Action Plans & Commitments

Risk Transformation

Background

Within the CART program, SHUSA has established the Risk Transformation workstream to remediate the foundational elements of risk management in accordance with a holistic framework consisting of six broad categories: a) risk appetite; b) governance and organization; c) risk measurement; d) risk management processes; e) risk monitoring; and f) supporting data and systems infrastructure.

Root causes

SHUSA recognizes that management has failed to remediate deficiencies in risk management capabilities cited in prior regulatory feedback by the Federal Reserve. We also recognize that persistent lack of progress in this area represents a material supervisory concern. SHUSA has identified five clear themes around the root causes that underlie many of these historical deficiencies in its risk management practices.

Enhanced Governance and Oversight across BHC

SHUSA's failure to oversee and control risk-taking and risk management at the subsidiary and consolidated levels has been a significant source of criticism from supervisors. Santander's multiple U.S. legal entities still lack integrated governance, management and oversight. This raises significant challenges in communication, coordination, and cooperation across the entities, and reduces SHUSA's ability to impose top-down risk standards and governance. Despite progress in 2014 towards developing a more suitable policy and governance structure, challenges in these areas persist. The suboptimal composition of SHUSA's senior leadership team, as well as its risk-related committee structures and senior organizational reporting lines, have limited SHUSA's capacity to provide effective oversight. In addition, SHUSA's processes and documentation have been ineffective in communicating to the Board in a manner that allows for a comprehensive understanding of the enterprise's material risks.

Foundational Risk Management and Ownership of Risk across Three Lines of Defense

Historically, business lines have been siloed in their management and reporting of risks, with no formal escalation channels. This has led to a lack of consistency of practice across businesses. In addition, business line staff have relied too heavily on the Risk function as the sole group that identifies and manages risk. This has hindered risk identification, model development, model usage, operational risk loss identification, and data requirements generation.

Although SHUSA recently implemented a "three lines of defense" model, significant gaps still remain in a) the clarity and consistency of defined roles and responsibilities for SHUSA versus subsidiaries and across the three lines of defense; and b) the resources, knowledge and capabilities required to identify, measure, monitor, and control the enterprise's risks, especially in the first line of defense. Although the risk operating model assigns business executives with risk ownership, business authority over critical risk-taking decisions is underdeveloped, and responsibilities and accountability between the business lines and risk management are still evolving. For example, certain underwriting activities by the second line of defense affect both the business lines' ability to assume responsibility for overall risk levels and the independence of the risk function that must assess the effectiveness of the underwriting process.

Effectiveness and Integrity of Processes and Controls

Risk management has not consistently developed or enforced sufficient process discipline in various areas. In many cases, it has only loosely defined core processes and ineffectively monitored compliance of processes with policies and procedures. For example, supervisors noted deficiencies in our wholesale credit loss models concerning the over-fitting of macroeconomic risk factors. This apparently technical consideration can be viewed as a symptom of an ill-defined model construction process that does not require incorporation of appropriate business and economic rationale. The proper stakeholders from the business units should have been engaged from the start as a matter of standard process. Other examples can be found in the spotty surfacing of operational risk losses and ad hoc preparation of senior risk reports, which are a result of weaknesses in our ability to ensure compliance with established guidance and identify and correct lapses.

Improved Data Quality and Robust Technology Applications

SHUSA's risk data is not comprehensive and lacks integrity because of underdeveloped data management practices and lack of ownership and accountability for data quality. Requirements have historically been defined in isolation by specific projects, business units, or functional areas, following different processes with varying degrees of completeness and accuracy. SHUSA continues to rely on multiple information warehouses that contain inconsistent risk data segmentation and data definitions, negatively impacting processes such as aggregation, reporting and analysis of risks at the consolidated level. Legacy system migrations have resulted in missing or inaccurate data on loan terms, delinquency and charge-offs. Many areas of the enterprise lack risk-related tools and technology systems that would enable robust process discipline, such as platforms for model development, model tracking, and attestation.

