HOW TO RATE

Your Vendor's Regulatory RISK LEVEL

Why Do You Need to Know Your Vendor's Regulatory Risk Level?

Knowing your vendor's risk level is both a regulatory requirement and good business practice. Evaluating and knowing risks ahead of time and taking steps to address them now can help you avoid some very costly and stressful surprises down the road. Failing to anticipate and then address risk is a key contributor to an organization's failure. The regulatory risk is a portion of the overall risk presented.

Where Does Regulatory Risk Fit In?

When conducting a vendor risk assessment, there are two main categories of risk to review:

Business Impact Risk
Business impact risk determines if the vendor is critical or non-critical to the organization. You can determine the criticality by asking these 3 questions:

1. *Would a sudden loss of this third party cause a disruption to the organization?*
2. *Would such loss have an impact on the organization's customers?*
3. *Would the time to recover normal operations exceed one business day?*

If you answer "Yes" to any of the above, then the vendor is critical to the organization.

Regulatory Risk
Regulatory risk determines the risk rating. These include several risk types and can be found in the regulatory guidance (e.g., FDIC FIL-44-2008).

It's important to understand that a vendor relationship will have both a business impact criticality level **AND** a regulatory risk level.

The Vendor Regulatory Risk Types to Examine

STRATEGIC
Strategic risk is present if the third party offers products and services that are not compatible with your organization's strategic goals, cannot be effectively monitored by the organization or do not provide an adequate return on investment.

OPERATIONAL
Operational risk occurs in all products, services, channels and processes when it's critical to your organization's operations.

TRANSACTIONAL
This risk occurs if there are issues with the service or product delivery.

FINANCIAL
A third party's financial posture is important to keep in mind. If there is a decline in earnings or pending litigation, it can affect the overall relationship.

REPUTATIONAL
A third party relationship that interacts directly with your customer presents reputation risk. If the relationship does not meet expectations, a reputation risk can be posed to the organization.

COMPLIANCE
The third party's adherence to laws, regulations, guidelines and industry specifications should be evaluated.

OTHER
There are dozens of additional risks that may come into play such as liquidity, interest rate, price, foreign currency translation and country risks.

The 3 Vendor Regulatory Risk Rating Levels

LOW:
The vendor represents little risk overall and extensive monitoring is not required.

MEDIUM/MODERATE:
You should do some periodic monitoring and ensure you are keeping an eye to make sure things don't get out of control.

HIGH:
Regular ongoing monitoring should be intensive – be sure you have contractually obliged them to provide you with reporting and stay on top of how they are doing.

How to Determine the Regulatory Risk Level

1. **CREATE A VENDOR QUESTIONNAIRE.**
It's up to your organization to determine the format that works best for you and which questions to ask. Consider regulatory expectations, what rating system you want and what services/products they provide.

2. **COMPLETE THE QUESTIONNAIRE.**
Have the right individuals sift through the questions and provide their answers (e.g., internal vendor manager, the vendor). It's a good idea to have an area where they can expand after each answer. This way they have an opportunity to further explain and clarify why they responded the way that they did, if needed.

3. **REVIEW ANSWERS.**
Take time to properly analyze the answers to determine where the vendor stands. After reviewing, your team may need to begin mitigating any risk present.

4. **COMPARE INFORMATION GATHERED FROM THE ANSWERS TO HOW THEY AFFECT YOUR ORGANIZATION'S OPERATIONS AND PERCEPTION OVERALL.**
What is good, okay and bad? Determine next steps based on the findings. If risky elements were discovered, you may need to increase the due diligence performed and frequency of monitoring. Risk assessments can help ensure you've created the right contractual standards.

5. **DESIGNATE THE RISK LEVEL.**
Are they low, medium/moderate or high? Document the rating so that you can easily share the result with senior management, the board and examiners.

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