

ERM Push Among Banks Intensifies

Financial institutions are taking a more serious look at enterprise risk management as they seek ways to cope with the new risk-averse banking climate.

By Maria Bruno-Britz February 19, 2009, Bank Systems & Technology

It's a new year, but the specter of the financial crisis still looms over the banking industry. The blame game continues to play out in Congress and the arena of public opinion. Newly minted megabanks are struggling with their new structures, and the Obama administration continues to tweak a stimulus package that could make or break not just the industry but the entire economy.

Rather than point fingers, however, many financial services executives simply want to find solutions to the problems that caused the meltdown in the first place. One theme commonly expressed among experts is that an infrastructure that gives banks a broader view of risk could have helped avoid much of the calamity of 2008. Has enterprise risk management's (ERM) time finally come?

Many believe that with the pressures brought on by the financial meltdown, the industry has finally gotten the kick in the pants it needs to approach its ERM initiatives in earnest. Even in Canada, where the effects of the housing crisis have been somewhat muted compared to the mess that has engulfed the United States, ERM is gaining momentum.

"Canadian banks are generally more highly capitalized [than their U.S. counterparts]," notes Bill Kasali, managing director, risk analytics, reporting and Basel projects, enterprise risk, and portfolio management, with Bank of Montreal (US\$341 billion in assets). "However, the ongoing economic crisis is a global one. As such, any bank with global operations is likely to be impacted. The issue is the degree to which your risk management practices help you as a bank to prepare and/or anticipate the marketplace."

"I don't see any other way for things to evolve other than ERM," Kasali adds. "The business of risk begets everything else."

Morten Friis, chief risk officer with Toronto-based Royal Bank of Canada (US\$580.4 billion in assets), says ERM, or the concept of looking at a bank's risk holistically rather than in silos, is not a new idea, pointing out that the major global banks have been on the road to ERM for several years. But, he adds, the crisis "provided a bit more impetus" for banks to start taking ERM more seriously.

"We've been on the ERM journey for at least a decade," Friis asserts. "This is an evolution where you're bringing all your risk together and allowing people to collaborate on full enterprise risk."

That evolution has been slowed largely by the enormous task banks face in deciphering the volumes of data they house, according to Steve Adler, chairman of the IBM Data Governance Council (Armonk, N.Y.). "It's a matter of normalizing the data," he says. "Will every part of the company describe the data in the same way? How do you know it's accurate? It's how you treat the data, analyze it and distribute it so it gets in the right hands at the right time and will be acted upon properly."

The immediacy of the data is a critical component to good risk management, stresses Mary Tuuk, chief risk officer with Fifth Third Bank (\$116 billion in assets), which has had a formal ERM division since 2003. Tuuk recalls the manner in which the bank was able to better view its exposures to many of the failing institutions in late 2008: "Fifth Third has systems to monitor these exposures on a real-time basis," she says, declining to provide specifics on the solutions used by the Cincinnati-based bank. "Other companies didn't have the capability in place to do this. Looking at data in aggregate and in real time is very important."

Real-time or, at least, same-day data access is vital to effective risk management, agrees Damian Shaw Williams, a senior analyst with Datamonitor in New York. "Risk shouldn't be about 'X number of breaches occurred this month and we did this to fix them.' You need to be able to see information on that very day," he contends.

IBM's Adler suggests that achieving this greater visibility might require the creation of a new "data supply chain" that spans from the collection of data to regulatory reporting. "The data has to be in real time, and it has to be at people's fingertips," he says. "There will still be mistakes, but you can at least do more to mitigate their frequency and severity."

Bringing Data Analysis to the Front Office

More than simply marshaling data, banks need to rethink how they analyze data in order to improve risk management, according to Accenture's Ed Grau, who runs the firm's risk management practice for financial services and capital markets for North America. The way risk data is analyzed in most organizations is backward, he asserts, explaining that analytics tools need to be moved into the front office rather than handled in the back office.

"Risk management must focus on creating a unified set of positions and transactions," he says. "Move all the analytics into the front-office systems rather than re-creating it in the back office. Calculate the price sensitivities in the front-office systems and just bring back the results. You're eliminating redundancies and it creates a more real-time, realistic evaluation of the records as they stand."

Grau maintains that banks can spend 80 percent of their time re-creating this environment in the back office -- time that could be better spent actually analyzing the data and their portfolios. "Move the calculations to the data," he says, adding that Accenture is beginning to work with vendors to help them create applications that support this approach.

Similarly, infrastructure considerations can go a long way toward enabling ERM. Straight-through processing (STP), for example, is inherent to an ERM strategy, notes Douglas McKibben, research VP with Gartner (Stamford, Conn.). STP, he explains, enables banks to automate processes and better share information across lines of business, which goes hand in hand with enabling ERM.

