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Welcome

Industry Overview for Financial Services Companies' Audit Committee Members

Oct. 6, 2021

Your Moderator and Presenters

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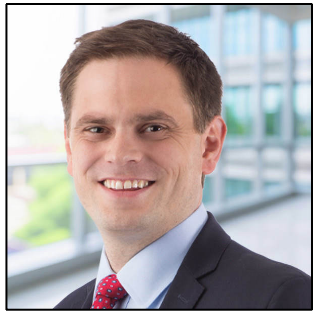

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Agenda

- Third party risk (*Jill Czerwinski*)
  - Innovation & Third-Party Risk
  - Proposed TPRM Regulatory Changes
  - Cyber Supply Chain Risk
  - Forward-Looking TPRM strategy

- Financial Reporting Observations *(Sydney Garmong and Mark Shannon)*
  - Observations from the 2021 AICPA National Conference on Banks & Savings Institutions
  - From the FASB: CECL and other activities
  - Other developments
  - ESG developments
  - From the SEC and PCAOB

- Q&A *(John Epperson)*

Third party risk

Balancing Innovation & Third-Party Risk Management (TPRM)

Innovation vs. Third Party Risk

"The **successful integration of financial technology into the community bank business model** is proving to be enormously valuable …Access to technology and services to meet customer needs is **critical to ensuring community banks remain vibrant."**

-Michelle W. Bowman, Federal Reserve Board member

Date of publication – Primary TPRM guidance

FDIC – 2008
OCC – 2013
Federal Reserve - 2013

Then:
Questionnaire, SOC Report, Check the box

Now:
More of the same?

Balancing Innovation
Third-Party Risk Management (TPRM)

Innovation vs. Third Party Risk

Start up companies bring new approaches

Alternative operational and technology at third parties

New, different risk climates than before

We need new ways of assessing and managing third party risk that **go beyond a simple check the box approval**.

We need new ways of **documenting, tracking, accepting and communicating** third party risk**.**

Proposed Regulatory Guidance

Published for comment in August by FDIC, Fed, OCC. Expected final in early to mid ’22.

Largely based on the OCC’s 2013 guidance and 2020 FAQ

Represents more detailed guidance, particularly for FDIC Banks

Places emphasis on issue management, termination, and the Board’s role is more significance compared to prior.

Cyber Supply Chain Risk

What is Supply Chain Risk Management?

A systematic process for managing supply chain risk by identifying susceptibilities, vulnerabilities, and threats throughout the supply chain and developing mitigation strategies to combat those threats whether presented by the supplier, the supplies product and its subcomponents, or the supply chain (e.g., initial production, packaging, handling, storage, transport, mission operation, and disposal).

- Committee on National Security Systems

3 https://csrc.nist.gov/glossary/term/supply_chain_risk_management

Why is Supply Chain Risk so Dangerous?

- Reliance on vendors/suppliers to support the organization's critical functions
- Organizations have grown highly interconnected and interdependent on others for critical products and services.
- Concentration risk
  - Many third parties use the same 4^{th} parties to facilitate their services.
  - Significant 4^{th} parties may be in the same city or country.
- A significant number of modern applications use open-source components and third-party APIs.

Managing Supply Chain Risk

- Contracting and initial due diligence
- Assess your vendors' third-party risk programs
- Only inventory key fourth parties

Benchmark Study Results

2021 TPRM Trends

Technology enablement

New technology partners/platforms to centralize and automate TPRM functions

Organizational buy-in

Establish buy-in and cooperation from business line owners and relationship owners

TPRM program enhancements and changes

Many program enhancements; some major overhauls

Fourth-party monitoring

Understand and execute rights to monitor and evaluate fourth parties

2021 TPRM Trends

Increased regulatory scrutiny

More attention on TPRM operations as data breach stories come to light

Larger focus on data privacy

Improve evaluations of third parties' practices for data handling, encryption, and storage

Closer monitoring of critical third parties

Critical third parties with access to sensitive and confidential data pose the greatest risk