Strengthened Organizational Capabilities and Resources

SHUSA's risk management staff had insufficient U.S. banking experience, and management did not grasp the consequences of this skills gap. As a result, SHUSA is not aligned with U.S. supervisory expectations and peer financial institution practices. Over the past year, we have recruited senior managers with deep expertise and extensive experience in risk management at large and complex U.S. banking organizations, including a new CEO. Nevertheless, gaps remain in the adequacy of overall headcount and the proper alignment of staff to roles within risk management. In addition, the risk organizational structure has not sufficiently evolved to support the effective governance, oversight and control of subsidiaries by SHUSA or facilitate the full implementation of the articulated three lines of defense model.

Summary of activities underway and recent progress within Risk

Prior to the establishment of the Risk Transformation workstream within the CART program, SHUSA has been making targeted improvements and changes that further our progress in strengthening foundational risk management:

- Enhanced risk policies and Three Lines of Defense articulation: Made significant advances in the development of new policies by risk type that define SHUSA's approach to managing risk across the enterprise and document three lines of defense roles and responsibilities
- Material Risk Program: Developed program guidance, executive communications, training materials and the material risk inventory template (supporting overall risk identification); commenced program pilot
- Risk resources in the first line of defense at SBNA: Continued hiring efforts to build first line of defense capabilities, which have resulted in over 100 first line risk management staff at SBNA

Workstream Framework

SHUSA will use its understanding of the root causes of past failures to define a thoughtful multi-year plan for improving the fundamentals of risk management. We will carefully prioritize the remediation of the most critical issues while considering the elements that are preconditions for further progress. Our top priorities are to:

- Enhance governance and reporting protocols to ensure basic steps are taken to better manage the business, such as monthly risk reviews
- Develop a risk appetite statement for SHUSA that will inform and constrain risk-taking across the enterprise, and will ultimately be cascaded throughout the organization and embedded in key processes and business decision-making
- Compile a register of material risks to inform the Board and senior management, and for use in critical processes including capital planning and stress-testing
- Perform a talent assessment that will lead to a stronger, more capable risk staff
- Articulate three lines of defense principles to serve as a guide for implementing the target operating model for risk management.

Achieving these objectives will provide better information for better risk-based decisions and allow improvements and more consistency in the risk culture of the institution.

The Risk Transformation workstream will develop its action plan using this framework:

Category	**Definition**
Risk Appetite	Communication of key risk/return trade-offs and risk appetite
Risk Governance and Organization	Organizational structure of risk management and mechanisms to enforce the risk appetite statement, and oversight of that structure by the boards of directors
Risk Measurement	Tools and processes to quantify the enterprise's risks, where applicable
Risk Management Processes	Measurement and management of the enterprise's risks and application to strategic business decisions
Risk Monitoring	Reports key internal and external stakeholders, including the Board and regulators, summarizing the enterprise's risks
Risk Data and Systems	Information and systems architecture to support effective risk management

Certain risk-related efforts that fit within this holistic framework will be managed in separate CART program workstreams, including: a) model development aspects of risk measurement; and b) operational risk management and model risk management aspects of risk management processes.

Within each of these categories, we have identified and prioritized high-level deliverables for completion before the CCAR 2016 submission, before the CCAR 2017 submission, and beyond (as applicable).

1. **Risk Appetite**

MRAs addressed by this sub-workstream: CCAR 2013 MRA 27

Root causes of deficiencies in the Risk Appetite sub-workstream can be traced to issues in governance and oversight across the BHC and the effectiveness and integrity of process controls. SHUSA will address the root causes and the specific issues raised by the FRB related to its risk tolerance framework.

SHUSA's risk tolerance framework is currently fragmented, not properly calibrated to the risk profile of the business, and not cascaded consistently across subsidiaries and business units. The framework is not embedded in the organization's processes, and the exact consequences of breaches are neither articulated nor enforced. SHUSA intends to redevelop its risk appetite framework to consider both short- and long-term business strategies, as well as material risks and constraints placed on SHUSA by Santander Group, local regulation and external stakeholders, such as rating agencies.

Towards this goal, a key first-year priority is to create a SHUSA-level risk appetite statement, to inform risk-taking across the enterprise, which over time will be consistently cascaded throughout the organization. SHUSA will continue to refine the risk appetite framework as its risk identification and measurement processes mature and expect constraints implied by risk appetite to stabilize over the next two to three years until they serve as the ultimate guideline for decision-making and risk-reward optimization across the enterprise. In the target state, the risk appetite will be embedded in key processes and business decision-making across the institution, including strategic planning, capital planning and stress testing, new product approval, and outsourcing decisions.

