Risk Perspectives

Bringing together leading risk management insights from the banking industry*

*connectedthinking
We would like to thank the participants from ABN Amro, BNP Paribas, Citigroup, Euroclear, HSBC, Lloyds TSB, Royal Bank of Scotland and Wells Fargo, who kindly gave their time and insights to make this paper possible.
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Welcome to this special ‘Risk Perspectives’ discussion paper, which seeks to set out some of the current issues and concerns faced by CROs from a range of European and global banking groups.

Risk management professionals are experiencing the maturing of their core risk techniques and methodologies, from being a separate function and process within the bank, to becoming a core competence across all operations. Consequently, risk methodologies are becoming more integrated into all aspects of the organisation. The challenge for Chief Risk Officers (CROs) is to ensure that this process runs smoothly, while allowing their specialist teams to continue to add value to the business, ensuring that risk issues continue to be managed within a framework that allows the business to maximise returns.

In compiling this special paper, we carried out a series of face-to-face meetings with banking CROs to get an understanding of the sort of issues they are currently facing. A number of themes and topics emerged from these discussions, which are set out in this paper. In particular, we wanted to explore, ‘How do you know when you are doing a good job?’ We have focused less on the ‘hard’ metrics, but sought to gain insights into the more intuitive indicators that give CROs comfort that risk management is delivering value to the business. We have also asked about risk reporting to see how CROs are tackling the ever-increasing volume and complexity
of available data and compiling this into a reporting format that can provide informative risk analysis to the Board, senior management and day-to-day decision-makers.

Other areas that generated lively debate included how to create and embed an effective risk culture and the whole issue of risk appetite and tolerance, which was recognised as a subject that is not well understood or managed by some organisations. Interestingly, some areas of discussion prompted very different and indeed polarised views from different organisations. This includes the use and application of economic capital models, which have fervent supporters and detractors in equal measure. Reputational risk was also seen as either an important area for further research and analysis in its own right or the end result of the failure of other risk types.

Two areas of this paper were particularly interesting and challenging for all participants. Firstly, how do you reward your risk professionals and recognise best practice when frankly, in their best year, nothing happens! Secondly, how can CROs differentiate themselves from their peers by demonstrating significant benefits from implementing risk management best practice?

We hope you find the ‘Risk Perspectives’ discussion paper interesting and that it provides some thought-provoking ideas about the key issues facing CROs today. We welcome your feedback and comments as well as any thoughts and suggestions on the subjects that matter to you.

We would like to thank the participants from ABN Amro, BNP Paribas, Citigroup, Euroclear, HSBC, Lloyds TSB, Royal Bank of Scotland and Wells Fargo, who kindly gave their time and insights to make this paper possible.

PricewaterhouseCoopers is committed to facilitating the exchange of ideas and expertise to help develop best practice in risk management.

If you would like to discuss any of the issues raised in this report in more detail, please speak to Richard Smith (richard.r.smith@uk.pwc.com) or your usual PricewaterhouseCoopers contact.
‘Risk Perspectives’ explores how some of the leading risk management executives in the banking sector are responding to the key issues facing their businesses and their profession.

Risk Perspectives draws on a series of face-to-face interviews with banking CROs and executives from around the world, which were carried out earlier this year by PricewaterhouseCoopers risk management specialists.

The interviews focused on a number of fundamental questions including:

- Does your risk function make a real and measurable difference to the business?
- How do you know you are doing a good job?
- What do the Board need to know and how do you meet expectations?
- How do you support the Board in determining the risk appetite?
- Do you have the right people, skills, culture and values for effective risk management?
- How can you attract/retain the best talent in risk management?
The report also draws on PricewaterhouseCoopers continuing research and dialogue with banks and other financial services organisations, which aims to foster an exchange of ideas and the development of best practice in risk management.

Each section of this paper, which covers such areas as risk reporting, risk culture and risk-based regulation, includes a summary of participants’ perspectives, analysis and links to relevant research. ...an exchange of ideas and the development of best practice in risk management.
Risk management has moved out of the back office and into the Boardroom of financial services organisations.

