Enterprise Risk Management

An integrated approach towards effective and sustainable risk management
Why now?

Firms in the financial services industry have made significant progress in strengthening their risk management practices since the financial crisis. Advances have been made in how risk is governed, measured, monitored, mitigated and managed. Given the pace of change and the extent of new regulations, much of this risk management progress has been focused on individual components of risk management. This fragmented approach can lead to ‘blind spots’, inefficient coordination and management and insufficient insight into risks.

To operate effectively and sustainable, firms need a major change in how they approach risk management. The need for a next step in risk management is supported by the following developments:

• Impact of regulatory requirements: Firms are facing a regulatory environment which has materially changed over the years. A sizeable portion of these regulations impacts the risk management agenda. Besides, formal communications from supervisors do frequently cite risk management requirements. This continuously changing environment asks for a risk management approach that is able to stand and incorporate new regulations and requirements.

• Stakeholder expectations: Investor demands for sustainable returns has been increasing over the last years. The ongoing pressure on revenue and costs requires firms to operate new business models that are able to deliver sustainable performance. Within this context, it is crucial to translate this objective to a risk management approach that is forward-looking and linked with the overall strategy of the organization, as a precondition for sustainable performance.

To remain at the forefront of today’s market, firms should adopt an integrated approach that capitalizes on the value gained from upgrading risk management and is appropriate for these new and enduring demands. EY believes that future success requires an integrated approach on enterprise risk management that delivers on both firm, stakeholder and regulatory requirements.
What is enterprise risk management?

According to this definition, every organization needs to have an ERM process in place. This ERM process needs to be applied across the enterprise, at every level, and includes taking an entity level integrated view on risk. Also the regulatory authorities stipulate the need for an ERM approach and have imposed requirements with regard to the relationship between risk management and capital adequacy in the form of the ICAAP (Internal Capital Adequacy Assessment Process) for banks and the ORSA (Own Risk and Solvency Assessment) for insurance companies. The main requirements emphasize that all of the company’s material risks must be taken into account and that capital adequacy is directly related to the company’s risk profile. In order to be able to meet these requirements, firms should consolidate past progress and realize gains from an adequate and integrated ERM framework.

What should you consider in designing an integrated approach?

EY has developed an integrated ERM framework (Figure 1), that incorporates all elements that together form a strong basis for effective, enterprise-wide and integrated risk management. The framework complies with the regulatory landscape and is able to stand new regulations and requirements that are and will be applicable for the financial services industry.

The main components of this ERM framework are highlighted on the next page.
Risk governance is the basis for all risk management activities and includes strategy & risk appetite, board risk oversight and the three lines of defense mechanism. In setting the risk strategy and risk appetite it is important to realize a clear link with the company’s long term objectives, mission and vision. The organizational structure should provide for the effective and balanced fulfilment of the roles of the board of directors, senior management, and adequate board risk oversight in the various risk committees. The Three Lines of Defense model helps to define these fundamental roles and responsibilities and to place primary accountability for risk where it originates.

Effective ERM is for a large part dependent on having the right people, in the right roles, with the right skills, incented to deliver the organization’s goals, while appropriately managing risk. Board and senior management should provide for adequate resourcing of risk management activities in all lines of defense and an adequately balanced talent & incentives program. The risk function plays an important role in training risk awareness of people throughout the organization.

A sound risk culture promotes sound risk-taking and ensures that emerging risks and excessive risk-taking activities are assessed, addressed and escalated in a timely manner. This places risk culture at the intersection of behavior and risk management. Risk culture provides a specific lens allowing general concerns about culture to focus on risk-taking and risk control activities. Although ‘Tone at the Top’ is a very important element, focus should be also on how sound risk taking is embedded in the daily behaviors and decision making processes throughout the organization.

Besides the expanding regulatory framework, the financial services sector also has to cope with growing demands related to the increasing focus on consumer protection. This may lead to new business models which also brings new implementation and execution challenges for risk management. Moreover, other parties such as shareholders, investors and rating agencies are placing increasingly high demands on the structure and transparency of risk management.

Board and senior management need to have timely, accurate and comprehensive risk information, which is also expected by the stakeholders. This requires adequate data management and ERM information systems that deliver the right information at the right moment. IT infrastructure and data management need to enable a forward-looking and integrated view across the firm, that enables the board to make well informed decisions.