For CCAR 2016, SHUSA plans to:

1. Develop a SHUSA-level risk appetite statement (RAS):
    - Articulate the overall risk philosophy and risk types to define an enterprise-level appetite
    - Define thresholds for each material risk type within which the enterprise must operate, including qualitative statements and quantitative metrics (based on capital weighted measures where possible)
    - Integrate binding constraints by Santander Group, regulatory bodies, rating agencies and other external stakeholders on the enterprise
    - Identify key risk limits in use across the enterprise and ensure appropriate linkages and consistency with SHUSA RAS.
2. Develop an approach to cascade the RAS to subsidiaries and below, aligned to target Risk Management and business organizational structure, material risk types and any additional risk appetite constraints relevant to individual businesses
3. Complete RAS for SCUSA and SBNA and initiate cascading of the respective RAS
4. Define RAS reporting, breach escalation, and remediation processes, including the consequences for business areas responsible for breaches
5. Provide education to the Board Risk Committee to communicate the new RAS framework, the context behind qualitative and quantitative statements, and the role of the Board
6. Communicate the RAS across the enterprise.

For CCAR 2017 and beyond, SHUSA plans to:

1. Continue to cascade the RAS for the remainder of subsidiaries and business units; ensure alignment with overall SHUSA RAS
2. Embed RAS in key strategic processes and decision-making, including strategic planning, capital planning and stress testing, and new product approval
3. Continue to communicate RAS throughout the enterprise, including training in the new escalation and remediation process

4. Periodically enhance RAS based on the latest results of material risk identification and improved risk measurement across the enterprise
5. Incorporate risk-based capital metrics into risk appetite.

2. **Risk Governance and Organization**

MRAs addressed by this sub-workstream: N/A

Root causes of deficiencies in the Risk Governance and Organization sub-workstream can be traced to issues in: a) enhanced governance and oversight across the BHC; b) foundational risk management and ownership of risk across three lines of defense; and c) organizational capabilities and resources. SHUSA will address the root causes and the specific issues raised by the FRB related to its risk management oversight.

Risk management has suffered as a result of weak Board and senior management oversight, unclear roles and responsibilities across the three lines of defense, and the duplication of functions. Staff capabilities are also misaligned with the skills required to fulfill specific roles, particularly in Risk leadership positions. This sub-workstream will further strengthen oversight through training and a review of committee effectiveness. The target operating model for risk management will be redesigned and implemented in alignment with the three lines of defense governance principles. In the short term, we will continue hiring resources in areas where we have the biggest staffing gaps, with a focus on filling Risk leadership positions. We will also conduct a detailed talent assessment and create a hiring strategy to support the wider implementation of the target operating model.

For CCAR 2016, SHUSA plans to:

1. Strengthen Board and management oversight:
   - Develop a risk education curriculum and schedule for the Board Risk Committee
   - Establish governance and coordination mechanisms between SHUSA and the Santander Group
   - Update the composition, mandates, and charters for risk committees
   - Assess ongoing work on performance scorecards, including identification of elements that can be incorporated in this year's performance assessments
2. Redesign and begin roll-out of the operating model for SHUSA and its subsidiaries:
   - Articulate and formalize three lines of defense principles at the enterprise and granular risk-based levels, including clear differentiation between roles and responsibilities at SHUSA and its subsidiaries
   - Define senior management reporting lines
   - Design a detailed organizational structure aligned with the three lines of defense principles
3. Design and approve enhanced frameworks across all risk types
4. Perform a talent review and assessment of key risk staff and develop a strategy to address gaps in hiring, training, leadership programs and so on, and begin executing hiring strategy to fill staffing gaps
5. Articulate a strong and desired risk culture and create risk communication forums on the intranet, in Risk town halls and so on.

For CCAR 2017 and beyond, SHUSA plans to:

1. Roll out performance assessment and compensation frameworks across the organization, including:

- Communication and stakeholder engagement
- Updates to performance assessment templates
- Compensation impact analysis

2. Complete roll-out of the new operating model, including:
   - Communications
   - Development and delivery of materials to convey organizational changes to the enterprise
   - Enterprise-wide training and development of job descriptions with explicit focus on three lines of defense
3. Develop talent management mechanisms, including:
   - Recruitment and retention mechanisms
   - Professional development and job rotation programs, job satisfaction assessments, and compensation structure
   - Action plans for necessary remediation efforts
4. Assess risk culture across the organization, including:
   - Diagnostic of risk culture
   - Definition of a multi-year plan to achieve end-state culture.

