

# The Point

An Outlook Financial Services Publication

## Targeting Risk

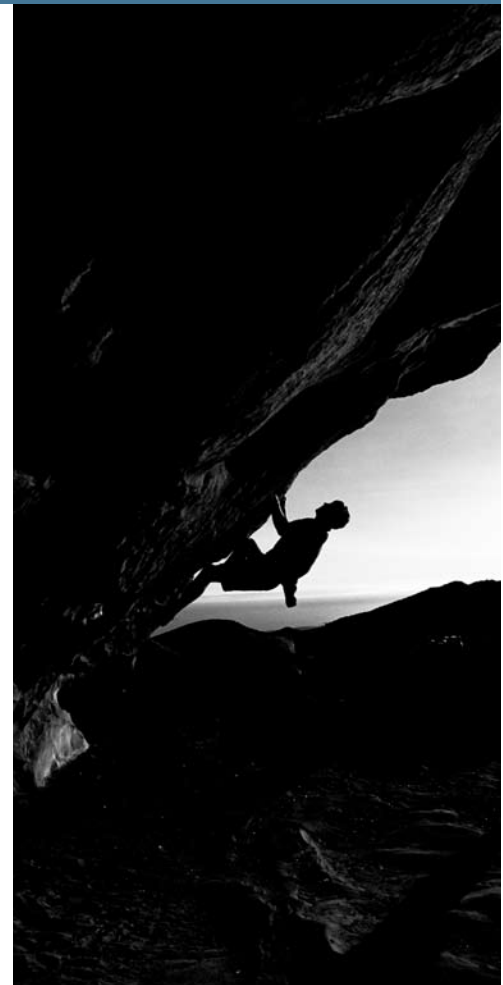
Transforming risk management for  
high performance in financial services

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A recent Accenture survey on global risk not only sheds light on the risk management shortcomings that helped bring about the global financial crisis, but also points to the kind of changes necessary to avoid future meltdowns in an increasingly economically intertwined, multipolar world. Risk executives at 74 banking, capital markets and insurance firms reveal that many financial services companies have generally managed risk merely as a compliance issue, meaning they neglected to:

- Align risk strategy and risk appetite to overall business strategy.
- Include risk management in decision making and performance management.
- Measure risk at an enterprise-wide level—considering accumulations and correlations across different risk types.



The scale and scope of financial losses has greatly undermined people's confidence in risk measures, the models used to calculate them and the supervisory standards that were supposed to ensure a conservative approach is taken. While much of the development over the last few years has been positive, building solid foundations, the platforms have generally not been fully exploited.

As a result, risk systems were often independent of each other and did not produce an overall picture of firm-wide risk. Management could not see how credit, liquidity, market and other risks might reinforce each other in a vicious circle that could lead to crippling losses, outright firm failure or, in the worst-case scenario, total systemic failure globally. Organizational cultures and incentive schemes encouraged risk taking without a proper eye on risk management.

What can be done? Industry executives rightly expect more regulation and more investment in risk management. To many executives, increased regulation—like upcoming Basel II enhancements and Solvency II—actually increases, rather than decreases risk exposure. Instead of

compliance-driven risk management, companies need a holistic risk management approach that can restore the public trust and drive business value for the long term.

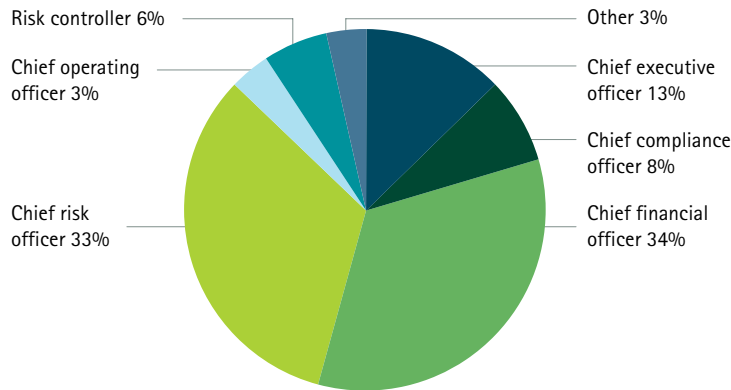
To better understand the challenges companies are facing with regard to their risk management capability during the financial crisis, the Accenture 2009 Global Risk Management Study was recently conducted in 21 countries with over 250 chief risk officers and C-suite executives participating, including 74 from leading financial services companies in banking, capital markets and insurance.

