Silos Belong On Farms, Not In Banks!

Why Managing Risk at the Enterprise-Level is Good For Business

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Many banks still manage risks—compliance, operational and financial—separately in silos throughout various departments and operating entities across their organization. In doing so, upper management is not only left open to unforeseen threats and potential catastrophes but is also missing the opportunity to embrace and capitalize on risk. By managing all risks at the enterprise-level, an institution can achieve a complete and timely view of all threats and opportunities.

One New York bank succeeded in implementing an automated software system to establish consistent processes and methodologies, breaking through the organizational silos and facilitating enterprise-wide risk assessments. Besides protecting the institution from risk, they can now leverage their risk assessments to seize opportunities; to bring better products and services to market faster; invest resources in business areas where they have the greatest opportunities; and ultimately better position themselves against the competition.

What is ERM?

Enterprise Risk management (ERM) provides a framework for risk management, including identifying particular events or circumstances relevant to the organization's objectives (risks and opportunities), assessing them in terms of likelihood and magnitude of impact, determining a response strategy, and monitoring progress. By identifying and proactively addressing risks and opportunities, business enterprises protect and create value for their stakeholders, including owners, employees, customers, regulators, and society overall.Following September 11 and the resulting heightened regulatory focus on BSA matters, most banks expended significant resources to enhance or even rebuild their BSA programs. As a result, BSA evolved into a full-fledged investigative tool instrumental in uncovering financial crimes.

Organizations by nature have a variety of existing departments or functions ("risk functions") that identify and manage particular risks. This separation grew out of the fact that risk is inherent in every business process and risk management groups were historically parallel departments on the organizational chart. However, each risk function varies in capability and how it coordinates with other risk functions. A central goal, and challenge, of ERM is improving this capability and coordination, while integrating the output to provide a unified picture of risk for stakeholders and improving the organization's ability to manage risks effectively.

Why implement ERM?

Bank A is a mid-sized regional commercial bank in the New York City area, with satellite branches in other metropolitan cities. Like many in the industry, in the past the bank conducted risk assessments in silos, separated by department and operating entity. For example, Compliance conducted an assessment in January, IT in April, etc. In a 2009 audit, federal regulators strongly noted that there was significant danger that risks would not be identified nor mitigated unless ERM was instituted. This wake-up call prompted the bank to purchase an automated risk management system and to begin to lay the foundation for an enterprise-wide risk management program.

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Break down the barriers— how to succeed in implementing ERM

Just purchasing a software system alone does not equal implementation of an Enterprise Risk Management program. A substantive overhaul of methodologies and processes across departments is required for a successful ERM implementation. Although the end results promised to bring huge benefits to the organization, the ERM implementation project manager at Bank A found that there were a number of obstacles to overcome in order for the project to be successful. Below we discuss a few of the strategies developed by Bank A.

Garner buy-in from the boardroom to the front lines

Making any significant shift in the way that you do business or manage risk isn't a simple process. Leadership and line support are critical. The full backing of executive leadership, risk disciplines, and business lines were critical to Bank A's ERM implementation. The more that ERM goals and benefits were understood, the greater the chance for success and continued commitment. To secure needed approval, the Bank A project manager focused on presenting the benefits of ERM within the organization with the message tailored to specific audiences. For example, increased reporting efficiency and promoting the achievement of key strategic business objectives was used as a selling point to senior management, and ease of use and implementation as a key benefit for line managers.

Rolling out an effective ERM program also requires resources for it to succeed. Commitment of senior leadership ensured that resources were available to support Bank A's ERM initiative.

Choose the right partner and build the right team

Bank A selected a robust ERM system and engaged experienced consultants to help with the implementation process. The consultants brought an understanding of both the software and the industry that was leveraged to develop and execute an efficient and effective implementation plan. Choosing members of the internal team was also important to the process. Capitalizing on internal talent builds a team whose organizational knowledge can complement the consultants' expertise. Can an experienced Operations Manager make the transition to Operations Risk Manager? Can a veteran Branch Manager become a Compliance Risk Manager?

A key first step in team-building at Bank A was to bring the consultants and the business units together so that the consultants could gain an understanding of existing business processes. This was critical because the consultants would have to train the Project Manager and the business unit risk assessors to use the system and new process.

Define clear and consistent objectives, methodology, and reporting

ERM models vary widely and can be as complex or simple as is appropriate for each institution. Clearly established goals and measurements are critical regardless of the model that best fits an organization. Well-defined ERM goals and objectives aligned with the organization's strategic goals and objectives will ensure that the business lines clearly understand and own the risks associated with their activities. These goals should be clearly communicated and agreed to by all key stakeholders at the beginning of implementing an ERM program.

Once Bank A had defined their ERM objectives and consensus was reached, a consistent assessment and reporting methodology was developed to measure progress. It is important to recognize that there is always an element of subjectivity to assessment—there is no perfect science to measurement. A common approach to risk assessment, measurement, and reporting across the organization is key to gaining consistency across the risk disciplines and providing a holistic view of risks. Having a common methodology for how risks are identified, monitored and measured allows for issue aggregation and provides focus on issues of greatest impact. In developing this common approach, simple and standardized methodology will most often lead to consistent and actionable results with the end goal of deploying risk management into key decision-making processes.

