Topics

- The world is changing
- How leading companies turn risk into results
- Back to basics
Risk Management – an evolving journey

Pre-2008

**Attitude**
- What should happen!

**Compliance focus:**
- Tick-box style control theme
- Bureaucratic
- Costly

**Market**
- Corporate failures triggered increased corporate governance and risk management focus (e.g., Turnbull, King)
- Regulation on internal controls around financial reporting (e.g., SOX, FAS133)
- Primary focus on "staying out of trouble"

**Company focus**
- Comply, invest and grow

2008-10

**What has happened!**
- Risk management spend at high levels but did not protect market from downturn:
  - Poor culture
  - Reactive
  - Bottom-up
  - Silos

2011-

**What can happen!**
- Leading performers are focusing on:
  - Customer reach
  - Operational agility
  - Cost competitiveness
  - Stakeholder confidence

- Back to basics
- Primary focus on growth, often with limited capital
- Alignment of risk management and risk culture with new business models and strategic risks

**Grow and be resilient**

Company focus
- Grow
- Be resilient

* Relatively same trend line for FTSE, DOW, Russell 3000, CAC, DAX, NIKKEI, HANG SENG

Risk Management is being increasingly challenged to deliver ‘value’...to move from the back-benches to the front line...to become an offensive discipline
The world is changing ... with several forces at play

**Volatility** of the macroeconomic, demographic and political environment
- Weaker world growth outlook, fiscal austerity and liquidity
- Emerging market demand growth
- Pricing, cost cutting and profit pressure – cost to income ratio
- Commodity price volatility

Are your plans aggressive and risk-adjusted?

**Velocity** of innovation and information
- Emerging technologies – mobile money, social media, big data
- Changing regulatory environment – capital adequacy requirements
- Changing customer requirements and perception of value

Are you able to move quickly and carefully?

**Visibility** into everything an organization does
- Expansion of government’s role
- Capital effectiveness and efficiency
- Performance and continuous improvement
- Customers becoming more engaged (disruptive technologies, etc.)

Is your reputation authentic and managed?

The current environment creates the need to evaluate both what you do and how you do it.
Navigating uncertainty and unpredictability

The Ernst & Young Global risk and opportunity radar

Cost Competitiveness
- Sustaining companies’ economic viability

Stakeholder confidence
- Allowing firms to build stronger relationships with stakeholders

Customer reach
- Maximising potential market opportunity for products and services

Operational agility
- Improving ability to deliver effectively in a quickly changing market


Banking specific risks 2013 forecast

Cost Competitiveness
• Capital controls / financial transaction taxes
• Reduced profits / valuations

Operational agility
• Sovereign debt restructure
• New capital adequacy requirements
• New liquidity requirements

Customer Reach
• Increasing competitive intensity / non bank entrants

Stakeholder confidence
• Home country supervision of international operations
• Regulatory control of remuneration
• Reputation risk
• Geopolitical / macro economic shifts
Business is about balancing risk and reward to create value

- Risk-taking is fundamental to economic reward – the challenge is to recognize **which risks differentially impact business outcomes** and **transform how those risks are managed** in order to best protect the business, enhance performance and drive value creation.

- This requires companies to find innovative and effective ways to:
  - Grow revenues
  - Optimize performance
  - Protect their organisation
The goal of risk management should be to impact business results.

**Typical ERM focus**
- Risk identification and reporting

**Historical focus - practices**
- Independent risk identification and assessment process
- Designed to provide risk reporting to Leadership and the Board
- Process independent of operations and performance management
- Evaluation of current exposures based on historical perspectives
- Compliance focus

**Expanded focus**
- Risk insight and performance improvement

**Leading practices**
- Performance Risk Management

Integrate risk and performance management to create a competitive advantage.
Topics

- The world is changing
- How leading companies turn risk into results
- Back to basics
How leading companies turn risk into results

The importance of risk

82%
of institutional investors are willing to pay a premium for effective risk management
(Source: Ernst & Young study)

Companies are overspending on risk and controls; most are overspending by approximately 30%

3x
“Companies in the top 20% of risk management maturity delivered three times the level of EBITDA than the bottom 20%.”
(Source: Turning risk into results, Ernst & Young, 2011)

Where companies are looking to drive results

- Identify and understand the "risks that matter"
- Differentially invest in the risks that are "mission critical" to the organization
- Effectively assess risks across the business and drive accountability and ownership
- Demonstrate strength of risk management to investors, analysts and regulators
- Utilize a new risk operating model to materially improve the cost structure
- Reduce cost of control spend through improved use of automated controls
- Eliminate duplicative or overlapping risk activities
- Improve process efficiency through automated centers, business activities and continuous monitoring
- Obtain superior returns from your risk investments
- Accept and “own” the right risks to achieve competitive advantage
- Improve controls around key processes
- Use analytics to optimize the risk portfolio and improve decision-making
- Use risk management savings to fund strategic corporate initiatives
# The case for Performance Risk Management

