Transforming Risk Management to Achieve High Performance
Financial services companies have spent billions of dollars in recent years to improve their risk management practices. But, judging by the perilous state of the industry, it would appear that few have benefited from this huge investment.

Banks and securities firms worldwide have experienced unprecedented value destruction. They have written down hundreds of billions of dollars since the subprime mortgage crisis began in the United States in mid-2007. Some institutions have not survived and the total losses related to the crisis will exceed one trillion dollars.

Surviving financial services institutions are raising additional capital to shore up severely weakened balance sheets. Shareholder value is being eroded and diluted. Confidence in the quality of earnings and stability of revenue streams has been severely shaken.

Following years of benign economic conditions and plentiful market liquidity, banks became quite complacent about risks, even in the case of new and complex securities. According to recent studies of the credit crisis, banks in many instances failed to appreciate or adequately control the risks inherent in such financial instruments.

In light of all the turmoil, risk management is now in the spotlight. Banks are under increasing pressure to understand the risks they face, to measure and assess such risks appropriately, and to take the necessary steps to reduce, hedge or otherwise manage such risk exposures,” according to a report of the Senior Supervisors Group, a panel of leading bank regulators from Europe and the United States.

An effective risk management capability can not only help prevent the next crisis, it can also serve as a competitive differentiator by helping banks achieve high performance.
Addressing Multiple Challenges

Banks’ risk management and regulatory compliance functions face significant challenges in meeting the demands of both the business and regulators, including:

- **Implementing Internal Control.**
  Guaranteeing effective internal controls in an increasingly complex operating environment.

- **Becoming a Strategic Partner.**
  Transforming from a narrow “compliance and control” role into a strategic partner with the business, thereby enabling banks to assess revenues and profits on a risk-adjusted basis and provide valuable input into business decisions.

- **Complying with Increased Regulation.**
  Addressing additional regulations which are expected in light of the increasing role governments are taking to confront the global credit crisis.

- **Supporting the Changing Business.**
  Adapting to movement into new markets, the changing mix of business and greater complexity. This is increasingly relevant as the industry undergoes significantly more merger and acquisition activity, causing banks to modify business models.

- **Improving Operational Efficiency.**
  Delivering on the challenges above, while at the same time, increasing operational efficiency to help banks reduce costs.

In the years leading up to the current crisis, risk investments were mostly focused on meeting complex regulatory requirements such as Basel II, and trying to keep pace with aggressive growth.

Now, however, financial services companies are taking a collective step back and questioning the effectiveness of their internal controls and the breakdown in judgment that contributed to such significant and unexpected losses.

Creating and maintaining a finely tuned risk management function and culture is a complex undertaking. There are no magic bullets. Risk management must be considered in broad terms. Once risk has been appropriately measured, the information should be used to help inform business decisions that create (and protect) shareholder value, not just to comply with regulations.

Multibillion Dollar Business Case for Transformational Change

Until recently, business cases for many risk management change initiatives were predicated upon improving regulatory capital efficiency. With the benefit of hindsight, however, that was a narrow perspective.

Now, given the extraordinary level of write-downs, it could be argued that the current environment presents a multibillion dollar business case in support of risk management transformational change.

By that, we mean fundamental change that goes beyond addressing traditional risk control problems. Banks must focus more broadly on the role of the risk function and how it shares data and otherwise interacts with the business and finance areas so that senior executives can make well-informed business decisions.

Transformation is not limited to implementing new technology, analytics or sophisticated risk models. It involves adopting the right operating model to support enterprise risk management with views of risk across product lines and business units. The operating model should enable banks to address the unique character of different types of risk while also ensuring that risks are mitigated in an integrated fashion and from an enterprise perspective.