Move toward managed services/continuous monitoring

Ability to evaluate and identify potential risks in real-time

Level of regulatory scrutiny expected for TPRM in 2021

Preliminary Survey Results (Top Answers)

3 biggest challenges your TPRM program faces in 2021

Collaboration with business partners

Biggest challenge focus/review

Resourcing

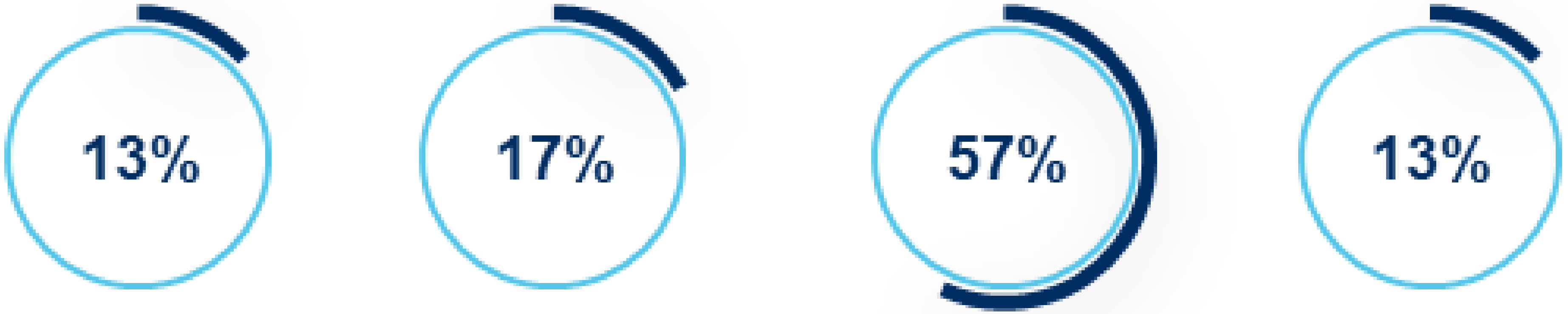
Second-biggest challenge

Technology enablement

Third-biggest challenge

Preliminary Survey Results (Top Answers)

Level of automation present in your TPRM program



Fully automated in a central tool

Fully automated but decentralized in a few tools

Partially automated
(Some activities online, others offline/via email)

Limited automation
(Rely on MS Excel, email, etc.)

Preliminary Survey Results (Top Answers)

What data feeds or ratings tools do you use?

- **33%** Negative news
- **30%** Financial health (RapidRatings, Dun & Bradstreet, CreditRiskMonitor, etc.)
- **25%** Cybersecurity ratings (BitSight, SecurityScorecard, RiskRecon, etc.)
- **3%** ABAC (Dow Jones, RDC, etc.)
- **9%** Other

So…where do we go next?

Recommendations for 2022 planning

Consider if TPRM has kept pace

A bank's TPRM function must be as mature as its desire to partner to drive innovation. We can't face 2022 challenges with a 2010 solution.

Look for blind spots.

Many Banks have scoped back the TPRM department and have some third-party types not managed by TPRM. The board may not have visibility to this third-party risk.

Run the numbers.

Consider how many vendors each TPRM professional oversees. As the third-party population has grown, has management added resources?

Institute issue management

Internal audits aren't expected to yield a perfect thumbs up/thumbs down. Why do we expect that in third party risk?

Financial reporting observations

Observations from the 2021 AICPA National Conference on Banks & Savings Institutions

AICPA Banking Conference – Sept. 18-20, 2021

Standard setters & Regulators
- FASB
  SEC
  PCAOB
- Federal Banking Agencies Chief Innovation Officers
- Federal Banking Agencies Chief Accountants

Keynotes
- Dr. Marci Rossell, former CNBC Chief Economist
- H. Rodgin Cohen, Senior Chair, Sullivan & Cromwell
- Doug Duncan, Chief Economist, FNMA

Topics
- ESG / climate change
- CECL
- LIBOR transition

Crowe's "Hot topics: Takeaways from the 2021 AICPA National Conference on Banks and Savings Institutions"