## Key differentiation of ERM versus Performance Risk Management

<table>
<thead>
<tr>
<th>Linked to performance</th>
<th>Linked to investment</th>
<th>Linked to future growth and protection</th>
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<tbody>
<tr>
<td><strong>Typical ERM today</strong></td>
<td><strong>Performance Risk Management enhancements</strong></td>
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<tr>
<td><strong>Primary focus</strong></td>
<td>Identification and prioritization of key risks</td>
<td>Enhanced insights to existing and emerging risks</td>
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<td>Board and management education</td>
<td>Identification and management of drivers of volatility which could impact performance and strategic goals</td>
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<td>Informs the audit plan</td>
<td>Clear visibility on how a company’s risk profile ties to the risk/reward balance</td>
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<td><strong>Key tools and approaches</strong></td>
<td>Management interviews and discussion session</td>
<td>Quantification of risk exposures/impacts</td>
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<td>Surveys</td>
<td>Risk/value driver analysis</td>
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<td>Qualitative orientation</td>
<td>Emerging risk awareness processes</td>
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<td><strong>Realized benefits</strong></td>
<td>High level awareness of key risks</td>
<td>Reduced volatility of performance results</td>
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<td>Initiates a common risk language</td>
<td>Improved line of sight to performance levers</td>
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<td>Increased ability to seize opportunities and protect the business</td>
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<td><strong>Ownership</strong></td>
<td>Internal Audit</td>
<td>Finance - CFO</td>
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<td>Risk Management</td>
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<td>Operations</td>
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<td>Performance management</td>
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## Ownership

- Internal Audit
- Risk Management
- Compliance

## Business integration

- Finance - CFO
- CRO
- COO
Enabling performance risk management

**Enhance risk strategy**
- Improved alignment to the objectives and strategy of the business
- Improved visibility to risks that matter most to the organization
- Proactive identification of risks
- Enhanced decision making

**Improve controls and processes**
- Better aligned risk coverage, including the identification of stronger, more pervasive controls
- Reduced level of effort associated with performing and testing controls
- Increased control and process efficiencies enabled through automation and continuous monitoring
- Improved control mix that addresses key business risks while driving process efficiencies

**Embed risk management**
- Comprehensive and continuous risk management and monitoring
- Central management of financial, operational and compliance risks and controls across organization

**Optimize risk management functions**
- Elimination of duplicate and fragmented risk management activities
- Increased integration and coordination among business, IT and compliance
- Sustainability of risk management process
- Effective top-down and bottom-up reporting

**Risk Agenda**

- **Turning risk into results**
- **Improve controls and processes**
- **Optimize risk management functions**
- **Embed risk management**
- **Enhance risk strategy**

**Processes/controls optimization and continuous monitoring**
- Compliance and audit management
- Policy management
- Risk management
To impact results, companies need to transform by effectively integrating risk management into the Rhythm of the business.

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<td>Approve risk vision &amp; appetite</td>
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<td>Perform environmental scan</td>
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<td>Assess business concept &amp; define strategy</td>
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<td>Review strategy &amp; strategic risk assessment</td>
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Traditional ERM domain

- Define risk governance structure, charters, and risk roles and responsibilities
- Define and obtain approval for risk vision and risk appetite levels
- Identification of emerging risks and evaluation of exposures stemming from the strategic plan
- Perform risk evaluation of strategic initiatives and risk-adjust capital allocations
- Evaluation of risks resulting from operating plans and definition of risk tolerances / targets
- Continuous monitoring of risks and performance levels through use of KRI / KCI
- Ongoing evaluation of risk response strategies through coordinate use of assurance functions
- Ongoing review of risk response strategies and risk-enabling performance

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- Continuous monitoring of risks and performance levels through use of KRI / KCI
- Ongoing evaluation of risk response strategies through coordinate use of assurance functions
- Ongoing review of risk response strategies and risk-enabling performance
What a ‘risk-enabled’ organization looks like - examples

| Board & board committee meeting | • Articulated risk appetite integrated into strategic considerations  
| | • Major investment recommendations include robust qualitative and quantitative risk analysis  
| | • Board oversight establishes tone from the top relative to risk management expectations  
| Executive-level strategic planning | • Portfolio risk exposures levels monitored and integrated into decision processes  
| | • Emerging risk analysis and indicators linked to strategic plan ‘pivot points’  
| | • Risk/reward ambitions and tolerance ranges defined  
| | • Enhanced analytical risk identification processes applied to remove inherent biases  
| | • Risk ‘line-of-sight’ extends from strategic plan through execution and monitoring and results  
| Operational & business-level planning | • Multi-year and annual operating plans ‘tie’ financially on a risk adjusted basis with strategic plan  
| | • Operational planning templates include risk sensitivities and stress testing  
| | • Capital allocation is ‘risk adjusted’  
| | • Robust operational processes in place, i.e., disproportional or potential cascading exposures,  
| | • Driver analysis and predictive analytics integrated into risk management planning insights  
| Monthly / quarterly performance reviews | • Risk tolerance metrics integrated into operational reviews and performance actions  
| | • Ongoing operational performance feedback incorporated into risk trend and indicator analysis  
| | • Risk management activities and expectations closely monitored to assess relevance and impact  
| Continuous performance management and reporting | • Effective technology enabled reporting  
| | • Continuous monitoring to track and forecast emerging risk areas  
| | • Consistent reporting templates and approaches  
| Continuous compliance and risk assurance activities | • Monitoring functions aligned in an integrated risk operating model  
| | • Monitoring activities linked to clear governance and early warning indicators/system/processes  
| | • Continuous and aligned risk & controls framework |
# The RISK Agenda: Understanding where you are today