Transformational change has organizational, process and technology implications. One Accenture bank client, for example, wanting to take a more portfolio-driven approach to risk management, is changing its risk organization by merging its market and credit risk functions. To support this enhanced capability, the bank will streamline processes and implement new systems.
Leading Risk and Regulatory Management Practices

A. Lessons Learned
What are the characteristics of the stronger performers? The end of the crisis is still not in sight, so final conclusions can’t yet be drawn, but the Senior Supervisors Group’s report outlines four risk management practices associated with these performers:

• Demonstrate a comprehensive approach to identifying and analyzing firm-wide risk exposures. Instead of limiting information sharing through “silo-based” thinking, these firms share quantitative and qualitative information across the firm and engage in effective dialogue across the management team.
• Establish rigorous internal processes requiring critical judgment and discipline in the valuations of complex or potentially illiquid securities. They understand critical risk exposure concentrations, and crucially, have mechanisms in place to reduce these concentrations based on discussions between the control functions and the business.
• Enforce active control over the firm’s balance sheet, liquidity and capital positions. The treasury function is closely aligned with risk management processes, incorporating firm-wide information into global liquidity planning and liquidity risk management and charging business lines appropriately for building contingent liquidity exposures.
• Employ flexible risk management processes, systems and analytics that could be rapidly modified to reflect changes in market circumstances. They rely on a wide range of risk measures and effectively balance the use of quantitative rigor with qualitative assessments. This approach has enabled the risk function to provide substantial insight to senior management about evolving conditions so that the bank could pursue emerging opportunities and reduce exposures when risks outweighed expected rewards.

B. Going Forward: Emerging as a Winner
Financial services institutions have been significantly affected by recent market events. Based upon our client work and deep industry experience, we see banks that aspire to high performance taking the following steps to enhance their risk management capabilities:

• Starting to consider embedding a risk/return-based culture into the business lines by establishing appropriate metrics, rewards and incentives to encourage desired behaviors.
• Breaking down traditional risk silos and introducing a portfolio-based approach to risk control and risk management.
• Implementing an enterprise performance management capability that enables current performance management and future scenario planning based on revenue, expense, capital and risk.
• Assessing opportunities to better integrate the roles and responsibilities of the risk and finance units to improve service, enhance control and cut costs.

C. Scales of Mastery: Where Does Your Bank Stand?
Based on extensive bank industry client experience, Accenture has developed a capability assessment model—the Scales of Mastery—that compares the characteristics of risk organizations across a continuum, from basic to market leading (see Figure 1).

For each category in the chart below, banks’ risk organizations and practices that fit the descriptions on the left side of the scale (number 1) are uncompetitive. The far right side of the scale (number 5) describes capabilities of market-leading risk organizations. While few financial institutions are performing at level 5 in all areas today, some are making significant investments in these capabilities.