ETA Oct.12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Hot topics:
Takeaways from the 2021 AICPA National Conference on Banks and Savings Institutions

Oct. 12, 2021

FASB: CECL developments and other activities

FASB Post Implementation Review (PIR) - CECL

Currently performing outreach related to three projects on FASB's technical agenda:

- Removing Troubled Debt Restructuring (TDR) accounting and enhancing disclosures
- Expanding scope of the purchased credit deteriorated (PCD) accounting model
- Requiring gross write-off and gross recovery information in vintage disclosures

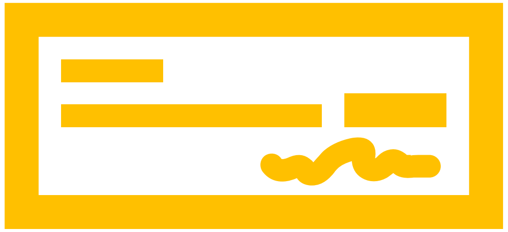
TDRs and Non-PCD

TDRs

- Recognition & measurement
  - Remove TDR designation and measurement
  - Focus on experiencing financial difficulty
- Disclosures
  - Modifications due to financial difficulty
  - Impact on the allowance
  - Performance

Non-PCD

- Expansion of the PCD model
- Scoping
  - Loans or other financial assets
  - Business combinations or all acquired assets, including asset acquisitions
  - Concept of “seasoning”



Gross Write-offs and Recoveries

> > Example 15: Disclosing Credit Quality Indicators of Financing Receivables by Amortized Cost Basis

Condensed example from ASU 2016-13

As of December 31, 20X5	Term Loans Amortized Cost Basis by Origination Year 20X5	20X4	20X3	20X2	20X1	Prior	Revolving Loans Amortized Cost Basis	Total
Commercial business loans:								
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial mortgage:								