The vast majority (85 percent) of corporate executives said they need to overhaul their approach to risk management if the lessons of the economic crisis are to be used to improve business results.

The senior financial services risk executives indicated that their industry has a lot of ground to make up when it comes to managing risk. The crisis seems to have proven that what does not get measured does not get managed. Because firms were measuring risk in silos,



Survey findings indicate risk management is now a C-level responsibility for over 90 percent of companies, with over 30 percent of firms having a C-level executive directly responsible for risk



Source: Accenture

total enterprise risk exposure was not transparent. Therefore senior management could not see how credit, liquidity, market and other risks were interacting and potentially compounding exposures throughout the institution.

Risk operating models often failed to define clear risk management responsibilities between the risk function at the corporate level and the business units. Collaboration was unclear, risk strategy was not directly aligned to overall business strategy and risk management not deeply embedded into performance management, objective setting or incentives. Urgent work is still needed to implement an enterprise-wide basis for effective management of risk, aligning business strategy and capital to risk and management decision-making.

Indeed, the Accenture survey revealed that risk managers spend only about 20 percent of their time advising business units—while almost 60 percent was spent on data management and compliance. Too frequently, the long-embedded organizational cultures actually encouraged the behavior that would ultimately destroy so many of them. Compensation practices often rewarded short-term revenues

without considering the longer-term risks traders were taking.

### A look at the key findings

For financial services companies, the key findings of the survey are:

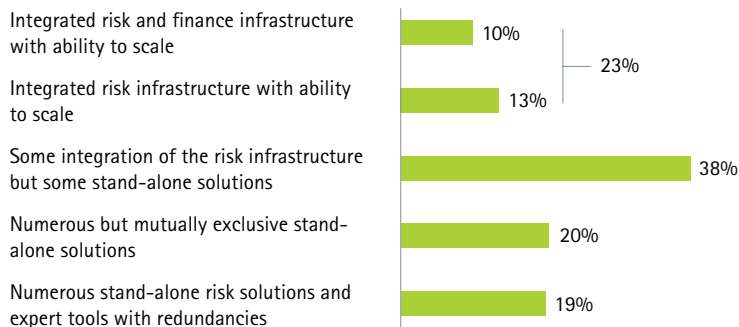
- 1. Risk management capabilities are not currently equal to today's challenges**—Significant changes are required with respect to an integrated approach to risk management.
- 2. Risk management is inadequately aligned with business strategy and poorly integrated into business operations**—Alignment to business strategy, integration with firm culture and collaboration with business units are the three biggest challenges faced by financial services firms.
- 3. The integration of risk management and performance management is limited**—The risk function is important in strategic decision making but is less involved in objective setting, incentives and performance management.
- 4. The costs of risk management increased significantly over the last three years as expected regulatory actions add to the pressures on existing risk capabilities**—For 73 percent of respondents, the cost of risk management is up by more than



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### Fewer than 25 percent of companies surveyed have an integrated and scalable IT infrastructure to help manage risk

#### Type of risk infrastructure and systems



Source: Accenture

10 percent and for 43 percent of respondents it has risen by more than 25 percent.

5. In addition to regulation, increased business complexity, poor data quality, fragmented internal processes and IT systems, along with an increased number of ad-hoc information requests, are the main cost drivers—These factors are also key contributors to the rising cost of risk for more than 30 percent of financial services respondents.

6. Financial services firms are investing to improve their risk management capabilities—More than two-thirds of respondents either have increased or are planning to increase investments in risk management.

7. The key challenges are seen in creating the right processes, systems and culture to embed risk management within and across the business while instilling a culture of risk awareness throughout the organization—Firms will need to rethink collaboration between corporate and business units, especially in such areas as enterprise-wide risk awareness and strategic alignment of risk appetite.

8. Optimism still exists about the ability of strong risk management to drive performance—Besides compliance, 58 percent of respondents expect a major impact from risk management on profit sustainability and growth.