Figure 1: Scale of Mastery for Risk Organizations

<table>
<thead>
<tr>
<th>Risk Organization &amp; People</th>
<th>1</th>
<th>2</th>
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<tbody>
<tr>
<td>Strategy and structure</td>
<td>Control &amp; Veto: Reactive and control focused. “Confrontational” engagement</td>
<td>←</td>
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<tr>
<td>Culture</td>
<td>Cost Center: Perceived as an expensive but necessary business overhead</td>
<td>←</td>
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<tr>
<td>Workforce capability</td>
<td>Limited Skills: Lacking breadth and depth compared to front office/business</td>
<td>←</td>
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<tr>
<td>Workforce management</td>
<td>Diluted Pool: Inappropriate deployment of skilled personnel</td>
<td>←</td>
</tr>
<tr>
<td>Workforce model</td>
<td>Localized: Limited ability to extend risk organization to lower-cost locations</td>
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<table>
<thead>
<tr>
<th>Risk Processes</th>
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<th>2</th>
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<tbody>
<tr>
<td>Control</td>
<td>Static &amp; Procedural: “Tick-box” compliance-driven processes</td>
<td>←</td>
</tr>
<tr>
<td>Management</td>
<td>Reactive/Backward Looking: Focus on after-the-fact events</td>
<td>←</td>
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<tr>
<td>Volume sensitivity</td>
<td>Growth Bottleneck: Processes are barrier to significant growth</td>
<td>←</td>
</tr>
<tr>
<td>Reporting &amp; analysis</td>
<td>Information Processor: Focus primarily on generating numbers</td>
<td>←</td>
</tr>
<tr>
<td>Risk measures</td>
<td>Segregated: Siloed approach with introspective focus by risk category</td>
<td>←</td>
</tr>
</tbody>
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<tr>
<th>Risk Technology</th>
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<tbody>
<tr>
<td>Application environment</td>
<td>Bespoke &amp; Fragmented: Multiple systems and bespoke &quot;end-user&quot; applications</td>
<td>←</td>
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<tr>
<td>Data quality</td>
<td>Poor Quality: Capability constrained by poor data quality</td>
<td>←</td>
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<tr>
<td>Data sources</td>
<td>Siloed: Risk and finance data fragmented across multiple sources</td>
<td>←</td>
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<tr>
<td>Processing frequency</td>
<td>Batch: Risk processes driven by end-of-day batch</td>
<td>←</td>
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<tr>
<td>Capacity</td>
<td>Static: Fixed technology infrastructure with limited ability to scale</td>
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<table>
<thead>
<tr>
<th>Risk Processes</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<tbody>
<tr>
<td>Business Partner</td>
<td>Proactive, aligned with business strategy, “Healthy tension” engagement</td>
<td>←</td>
<td></td>
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<tr>
<td>Value Creator</td>
<td>Supports controlled growth, provides value-added information to the business</td>
<td>←</td>
<td></td>
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<tr>
<td>Specialized Skills</td>
<td>Deep knowledge enables constructive dialogue with front office/business</td>
<td>←</td>
<td></td>
</tr>
<tr>
<td>Concentrated Specialization</td>
<td>Resources organized to match specialist skills to activity complexity</td>
<td>←</td>
<td></td>
</tr>
<tr>
<td>Extended</td>
<td>Use of sourcing models to access skilled resource pools at lower cost</td>
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<tr>
<td>Dynamic</td>
<td>Adaptive processes built for control within a risk/return framework</td>
<td>←</td>
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<tr>
<td>Proactive/Predictive</td>
<td>Focus on proactive intervention</td>
<td>←</td>
<td></td>
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<tr>
<td>Growth Enabler</td>
<td>Scalable processes enable controlled growth</td>
<td>←</td>
<td></td>
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<tr>
<td>Business Interpreter</td>
<td>Focus on interpreting information to assist business decision making</td>
<td>←</td>
<td></td>
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<tr>
<td>Integrated</td>
<td>Consistency of approach across risk categories</td>
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<tbody>
<tr>
<td>Specialized &amp; Shared</td>
<td>Streamlined environment providing framework for common data and functions</td>
<td>←</td>
<td></td>
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<tr>
<td>High Quality</td>
<td>Data quality managed under a consistent framework</td>
<td>←</td>
<td></td>
</tr>
<tr>
<td>Integrated</td>
<td>Integrated approach to sourcing risk and finance data</td>
<td>←</td>
<td></td>
</tr>
<tr>
<td>On-Demand/Near-Time</td>
<td>Enables intraday risk analysis</td>
<td>←</td>
<td></td>
</tr>
<tr>
<td>Scalable</td>
<td>Ability to scale by using grid/cloud-based infrastructure</td>
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Collaborating with Accenture

The success of a risk management change initiative hinges in large part on choosing an experienced partner with an industry track record. Accenture offers management consulting, systems integration and outsourcing services to accommodate the risk and regulatory needs of clients. We help clients successfully implement operating model, process and systems change to achieve high performance by improving the effectiveness and efficiency of risk and regulatory functions.

Based upon our work with many Tier 1 and Tier 2 banks, we have developed a set of guidelines and leading practices for banks’ risk organization, processes and technology.

We use diagnostic tools and current-state/future-state assessments to define the business case, identify gaps and develop a road map for realizing change.