Risk rating:								
1–2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3–4 internal grade	-	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-	-
Total commercial mortgage	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial mortgage loans:								
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -

ASU 2021-05: Lessor leases with variable payments

Issue and change

- Lessor were required to recognize a selling loss at inception for a sales-type lease with variable payments, even if the arrangement would be profitable overall.
- Account for lease an operating lease if both:
  - Lease would have been classified as a sales-type or a direct financing.
  - The lessor otherwise would have recognized a day-one loss.

Effective dates

- Public business entities (PBEs) – beginning after Dec. 15, 2021, and interim periods within
- Non-PBEs – beginning after Dec. 15, 2021, and interim periods beginning after Dec. 15, 2022

ASU 2021-06: Disclosures for banks and investment companies

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Codifies recent SEC final rules

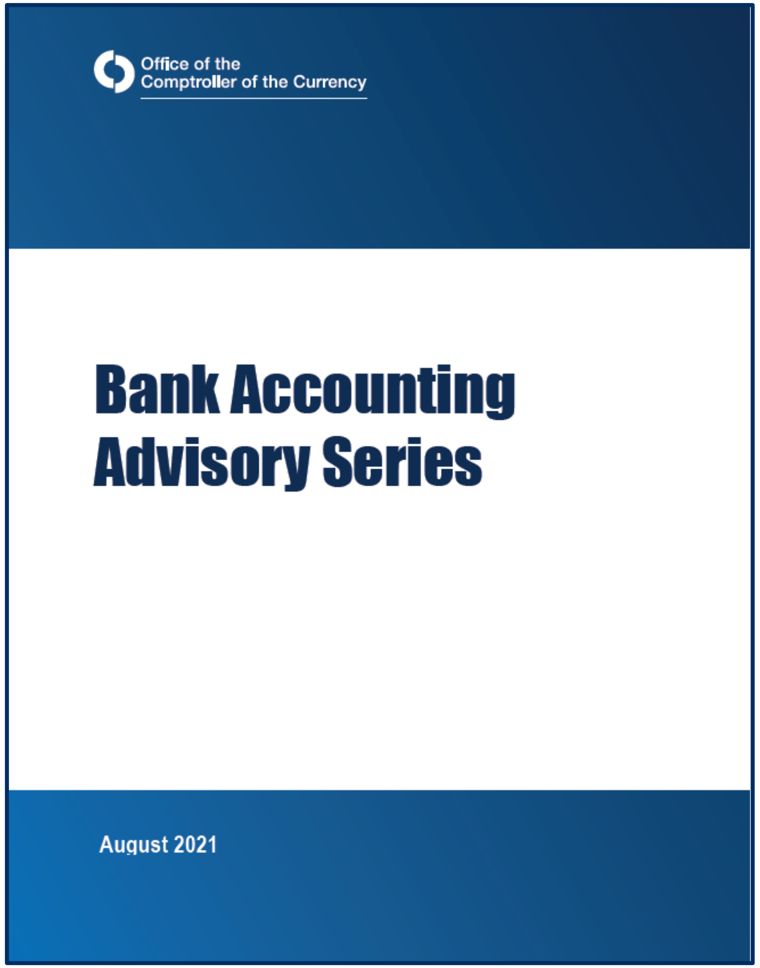
Rule	Mandatory Compliance
Amendments to Financial Disclosures about Acquired and Disposed Businesses (SEC Release No. 33-10786)	Business combinations consummated on or after Jan. 1, 2021 for calendar year-end entities
Update of Statistical Disclosures for Bank and Savings and Loan Registrants (SEC Release No. 33-10835)	Dec. 31, 2021 Form 10-K for calendar year-end entities