### From survival mode to value-oriented risk management capabilities

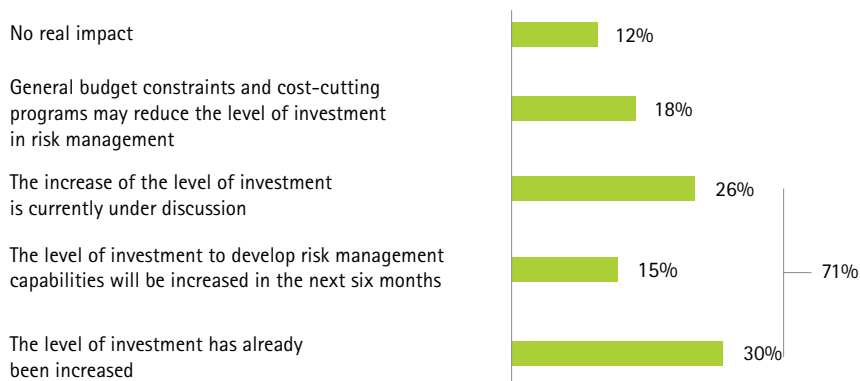
Dramatic deterioration of market value, liquidity and continuing capital pressures call for immediate changes in business and risk strategy. In the short term, firms need to ensure survival by properly managing liquidity and strengthening their capital positions. Government assistance, capital markets issues and business divestitures can all be helpful, but beyond the short-term survival mode, financial services firms need to establish a holistic and strategic risk management approach to rebuild trust and increase business value.

Firms must also focus on measuring liquidity, counterparty exposure and cross-product behavior. It is vital to assess counterparty exposure and credit risk concentration. Firms cannot continue to rely only on external rating agencies because their ratings may not keep pace with market movements



Despite the crisis and shrinking budgets, more than 70 percent of respondents, led by financial services firms, have increased or are planning to increase investments to improve risk management capabilities

#### Impact of financial turmoil on investment decision to develop risk management capabilities



Source: Accenture

and may not be applicable to certain exposures. Instead, firms should calculate their own internal ratings, based on market-derived ratings from spreads, derivatives and equities.

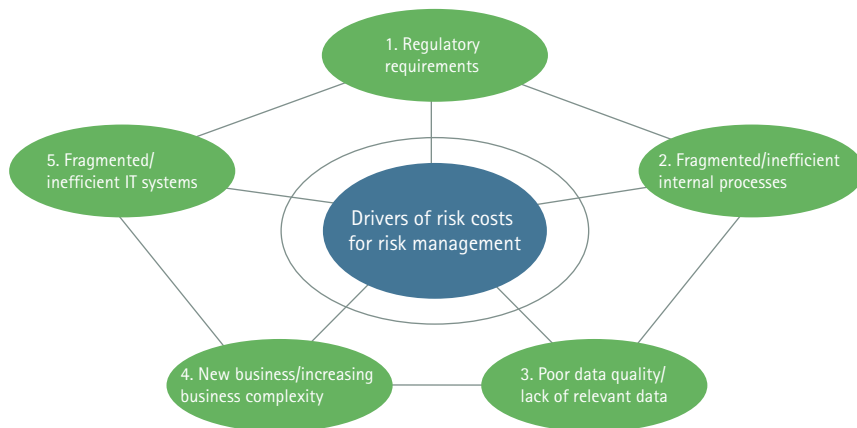
Among the most important changes necessary: the management of risk must become part of the performance management process. It must become a factor in strategic decisions. Short-term incentives will need another look to ensure that they are not encouraging too much risk or the wrong kind of risk at the wrong time.

In order to surmount the new challenges around risk en route to

high performance, financial services companies must align risk management with business strategy and integrate risk into every related process and the organizational culture. To be successful, the effort demands a closer collaboration between risk management and business units, coupled with a renewed emphasis on winning the war for talent and resources.

Financial services companies should enhance risk management in order to emerge from this turbulent market period stronger, more resilient and responsive to potential change. New supervisory proposals will continue to be a driver of change.