Executives and Boards increasingly rely on input from CROs to aid their decision-making and enhance business performance. Indeed, rather than just control and reporting, effective risk management is increasingly seen as giving companies the insights and assurance to exploit valuable opportunities and sharpen their competitive advantage.

The profile and role of CROs is evolving in the face of an increasingly complex and uncertain business environment. Boards now expect risk teams to look beyond the familiar financial risks to address the harder-to-quantify, though no less perilous, operational, reputational and related strategic risks. They also want risk teams to be more proactive in anticipating and responding to emerging threats and be involved in strategic decisions.

At the same time, CROs are often being called upon to preside over an increasingly elaborate infrastructure of compliance that is making it
The dilemma facing many CROs is how to demonstrate how well they are rising to these challenges and adding value to the business. Lesley Daniels-Webster, Executive Vice President and Market Risk Executive at JP Morgan Chase, addressed the 2004 ICBI Risk Management Conference and aptly remarked: ‘When things are good nobody says what an excellent job you’re doing. When they’re bad, they ask where were you?’

In the first quarter of 2005, PricewaterhouseCoopers conducted a series of face-to-face interviews with CROs from leading European and North American banks to elicit their ideas and insights at this critical juncture for their profession.

These discussions covered a range of key issues including risk reporting, risk appetite and risk communications, all built around the underlying themes of ‘How do you know you’re doing a good job?’ and ‘How can you do better?’

The interviews revealed that many firms are adopting a more forward-looking and issues-based approach to risk. Their influence on strategic decision-making is also increasing. However, the harder-to-measure risks, for example, reputational or legal risk management are still problematic. Many CROs are also finding it difficult to develop and embed relevant risk appetite approaches across their increasingly diverse global groups.

This paper looks in more detail at the CROs’ perspectives on the challenges they face and the development of best practice in the years ahead.

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1 ‘Banana Skins 2005, a survey of the risks facing banks, which was published by the Centre for the Study of Financial Innovation in association with PricewaterhouseCoopers. To order a copy please visit www.csfi.org.uk

2 PricewaterhouseCoopers published a conference highlights report to accompany the ICBI Risk Management Conference, December 2004. To download or order a copy please visit www.pwc.com/banking
In today’s cautious financial market environment, consistent earnings with no surprises are seen as the surest way to underpin the creation of sustainable shareholder value. The overriding goal and benchmark for success that emerged from the Risk Perspectives interviews was therefore the avoidance of unexpected losses – the ‘no surprises culture’ as it was widely termed.

Many organisations are responding through the ever-more active management of ‘non-financial’ risk types, for example reputational risk. Getting it wrong can result in the CEO and/or the CRO losing their jobs and personal reputations. A survey carried out in 2004 found that financial services organisations now regard reputational risk as the greatest threat to their market value.3 ‘The risk management function has failed if any reputational damage is suffered anywhere in the group,’ said a participant. Another stated that ‘there is no separate category for reputational risk – it is the consequence of doing something severely wrong or mis-managing other risk types’.

3 ‘Uncertainty tamed: The evolution of risk management in the financial services industry’, a survey of financial services organisations published by PricewaterhouseCoopers in association with the Economist Intelligence Unit. To download or order a copy please visit www.pwc.com/financialservices
Financial services organisations have moved towards a more holistic approach to risk management, which seeks to embed awareness of risk in the DNA of the business. CROs are the linchpin in bringing together risk, performance and strategic management.

Source: PricewaterhouseCoopers ICBI Risk Management Conference 2003 Highlights

Others stressed the importance of effective communication and speed of escalation in anticipating and mitigating threats to the business. Indeed, one of the banks now uses ‘timeliness of escalation’ as a key performance metric. The interviews also highlighted the growing alignment of key risk and financial performance measures as risk is ever-more closely aligned with business priorities and risk teams seek to demonstrate the value they add to the organisation (see Figure 1 and Figure 2).

**Benchmarks for success**
- No surprises;
- Proactive response to threats;
- Close cooperation of risk and business teams; and
- Culture/ownership of risk management by the business.