Other FASB projects of interest

- Investments in tax credits
  - Project added Sept. 22 to Emerging Issues Task Force's (EITF) agenda
  - To expand the proportional amortization method to investments in tax credits other than low-income housing tax credits (LIHTC)
  - Examples:
    - New Markets Tax Credits (NMTC)
    - Historic Rehabilitation Tax Credits (HTC)
    - Renewable Energy Tax Credits (RETC)

Other developments

OCC Bank Accounting Advisory Series (BAAS)


Office of the Comptroller of the Currency

Bank Accounting Advisory Series

August 2021

August 2021 changes:

New

- Loans held for sale (Question 4)
- Employee stock options (Question 2)
- Grants received (Questions 1 and 2)

Updated

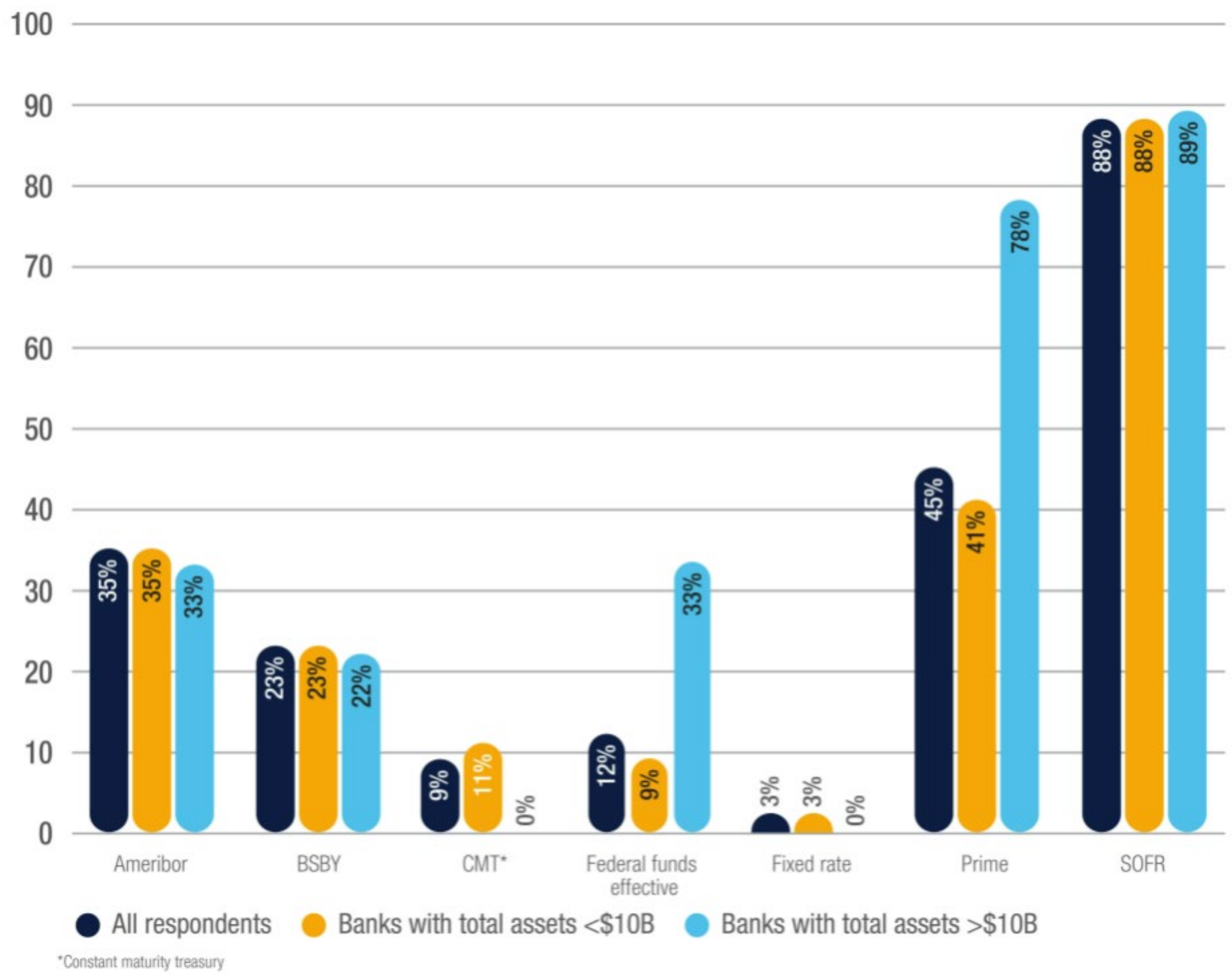
- Investments (Question 19)
- Loans held for sale (Questions 3 and 15)
- Intangible assets (Question 1A and 7A)

https://www.occ.treas.gov/publications-and-resources/publications/banker-education/files/pub-bank-accounting-advisory-series.pdf