The cost of risk management has risen in recent years due to multiple factors



**1. Regulatory requirements**

- Stringent and increasing number of regulatory and compliance requirements
- More frequent reporting for internal and external compliance needs

**2. Fragmented / inefficient internal processes**

- Lack of proper streamlining of processes and well defined roles and responsibilities
- Appropriate risk culture not being embedded in the firm

**3. Poor data quality/lack of relevant data**

- Poor and ill-defined data management capabilities
- Lack of critical data for managing risks and reporting

**4. New business/ increasing business complexity**

- Increasingly complex business models
- Multi-geography expansion and rising complexity due to rapid changes in global economy

**5. Fragmented / inefficient IT systems**

- Multiple, fragmented and legacy systems with limited interoperability
- Lack of single source of truth for the data
- Inefficient and non-scalable architecture



However, changes in risk and business strategies, and the recalibration of enterprise risk tolerance, are the catalysts of enterprise risk transformation.

A dedicated risk transformation program can help financial services firms deal with increasing complexity, optimize risk/rewards and transform the risk function into a value-adding partner.

### Risk management transformation

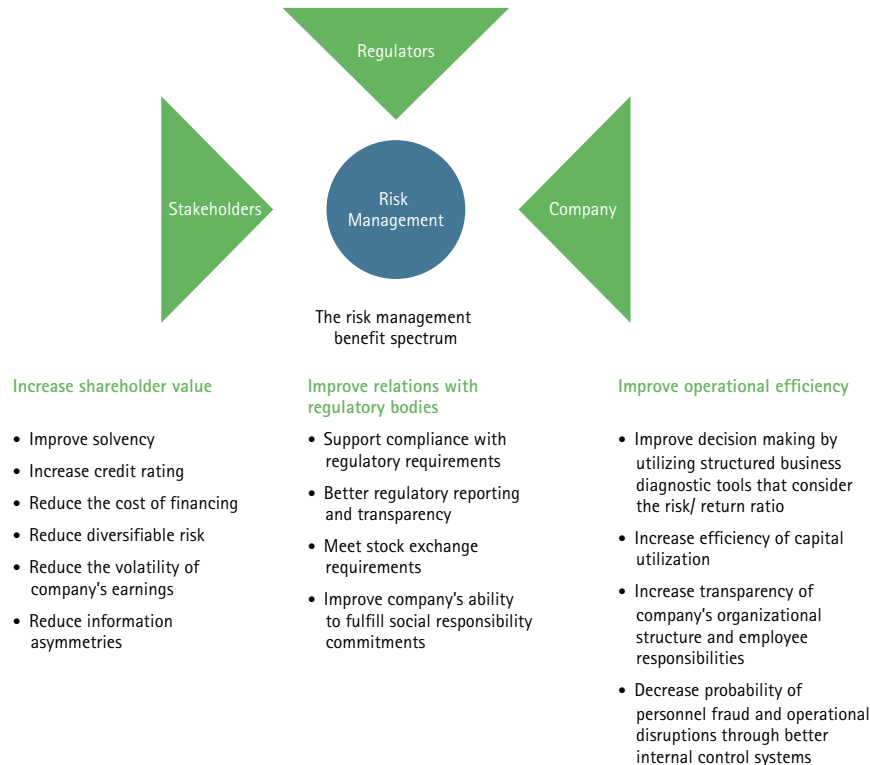
Financial services companies need to focus less on minimum compliance and regulatory guidance and more on developing risk operating models and control frameworks to protect shareholder and franchise brand value. Fundamental change is needed to restore credibility and promote the implementation of a truly integrated approach to enterprise risk management across all entities and business units of financial institutions and conglomerates.

While financial institutions need to take decisive short-term risk mitigation actions, they also must renew confidence by creating a transformed, fully integrated risk management approach. This requires scrutinizing and redefining the business model and synching business strategy with risk strategy.

Risk needs to be repositioned within the organization to tightly integrate risk management and governance into decision-making processes. Both risk and revenue considerations should inform decisions. Performance and incentive systems should be similarly risk-adjusted by adapting a risk-based framework, where capital and liquidity requirements will be more reflective of institutions' risk profiles, underpinned by greater competencies in risk assessment and a harmonized approach for valuation of assets and liabilities, including technical provisions.