‘You know you’re doing a good job when there are no surprises and you know immediately about anything unusual…Results need to look right, which is the philosophy adopted by the Board.’

CRO, Global Banking Group
The acid test of whether risk is doing a good job is a marked change in the risk culture...

Ultimately, however, several participants indicated that the acid test of whether risk is doing a good job is a marked change in the risk culture/ownership, rather than the production of bulky management information packs or searching for any new or yet-to-be-discovered metrics. The key features of the desired culture include a close working partnership between risk and business personnel, capable of identifying market opportunities and anticipating and responding to risks before they materialise.
Risk reporting: focusing on the real issues

Boards are demanding more focused and forward-looking risk analysis.

‘There is a strong appetite at Board level for more risk information’, said one CRO.

Most of the participants appeared comfortable with the quality of their credit, market and other financial risk analysis. However, ‘data quality and managing the cost needed to get good information are growing challenges’, as one said. There is also a recognition that management information packs require more streamlining to avoid a deluge of meaningless data. ‘The data we provide is neither tactical nor strategic enough’, said a participant.

In particular, several of the interviewees were concerned that risk information may be ‘skewed’ towards financial risks at the expense of equally hazardous, though less tangible, operational and strategic threats. Indeed, the greatest perils may be lurking off the conventional radar and these are certainly the key concerns of the Board. In looking forward,
operational risk metrics were seen ‘as much less robust as a predictive tool’ than their financial equivalents.

Many of the participants are therefore moving towards a more holistic, issues-based approach to risk, for example by producing forward-looking risk information, which relates the critical business issues and allows senior management to take action. Possible issues in today’s market might include the rise in personal indebtedness. The challenge is how to identify, prioritise and keep pace with new and emerging threats. Sharing knowledge and regular input from the business were seen as essential (see Figure 3).

But how do you identify the business critical issues and risks? Some banks still rely on the business ‘gurus’ to come up with their ideas and thoughts on evolving

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**Figure 3: Internal governance and processes:**

*Which of the following areas should be the top priorities of board members?*

<table>
<thead>
<tr>
<th>Area</th>
<th>Critical</th>
<th>Important</th>
<th>Not a priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ensuring adequacy of internal controls</td>
<td>69%</td>
<td>29%</td>
<td>2%</td>
</tr>
<tr>
<td>Defining risk appetite of the company</td>
<td>49%</td>
<td>47%</td>
<td>5%</td>
</tr>
<tr>
<td>Ensuring compliance with regulations</td>
<td>53%</td>
<td>46%</td>
<td>1%</td>
</tr>
<tr>
<td>Identifying emerging areas of risk</td>
<td>37%</td>
<td>58%</td>
<td>5%</td>
</tr>
<tr>
<td>Questioning and refining company strategy</td>
<td>52%</td>
<td>42%</td>
<td>4%</td>
</tr>
<tr>
<td>Choosing and remunerating senior management</td>
<td>32%</td>
<td>49%</td>
<td>13%</td>
</tr>
<tr>
<td>Questioning internal and external auditors</td>
<td>34%</td>
<td>53%</td>
<td>13%</td>
</tr>
<tr>
<td>Ensuring independence of company officers and staff</td>
<td>39%</td>
<td>45%</td>
<td>16%</td>
</tr>
</tbody>
</table>

Source: ‘Governance: From compliance to strategic advantage’

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4 ‘Governance: From compliance to strategic advantage’, a survey of financial services organisations published by PricewaterhouseCoopers in association with the Economist Intelligence Unit. To download or order a copy please visit www.pwc.com/financialservices
industry risks. Dependence on this small number of key individuals is a risk in itself and some of the leading edge banks are formalising the process of risk identification. Risk intelligence networks should ideally be integrated throughout the business and linked into a formalised knowledge management process. One of the participants has gone further by developing a rating and tracking system based on such factors as potential ‘management distraction’ and ‘impact on reputation’.