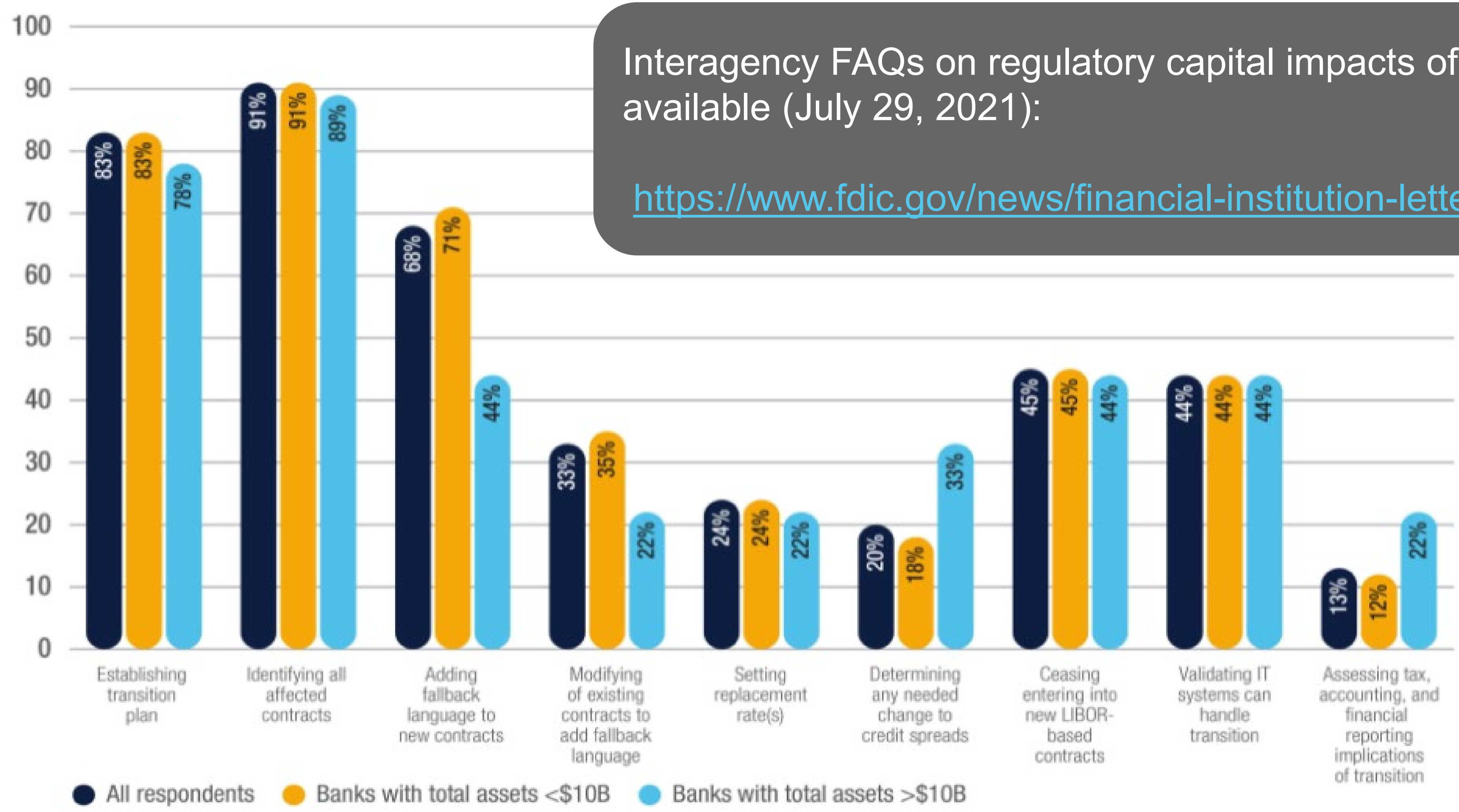
Crowe's Community Bank LIBOR Transition Survey

Crowe surveyed community banks in July 2021 on what LIBOR replacement rates they were considering. This chart reflects the responses of the 75 respondents comprised of banks with assets < $30 billion.

https://www.crowe.com/insights/takeaways-from-the-crowe-community-bank-survey-on-libor-transition



LIBOR transition steps already completed

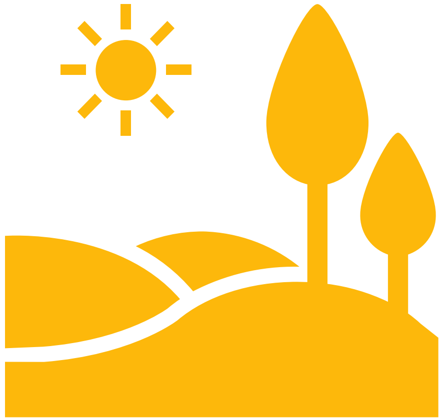


Interagency FAQs on regulatory capital impacts of LIBOR transition are available (July 29, 2021):

