ul>	
FDIC	<a href="#">2023 Risk Profile</a>	“Operational risk remains one of the most critical risks to banks.”	n/a
SEC	<a href="#">2024 Examination Priorities</a>	Information security (e.g., data privacy, access, cyber) and operational resiliency identified as key emerging risk areas. Attention to safeguarding data and assets; risk management/prevention; and event response. Specific attention to clearing agencies, and changes related to the standard settlement cycle.	<a href="#">Examinations: SEC 2024 Priorities</a>

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