**Sharpening the risk focus – management information needs**
- To focus on key issues;
- Should not over-concentrate on financial risks at the expense of operational, reputational and strategic risks; and
- To identify emerging threats and needs input from the business.
Risk intelligence networks should ideally be integrated throughout the business...
Risk management is increasingly under the spotlight at a time when society expects integrity as well as competence. As a result, the participants are spending the equivalent of at least one day per week – some considerably more – addressing the needs of a range of different stakeholders, including customers, investors, regulators and rating agencies. Along with direct contacts, risk professionals are increasingly being called upon to brief CEOs and CFOs ahead of shareholder meetings. This reflects the ever-greater interest and indeed probing questions being asked about risk by analysts, institutional investors and shareholders as a whole (see Figure 4).

Several reported that scrutiny of risk management has been intensified in the wake of recent scandals. However, many of the CROs also viewed this focus as a positive opportunity to demonstrate their value. Indeed, a recent survey of financial services organisations found that a reputation for integrity is almost universally seen as a source of competitive advantage.5 Unfortunately, while the survey respondents were keen to emphasise the importance of better communications in demonstrating a culture of integrity, they placed interaction with key stakeholders near the bottom of their spending priorities.
Moreover, some firms may be failing to respond to the often very different demands of particular groups. It is telling that PricewaterhouseCoopers latest global CEO survey found that while most respondents feel they can meet stakeholder concerns that are based on clear-cut legal requirements, far fewer are confident they can address the more ambiguous expectations of other constituents.

‘Rating agencies have noticeably stepped up their focus on the quality of risk management. Some of my staff are now dealing with external stakeholders full-time.’

Participant CRO

**Figure 4: The governance environment**

*Which of the following groups do you see as being stakeholders in your business?*

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Critical</th>
<th>Important</th>
<th>Not a stakeholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>57%</td>
<td>34%</td>
<td>9%</td>
</tr>
<tr>
<td>Customers</td>
<td>77%</td>
<td>16%</td>
<td>7%</td>
</tr>
<tr>
<td>Shareholders</td>
<td>71%</td>
<td>21%</td>
<td>8%</td>
</tr>
<tr>
<td>Regulators</td>
<td>35%</td>
<td>48%</td>
<td>17%</td>
</tr>
<tr>
<td>Rating agencies</td>
<td>16%</td>
<td>46%</td>
<td>38%</td>
</tr>
<tr>
<td>Government</td>
<td>20%</td>
<td>48%</td>
<td>32%</td>
</tr>
<tr>
<td>Suppliers</td>
<td>8%</td>
<td>51%</td>
<td>41%</td>
</tr>
<tr>
<td>Media</td>
<td>7%</td>
<td>44%</td>
<td>49%</td>
</tr>
<tr>
<td>Citizens/civil society organisations</td>
<td>10%</td>
<td>46%</td>
<td>44%</td>
</tr>
<tr>
<td>Auditors</td>
<td>22%</td>
<td>53%</td>
<td>8%</td>
</tr>
<tr>
<td>Business partners</td>
<td>39%</td>
<td>53%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: ‘Governance: From compliance to strategic advantage’

**Meeting stakeholder expectations**

- External communications seen as growing priority/opportunity;
- Communications still primarily focused on regulators at expense of other equally important stakeholders; and
- Companies are finding it difficult to gauge particular stakeholder expectations.

Moreover, some firms may be failing to respond to the often very different demands of particular groups. It is telling that PricewaterhouseCoopers latest global CEO survey found that while most respondents feel they can meet stakeholder concerns that are based on clear-cut legal requirements, far fewer are confident they can address the more ambiguous expectations of other constituents.

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5 ‘Governance: From compliance to strategic advantage’, a survey of financial services organisations published by PricewaterhouseCoopers in association with the Economist Intelligence Unit. To download or order a copy please visit www.pwc.com/financialservices

6 ‘8th annual global CEO survey: Bold ambitions, careful choices’. To download or order a copy please visit www.pwc.com
Many of the worst banking calamities have stemmed from a cumulative breakdown of separate controls in areas ranging from systems to senior management oversight. The collapse of Barings was a case in point. Other scandals appear to have been rooted in a more straightforward disregard for the risk and control frameworks in place.