In adopting Oracle's (Redwood Shores, Calif.) Reveleus risk management platform enterprisewide, Bank of Montreal (BMO) sought not only to standardize the organization's risk management approach for efficiency and effectiveness, but also to future-proof the bank's risk management systems, according to BMO's Kasali. While the Montreal-based bank initially deployed Reveleus to help it comply with Basel II requirements, BMO is finding other ways to broaden the system's use throughout the financial institution, he says. "As an organization, we are always looking at opportunities to maximize and leverage our investments," Kasali explains.

Beyond Technology

Despite the importance of holistic ERM systems, Gartner's McKibben cautions that, like so many of the challenges faced by banks, ERM cannot be a pure technology play. "The technology does provide the consistent view across the organization, but it just enables the strategy," he insists.

Dana Wiklund, research director with Boston-based Financial Insights, also warns banks to look beyond technology to establish a culture of risk management throughout the organization. Although tools such as dashboards that allow a broad set of people within the organization to view the bank's risk position are a tremendous benefit, he says, there's no substitute for good people and policies. "There are millions of pieces of data housed in banks on multiple databases. However, what is needed is for the processes and people to become more efficient," Wiklund comments. "The technology itself will not keep banks out of trouble — it's the people who have to do this."

Recalling the industry turbulence of 2008, Barbara Matthews, founder of BCM International Regulatory Analytics in Washington, D.C., and the former U.S. Treasury attaché to the EU, notes, "A number of firms treated their risk management systems as something that just spit out all the answers. People who know how to use the technology to guide, rather than substitute for, judgment on strategic direction will be able to position their firms for survival."

As such, the chief risk officers and other risk managers at banks must come from slightly different stock than their predecessors if they wish to thrive in the current risk-aware environment. Much like the evolution of the CIO role in banks, the CRO position increasingly will require people with a broader sense of how the bank's business works.

According to Accenture's Grau, to optimize the risk management culture at a bank the CRO, CFO and CIO must join forces in the intertwined areas of risk management, cost cutting and streamlining the bank's operations. "Today's CROs are being told to do a better job with less," he comments. "The only answer is simplicity. Simplify the factory — go through all the legacy systems. The CRO must partner with technology and cost-savings initiatives and drive which businesses stay and which ones go."

In other words, enterprise risk management is a team effort. "[CROs] are not the only managers of risk," points out Gartner's McKibben. "They set the policy and try to guide the practices in the bank on a consistent basis. But the CRO leads with a risk management committee."

A shared risk management structure is even more critical for small banks, notes Steve Fritts, associate director of risk management policy with the FDIC (Washington, D.C.). Not all institutions, he notes, can afford to have one person exclusively dedicated to risk management. "Having a CRO can be a valuable part of risk management at a larger organization. But in reality, having a stand-alone CRO who builds systems around risk is not economically feasible for many community banks," he explains. "Instead, you want to have a culture of risk management and awareness for all employees."

Adds Michael Jackson, associate director of technology, supervision branch, with the FDIC, "That job is too large for one individual to handle. Risk has to be embedded in the culture. Business unit owners identify the risk for their areas, and the CRO identifies and coordinates the risk for the entire organization. It's a tremendous job."

Experts agree that to be effective, risk management must be baked into every aspect of what the bank does. IBM's Adler suggests that banks embrace the idea of more-open sharing of data throughout the organization. "People will disregard any information that doesn't meet their self-interest," he opines. To avoid this, "Have more information available to more people so someone is always watching it."

BCM's Matthews says it's no secret that things will get tougher for banks in the coming year as their risk management practices are subjected to greater scrutiny. But it's a matter of "enhancing" a bank's risk culture, she says, rather than instilling one, as managing risk is what banks have always done. "With broad-based government ownership of banks in the U.S. and the deep scrutiny and public skepticism, the world of risk is expanding beyond that which can be quantified," Matthews notes. "The CRO is now in the hot seat."

6 Benefits of ERM

According to Boston-based Financial Insights, enterprise risk management is a risk assessment process that spans the bounds of an organization. **Some of the benefits of an ERM strategy include:**

- 1. Preservation of capital.** An ERM program enhances a firm's ability to generate, preserve and grow capital for stakeholders.
- 2. Aligned risk tolerance.** An enterprisewide view of risk aligns organizational segments around a universally agreed upon tolerance for risk.
- 3. Greater accountability and transparency.** ERM processes provide visible accountability through ongoing risk assessments, controls and monitoring.
- 4. Best practices.** The very fact that processes are deployed adds to the improvement and the emergence of best practices.
- 5. Increased communication.** Increased communication vertically and horizontally within the firm aligns business objectives and accountabilities.
- 6. Understanding interdependent risks.** An ERM process not only exposes risk inherent to a particular segment but also should indicate where risk might cross over to another business segment.