https://www.fdic.gov/news/financial-institution-letters/2021/fil21054.html

Source: Crowe Survey Banks <$30 Billion Assets

Environmental, social and corporate governance (ESG) developments



Recent banking ESG developments

OCC appoints Climate Change Risk Officer

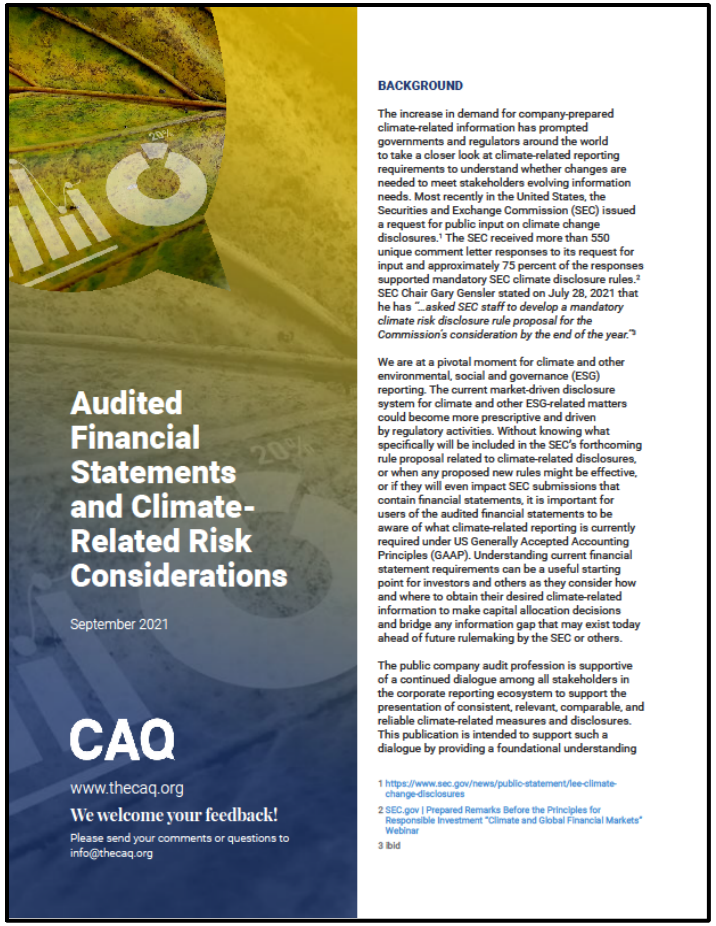
https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-78.html

Financial Stability Board issues climate risk reports

Issued July 7th

- Roadmap for assessing climate related risks (https://www.fsb.org/wp-content/uploads/P070721-2.pdf)
- Report on promoting climate related disclosures (https://www.fsb.org/wp-content/uploads/P070721-4.pdf)
- The Availability of Data with Which to Monitor and Assess Climate-Related Risks to Financial Stability (https://www.fsb.org/wp-content/uploads/P070721-3.pdf)

CAQ resource: Climate Risk Disclosure


Audited Financial Statements and Climate-Related Risk Considerations

September 2021

CAQ

www.thecaq.org

We welcome your feedback!

Please send your comments or questions to info@thecaq.org

BACKGROUND

The increase in demand for company-prepared climate-related information has prompted governments and regulators around the world to take a closer look at climate-related reporting requirements to understand whether changes are needed to meet stakeholders evolving information needs. Most recently in the United States, the Securities and Exchange Commission (SEC) issued a request for public input on climate change disclosures.[1] The SEC received more than 550 unique comment letter responses to its request for input and approximately 75 percent of the responses supported mandatory SEC climate disclosure rules.[2] SEC Chair Gary Gensler stated on July 28, 2021 that he has *"…asked SEC staff to develop a mandatory climate risk disclosure rule proposal for the Commission's consideration by the end of the year."*[3]

We are at a pivotal moment for climate and other environmental, social and governance (ESG) reporting. The current market-driven disclosure system for climate and other ESG-related matters could become more prescriptive and driven by regulatory activities. Without knowing what specifically will be included in the SEC's forthcoming rule proposal related to climate-related disclosures, or when any proposed new rules might be effective, or if they will even impact SEC submissions that contain financial statements, it is important for users of the audited financial statements to be aware of what climate-related reporting is currently required under US Generally Accepted Accounting Principles (GAAP). Understanding current financial statement requirements can be a useful starting point for investors and others as they consider how and where to obtain their desired climate-related information to make capital allocation decisions and bridge any information gap that may exist today ahead of future rulemaking by the SEC or others.