We provide support through the entire implementation life cycle (beginning with the operating model) of risk and regulatory projects with a variety of resources including program managers, business analysts and technology specialists who have the breadth of skills to deliver an end-to-end solution.

We use our leading IT outsourcing capability to develop, run and maintain risk and regulatory applications in cost-efficient locations. Additionally, we leverage our deep experience with finance business process outsourcing—where we provide finance and accounting business process outsourcing and offshore analytics—to start driving efficiencies in the risk function.

By combining our risk, finance and enterprise performance management experience, we can help clients align these closely related disciplines to realize synergies and integrate risk-adjusted performance measurements into the overall enterprise performance management framework.

Figure 2: Accenture’s Risk and Regulatory Services

<table>
<thead>
<tr>
<th>Risk Management</th>
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<tr>
<td>Compliance Efficiency</td>
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<tr>
<td>Risk Governance and Control Enhancement</td>
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<tr>
<td>Risk/Reward and Efficiency Optimization</td>
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</tbody>
</table>

- Regulatory Capital Compliance
- Customer & Transaction Compliance

- Governance & Risk Control
- Risk Control Enhancement

- Risk/Reward Optimization
- Risk & Finance Integration
- Risk Efficiency Optimization

Accenture’s Approach: Comply, Enhance, Optimize

We believe that financial institutions achieve the biggest return on their investment by taking a broad approach to risk and regulatory management. That is why Accenture’s risk and regulatory practice offers a wide spectrum of services that help banks efficiently comply with regulations, protect shareholder value and leverage risk as a competitive differentiator (see Figure 2).

In light of the global credit crisis, we believe there is a strong need to transform the risk function. Moving beyond pure compliance, banks must also:
- Embed risk management culture in business decision making.
- Provide stronger enterprise-wide risk exposure measurement and control, including the ability to proactively position for potential stress situations and react quickly to fast moving events.
- Increase cost efficiency despite the increasing regulatory burden expected in the future.

Transformation of the risk function will affect the:  
- Risk management operating model and related capabilities such as valuation, measurement, control and reporting.
- Governance structure and processes required to support these capabilities, including closer collaboration with the business.
- Technology architecture, including applications, data and technical infrastructure, required to support these capabilities.

A. Compliance Efficiency

Complying with a multitude of regulations across multiple jurisdictions is a complex and costly undertaking. Accenture helps clients efficiently comply with Basel II, anti-money laundering (AML) and other regulations, as well as streamline compliance architectures to reduce costs.

We support compliance programs with a wide range of services, ranging from operating model definition to large-scale solution delivery. Our understanding of regulatory change enables us to help our clients identify implementation efficiencies.

Using a combination of methods, process templates, pre-configured data models and leading practices (gained from successfully implementing many Basel II, AML, MiFID and other regulatory compliance programs for clients globally) we are positioned to support compliance initiatives in a timely and cost-effective manner.

B. Risk Governance and Control Enhancement

Accenture helps clients protect shareholder value from adverse business and market events. We have cross-industry experience in helping clients define and implement broad risk governance frameworks that cover both financial and non-financial risk management. We have developed an enterprise risk management framework based on industry standard approaches that provides clients with a qualitative assessment of the current-state enterprise risk management approach, to identify and set target-state goals and structure an improvement action plan.

We use current-state/future-state process and technology architecture templates for market risk, credit risk and operational risk and have broad experience in helping clients implement custom and vendor software solutions for their market risk, credit risk and operational risk objectives.

In implementing these solutions, we provide data quality diagnostic approaches and tools to target and improve poor data quality—a critical challenge facing financial services firms.
C. Risk/Reward and Efficiency Optimization

Accenture helps clients treat risk as a competitive differentiator to better manage the business, deliver superior shareholder returns and reduce the cost of managing risk. Risk/reward optimization links risk and profitability objectives to improve strategic capital decisions and increase shareholder returns. It enables banks to better coordinate risk measurement, capital allocation, performance assessment and management across the enterprise. Our approach embeds risk/reward optimization into the business lines, as well as the transaction and portfolio management processes in order to meet long-term business goals.