As the participants underlined, the challenge in today’s increasingly diverse organisations is, therefore, not only how to create the necessary infrastructure of risk and control to guard against such lapses, but also how to instil a culture of risk awareness and stewardship across the entire business.

‘You can ensure that certain things are in place such as training, effective communication, compliance sign-off and an ethical hotline’, said a participant. Such elements are ideally underpinned by firm-wide transparency, inclusion of risk management in the basis for rewards and a readiness to communicate concerns. A culture that seeks to deal positively with threats rather than apportion blame, can help management to identify risks at an earlier stage.
and avoid growing, concealed disasters. Indeed, risk teams need to be prepared to flag up emerging issues without necessarily always having the supporting data to hand.

Ultimately, the business needs to encourage and reward an instinctive awareness of what might threaten its stability or reputation, even if it is within regulatory or internal control guidelines. Indeed, recent experience indicates that even if certain dealings comply with the letter of the law, they may still fall foul of what may ultimately prove to be the more damning court of market and public opinion.

Finally, it was expressed by one leading industry figure that the tone and ethos for risk management must be set at the very top of the organisation. The CEO and CRO must speak with one voice. Without this consistency and united approach, there is little chance for the CRO to make a difference to the culture.

′We have a strong culture and look at its core values very closely. Errors or mistakes are viewed very seriously.′

Participant CRO

<table>
<thead>
<tr>
<th>Risk culture essentials</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Tone is set at the top;</td>
</tr>
<tr>
<td>• Training and incentives need to be in place to raise awareness; and</td>
</tr>
<tr>
<td>• Clear communication channels must exist.</td>
</tr>
</tbody>
</table>
Risk appetite: how hungry are you?

CROs play a key role in ensuring that the organisation strikes efficient balance between risk and reward. Yet, risk appetites are not always realistic, relevant or well communicated.

It is accepted that risk appetite is poorly understood and managed in some organisations.

There can clearly be no one-size-fits-all approach. Indeed, there were opposing views on how risk appetite is defined and rolled out across the organisation. There were also wide variations in its scope and characteristics (see Figure 5).

In general, however, the capacity to take risk needs to reflect the overall strategy of the business and take full account of the expectations of investors, customers and other key stakeholders. To remain relevant, it also needs to be proactively managed and effectively communicated. For example, one bank communicates its risk appetite across the business by posting the results of regular reviews by say, portfolio concentration or geographic exposure on its intranet, which is well used by the business and risk functions across the organisation.

From a group perspective, risk appetite is an important input into the determination of economic capital. In turn, a risk-based capital approach can help to quantify the risks and embed risk appetite into the operational
infrastructure of the business. The result is a better understanding of the relationship between risk and return.

On a strategic level, even though stable earnings are a priority, overcaution can be a risk in itself, especially if it ‘means saying no to business that would have been profitable’. Indeed, one bank believes that ‘every risk has a price’. ‘We have a “can do” ethic so long as the price is adjusted appropriately.’ A possible example might be the initial introduction of credit cards into an emerging market, where interest rates may need to be much higher than more established markets to reflect the higher potential risks and losses.

Risk appetite essentials

- Risk appetite needs to reflect overall business strategy and stakeholder expectations;
- Understanding, communication and frequent updating of risk appetite is essential;
- Over-caution is a risk in itself; and
- Risk tolerance needs to be determined.

The Board does not understand risk appetite.’
CRO of European banking group

Figure 5: Approach to risk appetite

This approach assesses the risk appetite for different risk types and stakeholder perspectives. The appetite can then be articulated and used to form the basis of the actual risk profile and an action plan to achieve/maintain it.

Source: The Journal January 2005

7 ‘The Journal’ – Special risk management edition. To download or order a copy please visit www.pwc.com/banking
Economic capital divided the Risk Perspectives participants into two opposing camps.