An integrated approach to cyclical and stress testing is required as

The risk management function strongly enables companies to improve operational performance and create additional benefits for stakeholders



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a counter-cyclical capital adequacy regime combined with greater emphasis on stress testing and sensitivity analysis enabling an internal assessment of capital adequacy under Pillar 2 provisions (capital and solvency directives) at a business unit and group level. The integrated approach to stress testing and cycle sensitivity analysis has to provide the board and executive management and regulators with a comprehensive and consistent forward-looking view of the potential risks and vulnerabilities resulting from the business strategy, as well as changes in the economy and financial markets.

Organizational design should put the focus on strategic risk management. This means placing risk at the core of strategic implementation, and sharpening collaboration between the corporate function and business units.

To ensure that business and risk decision-makers have the right insights and capabilities to actively manage the enterprise portfolio, data services

and IT applications are required. Firms need integrated IT capabilities and infrastructure to support and drive the transformation of their risk model and ensure its effectiveness, but in fact, the Accenture survey revealed that only 27 percent of respondents have an integrated risk-and-finance IT architecture.

Taken as a whole, the Accenture survey results constitute a road map to overhaul the approach to risk management and transform risk functions and capabilities, covering both the layers of day-to-day accountability within the organization as well as the bigger rules and governance structures by which it operates.

The financial services executives surveyed are keenly aware of the potential business value integrated risk management capabilities can create. Besides the reduction in cost of capital, most companies expect such integration

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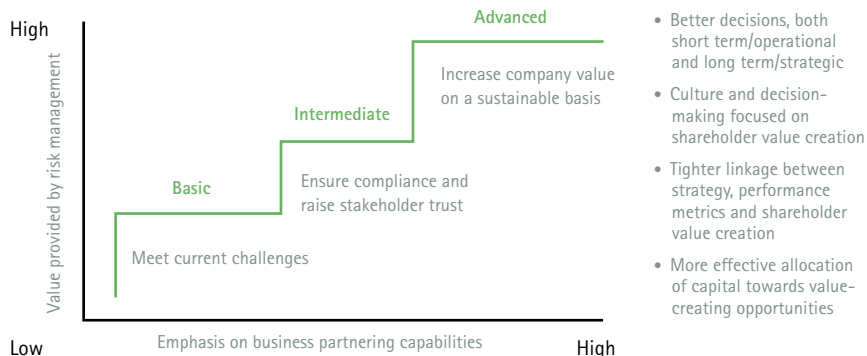


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**Increasing maturity of the risk management function positions it for higher value delivery via business partnering**

Increased focus on strategic business partnering . . .

. . . Results in increased value



**Basic**

- Transaction processing
- Basic P&L reporting
- Basic analytical skills
- Primary loss factors
- Probable loss magnitude
- Loss event frequency