3. **Risk Measurement**

MRIAs addressed by this sub-workstream: CCAR 2014 MRIA 4

Root causes of deficiencies in the Risk Measurement sub-workstream can be traced to issues in: a) enhanced governance and oversight across the BHC; b) foundational risk management and ownership of risk across three lines of defense; and c) effectiveness and integrity of processes and controls. SHUSA will address the root causes and the specific issues raised by the FRB related to its risk identification and assessment process.

Our risk identification process has been ineffective due in large part to limited progress implementing the three lines of defense model and a general lack of process maturity. Risk identification process improvements will require a multi-year effort, demonstrating a strong culture shift towards rigorous process discipline and integration with BAU activity. Weaknesses in our model development, model usage and model risk measurement will be addressed by separate workstreams of the CART program.

SHUSA classifies risk identification into two categories: foundational and material. Business and functional managers use foundational risk identification throughout the organization, typically as ongoing BAU activity. Examples include compliance or vendor risk assessment, reviews of credit loss trends, and inventories of model risk. Many of our foundational risk identification processes do not match up to those of our U.S. peers or to supervisory expectations, however, so we intend to advance our capabilities in several risk assessment areas prior to CCAR 2016. In addition, we will review the landscape of foundational risk identification processes and data sources to develop multi-year objectives for continued enhancement.

Material risk identification processes will synthesize a concise and comprehensive compendium of the organization’s most material risks for senior management and the Board, and for use in downstream applications, such as capital planning. We intend to design and execute an enhanced material risk identification process (the “Material Risk Program”) in time for use in scenario generation for CCAR 2016. The process design will ensure sustainable and repeatable program execution on a periodic basis.

The Material Risk Program will:

- Leverage the first and second lines of defense to identify, assess, and aggregate material risks
- Require the identification, assessment and documentation of material risk inventories for the Line of Business ("LoB"), Business Segment, Business Entity and SHUSA entities
- Deliver comprehensive program guidance, training, tools and templates to the first and second line of defense, ensuring the comprehensive and consistent capture of material risks
- Require executive approval and challenge throughout the risk assessment process to comprehensively and consistently assess all material risks
- Require the inclusion of new product, strategic plan, emerging, and off-balance-sheet risks
- Utilize a standard risk taxonomy to identify and aggregate granular risks at the product, concentration and counterparty levels
- Establish links to the capital planning process, including scenario generation
- Incorporate a three line of defense approach consistent with overarching SHUSA governance principles (i.e., first line of defense ownership for LoB and Business Segment Material Risk Inventories, second line of defense providing oversight, review and challenge, and third line of defense testing and validating process and outputs).

For CCAR 2016, SHUSA plans to:

- Develop a framework to identify material risks, including tools, templates, risk taxonomy, guidance, and policies and procedures
- Develop a register of material risks, with reporting to senior management and the Boards
- Establish clear linkages of risk identification output to the capital planning scenario generation process
- Review foundational risk identification processes and develop multi-year enhancement objectives.

For CCAR 2017 and beyond, SHUSA plans to update and refine the Material Risk Program, revising tools, templates, risk taxonomy, guidance, policies and procedures as necessary. Further, we will continually enhance foundational risk identification processes and data sources to align with established multi-year objectives.

4. **Risk Management Process**

SHUSA's management of individual risk types must be consistent across the enterprise yet flexible enough to meet the needs of specific businesses. The issues in management of operational risk and model risk are known, and CART workstreams program will address the recognized areas of weakness. More work will be required, however, to identify the weaknesses of the approaches, processes and tools used to manage the remaining key risk types in each legal entity and business unit.

Identifying approach, process, and tools-based weaknesses within key risk types in each legal entity and business unit will require additional targeted efforts. SHUSA will analyze credit risk, market and trading risk, interest rate risk, liquidity risk, and strategic and reputational risk to identify and address material risk management gaps.