Accenture's Risk Reward Optimization Framework is an accelerator that identifies the building blocks—strategy, methodology, process, data and reporting components—required to embed risk-adjusted performance metric techniques such as risk-adjusted return on capital and economic capital into the bank. Risk efficiency optimization lowers the cost of the risk and regulatory function by streamlining and industrializing risk and regulatory processes, for example credit checking and risk reporting, and assessing and developing synergies between the risk and finance functions to drive effective management as well as cost savings. We use innovative sourcing strategies to optimize efficiency.

Accenture’s IT outsourcing capability reduces the cost of developing and maintaining risk and regulatory systems. We currently partner with several clients to provide on-shore and offshore managed service arrangements where we can adjust the size of the application development/maintenance team to efficiently meet clients’ changing demands.

Our business process outsourcing capability can also be leveraged to cut costs in the risk function. Using an analysis framework, we help clients identify risk management and control-related processes where efficiencies and improved service levels can be achieved through innovative sourcing strategies.

Case Studies

Improving Transparency

Business Challenge
A global financial services company based in Europe was challenged by bank regulators to improve transparency across its risk management function. The firm’s multiple lines of business were run as separate units with no overall common risk controls, methodologies or metrics. It wanted to avoid any compliance issues as well as demonstrate to stakeholders (shareholders, rating agencies, central banks) that it was clearly able to reach its strategic objectives. Its goal was to increase transparency by implementing a consistent and consolidated enterprise risk management (ERM) framework by year end.

How Accenture Helped
Accenture was hired based on its track record of success with this client.

• Organized and facilitated strategic risk assessments across the bank
• Conducted risk-based value chain analyses that provided insight into the roles and responsibilities regarding strategic risks
• Defined key control criteria and ERM dashboard report

High Performance Delivered
• Defined desired level of control for each criteria and conducted gap analysis
• Identified improvement areas and established improvement agenda
• Finalized the ERM dashboard report

Multicountry Compliance

Business Challenge
A large European bank’s rapid expansion into other European countries created complex business and IT challenges for complying with local Basel II directives in each of the countries into which it had expanded. The bank’s objective was to meet the deadline for Basel II compliance and achieve the approach levels of the risk and regulatory function by streamlining and industrializing risk and regulatory systems. The bank’s sponsor team. This work was based on well over 100 core systems in multiple countries.

• Drove and managed cultural, behavioral and operational change at central credit risk functions and business areas; for example, implemented scoring solutions, Loss Given Default models and collateral management solutions

How Accenture Helped
Accenture was chosen as lead consultant because of its business insight and track record for successfully delivering complex change, including implementation of IT systems. The bank also believed that Accenture could deliver quality services on time and was willing to commit to certain deliverables such as system readiness. Since the deadline for Basel II implementation was closing fast, it was crucial to get started with the most skilled partners.

• Provided program management support including operation of the program management office
• Implemented the Basel II calculation and reporting system in accordance with FSA requirements

High Performance Delivered
• Set up and ran the team that defined all the functional Basel II business rules together with the bank’s sponsor team. This work was based on well over 100 core systems in multiple countries
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• Developed and implemented a practical and transparent ERM framework
• Reduced cost of control by rationalization of control measures
• Helped raise confidence level of bank regulators and rating agencies (client received an improved rating from Standard & Poor’s)
• Helped improve risk culture and risk awareness enterprise-wide

• Enabled the internal audit department align its focus on key improvement areas
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About Accenture

Accenture is a global management consulting, technology services and outsourcing company. Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world’s most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. With more than 186,000 people serving clients in over 120 countries, the company generated net revenues of US$23.39 billion for the fiscal year ended Aug. 31, 2008. Its home page is www.accenture.com.