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<tr>
<th>The RISK Agenda</th>
<th>Strongly agree</th>
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<tbody>
<tr>
<td><strong>Enhance risk strategy</strong></td>
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<td>Risk are aligned with corporate goals, major initiatives and market trends</td>
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<td>Risks, risk appetite and tolerance levels are defined by the board</td>
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<td>Overall risk strategy is documented and communicated to key stakeholders</td>
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<td>Risk oversight at the Board and executive management level is clear and consistent</td>
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<td>Transparency and accountability exists throughout the organization</td>
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<td>Processes are in place to facilitate key communications with internal and external stakeholders regarding key risk issues</td>
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<td><strong>Embed risk management</strong></td>
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<td>Organization is focused on the key &quot;risks to own&quot; that drive growth and create value</td>
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<td>Differential investments are made in the strategic &quot;risks that matter&quot; to better enable performance</td>
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<td>Risk management efforts are linked to business planning and performance management</td>
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<td>Key risk indicators are aligned with KPIs and key control indicators</td>
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<td>There is a standard approach to defining acceptable levels of risk</td>
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<td>Mechanisms exist to investigate, remediate and document instances of non-compliance</td>
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# The RISK Agenda: Understanding where you are today

## Optimize risk management functions

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<tr>
<td>Each risk management function operates effectively and efficiently</td>
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<td>Redundancies and overlap in risk coverage have been eliminated or minimized</td>
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<td>Risk activities are coordinated and skills aligned to leverage infrastructure and resources</td>
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<td>Responsibilities and accountability for managing risks is clearly documented</td>
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<td>Risk-related training is incorporated into individual performance goals</td>
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<td>Responsibility for resolution of risk issues is clearly identified</td>
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## Improve controls and processes

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<td>Cost of controls is reduced and/or aligned with risks and risk tolerances</td>
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<td>Automated controls and manual controls are properly balanced</td>
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<td>Prevent vs. detect controls are properly balanced</td>
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<td>Controls supporting key business and IT processes are optimized to eliminate redundancies</td>
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<td>Critical controls and KPIs continuously to improve decision-making and performance results are monitored</td>
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<td>Key risk metrics have been established at the business level</td>
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## The RISK Agenda: Understanding where you are today

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<td><strong>Enable risk management/communicate risk coverage</strong></td>
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<td>Technology is available and fully utilized to enable risk management across the enterprise</td>
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<td>IT risk management systems are in place and operating effectively to manage technology risks</td>
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<td>Application controls for key systems (e.g., ERP) are turned on and configured properly</td>
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<td>Information security and privacy controls are in place and regularly monitored to minimize threats, vulnerabilities and intrusions</td>
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<td>Information about the organization’s risk management and control framework is included in external stakeholder communications such as the company’s annual report</td>
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<td>Assurance is provided to customers and other stakeholders using independent third-party reports (e.g., Service organization control reporting)</td>
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Topics

• The world is changing
• How leading companies turn risk into results
• Back to basics
Back to Basics – 3 key questions

Are we **taking the right risks?**

- How are the risks we take related to our strategies and objectives?
- Do we know the significant risks we are taking?
- Do the risks we take give us a competitive advantage?
- How are the risks we take related to activities that create value?
- Do we recognize that business is about taking risks and do we make conscious choices concerning these risks?

Are we **taking the right amount of risk?**

- Are we getting a return that is consistent with our overall level of risk?
- Does our organizational culture promote or discourage the right level of risk taking activities?
- Do we have a well defined organizational risk appetite?
- Has our risk appetite been quantified in aggregate and per occurrence?
- Is our actual risk level consistent with our risk appetite?

Are we **appropriately managing our risks?**

- Is our risk management process aligned with our strategic decision-making process and existing performance measures?
- Is our risk management process coordinated and consistent across the entire enterprise? Does everyone use the same definition of risk?
- Do we have gaps and/or overlaps in our risk coverage across our risk functions and business operations?
- Is our risk management process cost effective?
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Assurance | Tax | Transactions | Advisory

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