For CCAR 2016, SHUSA plans to:

1. Analyze and remediate gaps in liquidity risk management against IHC requirements:

- Define target liquidity risk capabilities aligned with regulatory guidance, including expected capabilities of first line of defense, in conjunction with Finance Transformation, with cash flow projection capabilities and the ability to execute stress scenarios
- Assess current state vs. target liquidity risk capabilities
- Assess first line of defense policies and processes, including liquidity contingency funding plan, liquidity buffers and asset and liability composition, linkage to Funds Transfer Pricing ("FTP")
- Articulate expected capabilities of the second line of defense, including oversight over first line, alignment of assumptions with risk appetite and other relevant policies

2. Perform high-level review and revision of wholesale credit process limits and controls and delegation of authority at SCUSA and SBNA:
   - Identify key steps in credit origination process by product type
   - Define controls and operational limits for each process step
   - Articulate scope of authority across the organization and associated escalation procedures

For CCAR 2017 and beyond, SHUSA plans to conduct gap analyses and launch remediation plans for the management of credit, market and trading, interest rate, and strategic and reputational risks:

- Identifying shortcomings in efficiency, methodology, tools and processes
- Benchmarking current practices with industry best practices
- Creating actionable prioritized remediation plans to address shortcomings and gaps to best practice.

5. **Risk Monitoring**

MRAs addressed by this sub-workstream: N/A

Root causes of deficiencies in the Risk Monitoring sub-workstream can be traced to issues in governance and oversight across the BHC and data quality and technology applications. SHUSA will address the root causes and the specific issues raised by the FRB related to its reporting processes.

Business unit silos have resulted in distinct risk reporting formats and content across legal entities, while information system challenges prevent SHUSA from aggregating data easily or reporting on the risk profile in a timely fashion. SHUSA intends to significantly enhance its ability to monitor risks and report on them in an action-oriented and timely manner.

We will define the target reporting landscape and identify critical data elements to institute the MIS to meet reporting needs. First-year efforts will focus on Board and senior management reporting, with lower-level reporting needs addressed in years 2 and 3. This sub-workstream will be closely integrated with Risk Governance and Organization to ensure that appropriate resources are available to support risk reporting. For CCAR 2016, SHUSA plans to:

1. Assess the current reporting landscape:
   - Identify and make quick-win reporting enhancements
   - Define and implement consistent reporting protocols, including regular risk reviews that incorporate all key businesses and areas (embedding in existing committees where appropriate)
2. Define the target reporting landscape by audience and risk type:

- Identify audiences for risk reporting, including the Board, executive-level management, risk-specific committees, business units and day-to-day process operators
- Outline content and frequency of reporting per audience type

3. Create templates for Board and senior management (Management Committee Level 1) reports, relying on first available information and metrics
4. Define business requirements based on desired reporting contents and frequency, including both type and frequency of data; prioritize business requirements based on report and metric materiality
5. Identify risk aggregation needs and cultivate dedicated resources to manage reporting:
   - Identify reporting groups within SHUSA and its subsidiaries
   - Define target organizational structure for reporting groups (e.g., central aggregation team at SHUSA level)
   - Define resource needs to support desired reporting in current and future states
   - Train and on-board resources for reporting.

For CCAR 2017 and beyond, SHUSA plans to:

1. Develop templates and launch reports at multiple levels of granularity, including management committee (Level 2) and subcommittees level, LoB, and day-to-day operations level
2. Continually update business requirements for reporting, and assess resources to produce and deliver reports.

6. **Risk Data and Systems Infrastructure**

This sub-workstream within Risk Transformation will provide the necessary business and systems requirements for the CART Data and IT workstream as it relates to risk management. This year, SHUSA will better prioritize and focus its efforts to deliver consistent and clearly defined data segmentation and data requirements for Board, senior management and regulatory risk reporting. We will apply a common approach, methodology and governance for defining and collecting requirements.

For more details on the overall CART plan for data and systems remediation, please refer to the Data and IT workstream.

CCAR 2014 MRIA 4

The Board of Directors is required to develop a risk identification process that aligns with the expectations of the ROPE paper. These processes should evaluate the full set of potential exposures stemming from on-and-off balance sheet positions, including those that could arise from provisions of non-contractual support to off-balance-sheet entities, and risks conditional on changing economic and financial conditions during periods of stress.