The public company audit profession is supportive of a continued dialogue among all stakeholders in the corporate reporting ecosystem to support the presentation of consistent, relevant, comparable, and reliable climate-related measures and disclosures. This publication is intended to support such a dialogue by providing a foundational understanding

1 https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

2 SEC.gov | Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar

3 Ibid

- Audited Financial Statements and Climate-Related Risk Considerations (Sep. 9, 2021)
- Explores how current US GAAP addresses climate risk that has:
  - a direct impact on the financial statements
  - an indirect impact on financial statements
  - no impact

https://www.thecaq.org/audited-financial-statements-and-climate-related-risk-considerations/

SEC recent ESG messages

MESSAGE	DATE
Commissioner Peirce, “Chocolate-Covered Cicadas”	Jul. 20
SEC Chair, “Remarks Before the Principles for Responsible Investment “Climate and Global Financial Markets” Webinar”	Jul. 28
Various, “Commission’s Approval of Nasdaq’s Proposal for Disclosure about Board Diversity and Proposal for Board Recruiting Service”	Aug. 6
Chair, “Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs”	Sep. 14

RESOURCES
SEC speeches and statements: https://www.sec.gov/news/speeches-statements
SEC press releases: https://www.sec.gov/news/pressreleases

SEC recent ESG messages

Division of Corporation Finance – Sample Letter to Companies Regarding Climate Change Disclosures (Sep. 22, 2021)

Provides example comments related to:

- Consideration of information in corporate sustainability report (CSR)
- Risk factors
- Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

CSRs are often separate and apart from SEC filings (for example, on the entity's website)

https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures#_ftn1

SEC and PCAOB developments

SEC regulatory agenda

Forecasted action: late 2021

- Climate change disclosure
- Human capital management
- Cybersecurity risk governance
- Corporate board diversity
- Rule 10b-5 (insider and company trading plans)

Forecasted action: early 2022

- Incentive based compensation arrangements and claw-back listing standards
- Share repurchase disclosure modernization
- Shareholder proposals (Rule 14a-8)
- Special Purpose Acquisition Companies (SPACs)

https://www.reginfo.gov/public/do/eAgendaMain

Meeting of SEC Investor Advisory Committee (IAC)

- Sept. 9, 2021; 4 panel discussions
  - Competition and Regulatory Reform at the PCAOB
    - Wes Bricker, PwC; former SEC chief accountant
    - Colleen Honigsberg, PhD, Professor of Accounting, Stanford Law School
    - Sara Lord, RSM
    - Alistair Thompson, Director of Remedies, Business and Financial Analysis, United Kingdom Competition and Markets Authority (CMA)
    - Lynn Turner, Senior Advisor, Hemming | Morse; former SEC chief accountant
  - Other three panels:
    - Reimagining Investor Protection in a Digital World: the Behavioral Design of Online Trading Platforms
    - Recommendation Regarding 10b5-1 plans
    - Recommendation Regarding SPACs

Panel discussion – Competition and PCAOB reform

- How do audit committees and investors receive and use information about audit quality?
- Can communication of that information be changed or improved to meet various stakeholder objectives?
- Is competition in US audit marketplace sufficient?

Crowe Resource: SEC comment letters in banking

- 2021 Edition
  - 28 pages
  - Analyzes topical areas of frequent SEC comment for banking registrants
  - Includes example SEC comments for each topic
  - New for 2021 edition: example SEC comments addressing CECL adoption, LIBOR transition, assessing financial statement errors, and potential comments on ESG matters

Issued Sept. 9th

https://www.crowe.com/insights/asset/s/sec-comment-letters-in-the-banking-industry-2021-edition

PCAOB Developments

Joint Public Statement by Board Members Rebekah Goshorn Jurata and Megan Zietsman (Aug. 23)

PCAOB Acting Chair Announces Reassessment of Stakeholder Engagement, Advisory Groups (June 22)

Resource Links

- https://pcaobus.org/news-events/news-releases
- https://pcaobus.org/news-events/speeches

Questions?

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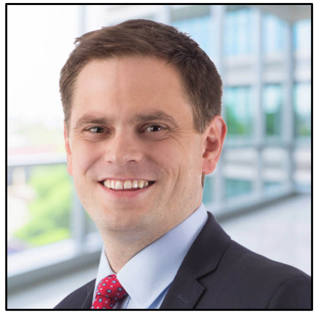

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