Identification of Risks/Controls and Scoring Methodology at Bank A

The process developed by Bank A is standard across business areas and has the advantage of communications between all major 'players' in the ERM methodology.

'Inherent risks' defined at Bank A are traditional risks of operating, strategic, credit, compliance, legal, reputation, and technology. They are assessed in terms of likelihood of occurrence and impact on the institution if and when an occurrence takes place. The risks are then considered to be high ("H"), medium ("M") or low ("L") and scored numerically within those buckets.

Mitigating controls are applied to each risk and labeled as 'effective', partially effective', or 'ineffective'. The resulting residual risk is analyzed and used to allocate resources to mitigate concerns or to harness opportunities.

Risk assessments are submitted to the Bank's Operations Risk Committee, chaired by the Risk Officer, for discussion and approval. The business unit representative who conducted the assessment will defend the assessment in front of the committee.

When the assessment is approved, it is reviewed by the Senior Management Executive Risk Committee and submitted to the Board of Directors for final approval. This ensures that management of the bank and the Board have been brought into the process and there is a chain of documentation from the business unit all the way to the Board of Directors.

Lastly, on an ongoing basis, the Internal Audit coordinator will test the assertions made by the business units in their assessments. This complies with the independence factor that is critical to internal controls, and is important for regulator acceptance. The scope chosen will include all controls deemed 'partially effective' or 'ineffective' and a statistical sample of those controls deemed 'effective'. In addition, FDICIA risks/controls are generally included in the test sample.

Collaborate and communicate

Like most organizations, Bank A had its share of internal politics to work through during the ERM implementation process. Existing siloed risk functions and their varying processes and procedures created challenges. Employees had to deal with uncertainty about the new alignment and how it would impact individuals and departments. The ERM project manager encountered old attitudes about how things have always been done and had to overcome resistance to change.

Open communication and strong working relationships were intangible elements that allowed the project manager and implementation team to build successful solid processes and better manage risk. One way this was done was by gathering consensus early on and ensuring that established objectives were agreed to by all key stakeholders.The team worked together to become risk business partners—not just identifying issues, but providing solutions and alternatives, all within an acceptable risk tolerance.

Effectively train and implement

For Bank A, a primary goal in the implementation process was to train assessors to use the system in an effective and efficient manner with minimal disruption of everyday operations, taking into consideration that resources were tight and schedules were busy. Bank A's implementation team became familiar with the benefits of the system and received training during the first quarter of 2011. During that time, business units were 'mapped' to the system; a scoring philosophy was agreed upon; assessments were conducted and approved; and the infrastructure of ERM at Bank A took shape.

Results and Benefits of ERM

Better decision making

The integrated risk management model provides decision makers with an organization-wide view, with more comprehensive data and analytics. Using an integrated approach can reveal interdependencies and facilitate better root cause analysis, avoiding issue resolution at the wrong level or solving of the wrong problems.The last thing management wants to learn is that they just spent time and money resolving problem A in business 1 when the greatest risk existed in businesses 4,5, and 6 and included problem B. The structured and cohesive approach of ERM gives executives greater confidence in their decision making, leading to better planning and an enhanced ability to meet operational and strategic goals.

Increased efficiencies of scale

Proactively measuring, monitoring, and managing risk exposure creates standardization and consistency throughout the organization, minimizing redundancy and maximizing return on risk management investments.

Implementation of an ERM model enhances the identification of systemic problems, providing management with the knowledge to proactively address identified issues, reducing the likelihood of audit and exam issues, and rework and remediation when problems are identified externally or after the fact. With less time spent on remediation, resources can be redeployed to other higher value risk prevention or business building activities. It is much less expensive to recognize and solve a problem before process changes are made or new products are released. A fully integrated enterprise risk management model is scalable and can grow with the organization, evolving along with the needs of the business.

Stronger risk management culture

Creating a pre-emptive risk management culture allows organizations to get ahead of the curve, proactively identifying challenges and opportunities rather than solely operating in a reactive mode. The focus on managing risk across the enterprise increases transparency across the organization and conveys value and competence to external stakeholders. Early detection of issues and enterprise-wide decision making will not just increase internal efficiencies and strengthen an organization's bottom line—it will also reduce reputational risk, promote shareholder confidence and strengthen relationships with regulators and external auditors. A strong ERM program at tests that the organization can take on and efficiently manage an acquisition, new line of business or other strategic initiative.

Heightened competitive advantage

Conversion from 'SILO" to ERM was relatively painless at Bank A because senior management and business units accepted the initiative, dedicated implementation teams and business areas cooperated with the effort, and the project manager understood the need for NOT disrupting everday ongoing operations.

Making risk management a part of the culture and a standard part of how business is conducted is at the core of a successful ERM model. Effective ERM increases business performance and directly supports the strategic objectives of the organization. By realizing this, Bank A implemented methods and processes to both manage risk and recognize and seize business opportunities, resulting in greater organizational efficiency, better audit and exam results, heightened regulator, analyst and investor confidence, and ultimately a stronger bottom line.

Conclusion

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