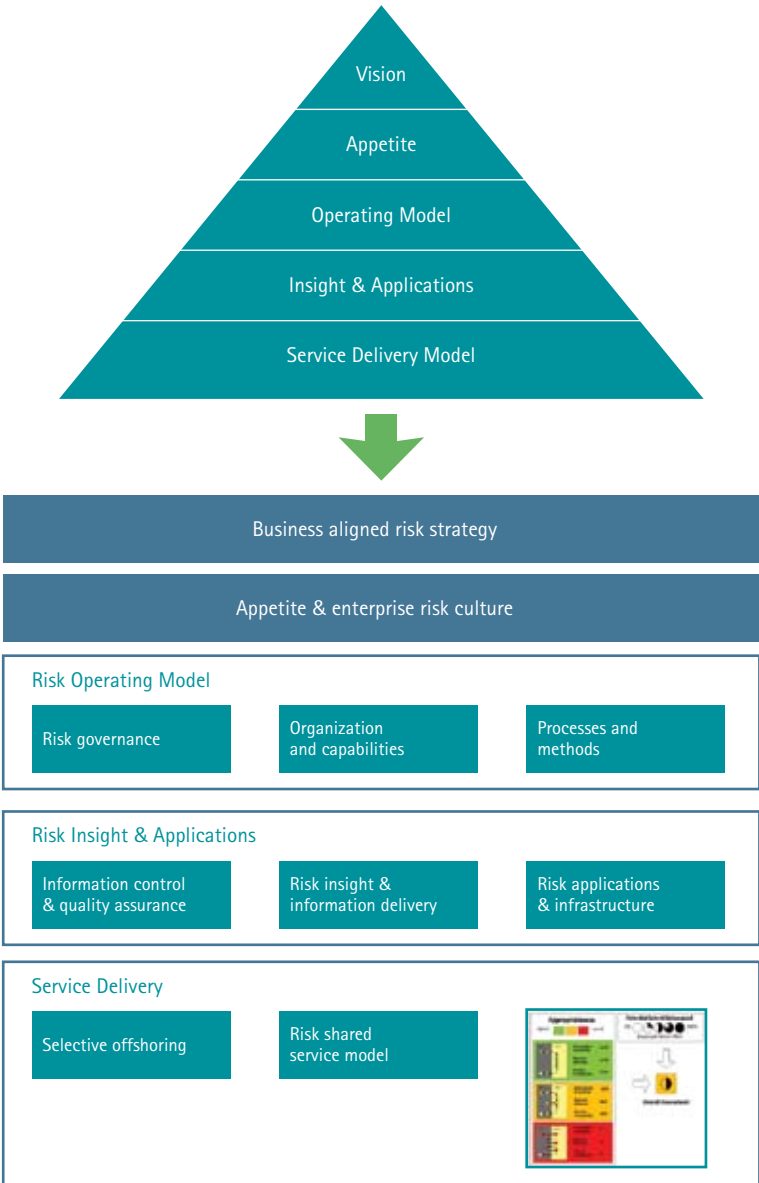
**Intermediate**

- Analytical skills—reactive and historical
- Translation of management goals into operating plans
- MIS – Controls and reporting
- Better data management

**Advanced**

- Proactive, forward-looking decision support
- Sustainability of profits
- Regulatory adherence
- Strategic decision-making
- Better equipped for economic shocks

The Accenture Risk Transformation Program can help clients deal with increasing complexity, optimize risk/reward and transform the risk function into a value-adding partner



**Key characteristics**

- Transition from risk measurement to risk management
- Realigning the axis of risk decision-making and risk transparency
- Ensure compliance with upcoming regulatory changes
- Focus on control effectiveness
- Control effectiveness and cost efficiency via organizational and IT alignment
- Focus on sustainability and profitable growth
- Ensure the right behaviors are demonstrated by employees to achieve overall business objectives and transform the risk function

Source: Accenture



In the current landscape, there is a pressing need for financial services companies to transform their risk function and move beyond pure compliance to value creation



Develop and continuously optimize the risk strategy for the firm

Source: Accenture

(continued from page 7)

to positively impact competitive advantage and profitable growth sustainability. But to get these benefits, financial services companies must move beyond more reactive risk compliance-driven activities to value creation.

Accenture believes by linking and balancing risk and performance management to aid decision-making and increase shareholder returns, an organization can improve its performance and position for economic recovery. The right risk management approach can enable companies to:

- Achieve the right balance between performance and risk.
- Treat risk as a competitive differentiator to better manage the business, deliver sustainable shareholder returns and reduce the cost of risk management.
- Integrate risk management practices and procedures throughout the enterprise to safeguard the achievement of targets while protecting against downside risks.
- Instill a culture of risk consciousness to improve bottom lines and reputations and use incentives to align individual behavior with organizational goals.
- Rely on a trusted partner for insightful strategic thinking, implementation at scale and outsourcing capabilities.

As previously noted, executives participating in the Accenture 2009 Global Risk Management Study know well the potential business value that improved enterprise risk management capabilities can create. They also know that enterprise risk management must be both comprehensive and cost effective. It must restore public trust and enable business growth, while also delivering the cost savings that are now so critical. It must encourage entrepreneurship—helping executives take reasonable risks to fuel growth and improve business performance—while discouraging excess.

The extraordinary circumstances of the current financial crisis and global economic downturn present not only daunting challenges, but also opportunities to rethink risk management strategies and practices to improve day-to-day operations. Cost management, customer retention, operational excellence and flawless execution are especially important when uncertainty is greatest.

Investors and other stakeholders of the world's financial services companies must be confident that robust risk management capabilities are in place to mitigate the kinds of risks that have undermined the global economy. However, companies, entrepreneurs and innovators must be able to trust that a sound risk management platform is in place that enables them to launch new ventures—to grow and expand, enter new markets, develop new products and sell to new customers around the world. Ultimately, effective risk management is about achieving and sustaining high performance.

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