To realize integrated and sustainable ERM, aligning the core risk management approaches across all risk types is key. Risk management should be embedded in the operational, day-to-day business decisions by means of a risk-based mindset and supportive risk infrastructure across the enterprise. This should enable reporting on the company’s risk profile in relation to the risk appetite.
How to create effective and sustainable enterprise risk management?

The pace and scale of regulatory change over the last five years have limited firms’ ability to address enterprise risk management in an integrated, strategic fashion. Firms have done their best to implement changes that have met evolving regulatory requirements. To enable firms to drive the changes in a way that delivers real value to the business and that meet regulators’ new and broader expectations and those of investors, a new mindset is required.

This new mindset can support the transition towards effective and sustainable enterprise risk management. Figure 2 shows that a next level in enterprise risk management can be realized by putting emphasis on the following key focus points:

<table>
<thead>
<tr>
<th>From satisfactory</th>
<th>To effective and sustainable</th>
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<td>Risk management involvement in key decision making is more focused on regulatory compliance than supporting business decisions.</td>
<td>Focus on capturing key benefits of effective risk management by aligning risk appetite with strategic decisions and the company’s long term objectives, mission and vision.</td>
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<td>Firms focus heavily on individual regulatory requirements with insufficient regard to future and global trends, which is suboptimal and unsustainable.</td>
<td>New approaches do incorporate a forward-looking view. Firms are fully considering future regulatory requirements.</td>
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<td>Reporting by risk discipline, requiring multiple data sources and complex aggregation processes.</td>
<td>Reporting on the firm risk profile against the risk appetite, using an integrated and forward-looking way of risk reporting which supports decision making.</td>
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<td>Firms majorly focus on strengthening second line resources and capabilities, by putting emphasis on compliance issues and an independent risk function.</td>
<td>Clear risk management roles and responsibilities are defined for each line of defense. First-line risk accountability is embedded and committee structures are adequately designed to challenge decision making.</td>
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<td>Risk oversight at board and committee level does not enable sufficient and credible challenge</td>
<td>Boards have a transparent and flexible role in overseeing the implementation of effective ERM throughout the organization.</td>
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<td>Risk culture depends heavily on tone at the top, corporate codes and financial incentives. Even with changes to compensation, employees are still acting in ways inconsistent with prudent risk-taking.</td>
<td>Emphasis is put on the importance of a sound risk culture to drive risk management at each level. Financial and non-financial compensation systems at board and business level are key in enabling desired risk-taking behavior.</td>
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<td>Risk data approaches are set-up in order to meet regulatory requests and deadlines.</td>
<td>Use of dynamic IT-enabled risk tooling, advanced analytics, integrated risk and finance data and stress-testing capabilities.</td>
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<td>Often decentralized, siloed and relatively complex (manual) solutions are in place for validation and testing processes and controls.</td>
<td>Risk and control approaches are centralized and integrated.</td>
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How can we help?

EY can support you in several ways. Our ERM advisory services include:

1. **Maturity assessment**
   A review of your ERM framework will provide you with detailed insight on the level of maturity of the various elements of the framework used by your organization. Our review/assessment will be based on the laws and regulations applicable to your organization and industry as well as (leading) market practices within that industry.

2. **Support in design**
   Support on the development and implementation of an integrated ERM framework and alignment with regulatory requirements applicable for the financial services industry. The focus can also be on specific components of the ERM framework such as risk governance, risk appetite or risk culture or specific elements in the Infrastructure & Operations area such as risk identification and assessment methodology, risk reporting and stress testing.

3. **Support in embedding and improving effectiveness**
   Perform a gap analysis to identify improvement areas and action points (roadmap) towards an ERM framework that works effectively and is embedded in the entire organization. The focus can also be on specific elements of the ERM framework such as risk governance, risk appetite or risk culture.

4. **Permanent education**
   We can deliver support to reach your goal in creating awareness on enterprise-wide risks and mitigation throughout the organization by providing training sessions for the organization’s employees and/or provide Permanent Education sessions for the Board of Directors and Supervisory Board.

**Why EY?**

Our market leading expertise:

- We bring together specialist and industry knowledge in an integrated team, working in a broad, international field of organizations in the financial services industry
- We have surveyed the industry to understand challenges and actions taken
- We have an established global ERM working team, which has performed multiple ERM related engagements on both national and international level
- We have developed our ERM solutions, leveraging cross-service line skills and experience across EY
- We have extensive experience in a series of specific projects and client offerings in the fields of risk appetite, risk culture, risk governance etc.
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.
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