In the CCAR 2015 process, our risk identification process surveyed stakeholders and data sources throughout the organization to compile an aggregate list of individual risks and key risk themes that could inform downstream capital planning applications. While this approach was generally sound in concept, there were several deficiencies in the execution of this process and in the final output:

- Identified risks were in some cases too generic: they did not identify Santander-specific vulnerabilities at the exposure, product, or counterparty level
- Identified risks were in some cases too narrow resulting in, for example, non-material risks being included in the final inventory
- The process did not identify all material risks
- The process was not standardized enough to allow management to update its risk assessments regularly
- The company did not evaluate whether concentrations of non-material risks could become material on a combined basis
- The capital planning process did not account for all identified risks
- Ownership and involvement of senior business leaders was not consistent and sufficient across all business lines
- The process was executed with timelines that were too tight and was initiated before the methodology was firmly in place

SHUSA's Material Risk Program will incorporate lessons learned from previous efforts and deliver clear process improvements. Consistency and comprehensiveness of the process will be improved through a) the development of program guidance, training, tools and templates that will be delivered to the first and second line of defense; b) first line executive ownership of LoB / business segment Material Risk Inventories; c) clear documentation of the process to complete Material Risk Inventories including use of foundational inputs, supporting analysis, and key participants; d) executive approval/challenge and enrichment throughout the assessment process; e) completion of Material Risk Inventories for key support functions including Human Resources, Legal, Finance and Technology and Operations; and f) the development of a standard Risk Taxonomy that will support the identification of risks at more granular levels such as product, concentration or counterparty level.

Coordinated development of project plans and timelines will ensure sufficient time run an effective risk identification and assessment process and incorporate in capital planning scenario generation. We plan to run this process annually, however, management will be able to update its risk assessment with changes in the business mix and the business environment; they will be able to do this by updates to foundational inputs such as RCSAs, the model risk inventory, and the new products and business activities process.

Prior to CCAR 2016, SHUSA will:

- Develop a framework to standardize identification of material risks and linkages amongst risks, including tools, templates, risk taxonomy, guidance, and policies and procedures.

  This will be completed by August 31, 2015.

- Execute the Material Risk Program to develop a register of material risks, with reporting to senior management and the Boards.

  This will be completed by September 30, 2015.

- Create a governance structure and process to ensure that the risk inventory is comprehensive and consistent across risk types.

  This will be completed by September 30, 2015.

- Establish clear linkage of risk identification output to the capital planning process.

  This will be completed by October 31, 2015.

- Review foundational risk identification processes and develop multi-year enhancement objectives.

  This will be completed by March 31, 2016.

Prior to CCAR 2017 and beyond, SHUSA plans to update and refine the Material Risk Program, revising tools, templates, risk taxonomy, guidance, policies and procedures as necessary. Further, we will execute continued enhancements of foundational risk identification processes and data sources in accordance with established multi-year objectives.

Owner: Director of Risk Architecture

CCAR 2013 MRA 27

Management is required to add to its project plan an update of the RTS with additional capital ratios in order to formalize the monitoring of capital adequacy.

As part of the risk transformation plans, high-level risk appetite priorities and activities have already been established, including the redesign of SHUSA's Board-level risk appetite statement, definition of the approach to cascading the SHUSA-level risk appetite statement to subsidiaries and levels below, and redesign of those lower-level risk appetite statements. Detailed planning efforts will ensure the appropriate inclusion of capital ratios to formalize the monitoring of capital adequacy.

Prior to CCAR 2016, SHUSA intends to:

- Develop SHUSA-level risk appetite statement (RAS).

  This will be completed by September 30, 2015.

- Develop approach to cascading RAS to subsidiaries and below, with cascading complete for key areas (to be defined by CCAR 2016)

  This will be completed by December 28, 2015.

- Define RAS breach escalation and remediation process, including consequences.

  This will be completed by December 28, 2015.

- Complete RAS for priority subsidiaries (SCUSA and SBNA) and initiate cascading of respective RAS.

  This will be completed by February 29, 2016.

Prior to CCAR 2017:

- Fully develop a cascaded RAS across material legal entities and businesses.
- Establish process to explicitly link RAS to key strategic processes, e.g., strategic and capital planning.
- Enhance RAS based on results of the risk identification process.

Owner: Director of Risk Architecture