The advocates are moving from tactical deal-by-deal and product-by-product implementation to fully embedding their models into strategic decision-making. ‘We want to get to a point where we can leverage our economic capital framework to demonstrate to the Board the economic capital consumption for different risk types’, said a participant. Detractors simply don’t trust the risk-adjusted return on capital (RAROC) numbers and therefore believe economic capital is, at best, overly complex and time-consuming and, at worst, a ‘waste of time’ and misleading.

However, regulators are increasingly moving towards some form of risk-based capital assessment and therefore even the detractors will need to look at how to make a virtue of necessity by making the most of economic capital techniques (see Figure 6).
‘If I could have one perfect risk management measure, it would be a really robust economic capital model that used common-sense assumptions and variables, picking up on both long and short-term horizons.’

Participant CRO

Figure 6: Economic capital: At the heart of managing risk and value

Economic capital allows financial institutions to judge the real risk-adjusted returns. CROs can use their understanding of risk to help validate and improve the reliability of outputs.

Source: ‘Economic capital: At the heart of managing risk and value’

8 ‘Economic capital: At the heart of managing risk and value’, a study published by PricewaterhouseCoopers in association with the Economist Intelligence Unit. To download or order a copy please visit www.pwc.com/financialservices
The key essentials are consistent and reliable data from around the firm and the use of appropriate and ideally observable underlying assumptions.

**Economic capital essentials**
- Tailor to the specifics of the organisation;
- Use consistent firm-wide data; and
- Validate outputs and underlying assumptions against empirical data.

While economic capital has acquired an enhanced profile in recent years, it is no more than a tool and needs to be used carefully as part of a balanced scorecard, for example, or suite of other measures, to be beneficial. The key essentials are consistent and reliable data from around the organisation and the use of appropriate and ideally observable underlying assumptions. Failure to do so could lead to potentially conflicting or counter-intuitive results across different risk types and areas of the business, which can only undermine the credibility of outputs and resulting capital allocations.

Companies certainly cannot base decisions on economic capital modelling alone. In addition, economic capital must be tailored to the specifics of the organisation, verifying it against comparable data and regularly challenging the framework. Validation is especially crucial when deploying bottom-up economic capital models, which may encounter problems in measuring operational risks or group-wide diversification benefits. Management may therefore require a top-down view as a cross-check.
Too much regulation topped the poll of the risks facing banks in the latest Banana Skins survey (see Figure 7). It is the first time this particular risk has come top in ten years of the survey, reflecting a wave of new risk-related directives, including Basel II, Sarbanes-Oxley and International Financial Reporting Standards, as well as other consumer protection legislation. The costs and distractions of compliance, as well as the false sense of security it brings, were the main reasons cited for its strong showing.

These sentiments were shared by several of the participants. As we outlined earlier, many are struggling to get on with the ‘day job’ in the face of vast implementation programmes and an encroaching bureaucracy of risk. Others appear to be frustrated by what they perceive as a lack of experience or breadth of resources of the regulators. Perhaps most troubling of all is what one interviewee described as ‘the danger that Basel II will lead to a herd mentality that might eventually precipitate a crisis if everyone follows in the same direction’.

Participants were concerned about the mounting burden of compliance with multiple rules and overlapping regulation. They believe certain aspects of new regulations such as Basel II could actually heighten systemic risk.
Clearly there have been benefits, including the increase in budgets for risk teams and the raising of the quality standard for risk management. However, a narrow focus on regulatory compliance may fail to address the broader ethical and reputational issues faced by businesses today. Most compliance costs would certainly appear modest when compared to the billions of dollars that can be wiped off share values if lapses in probity or governance come to light. The challenge is therefore how to guarantee a payback from this investment by using new regulation as a foundation and catalyst for improving business management processes.

Regulatory challenge

- Concerns about cost, complexity and systemic risk;
- Focus on regulatory compliance may miss wider issues; and
- Investment in new regulation can be catalyst for improved processes.

In 2001, PricewaterhouseCoopers was engaged by the respected Committee of Sponsoring Organizations of the Treadway Commission (COSO) to develop the Enterprise Risk Management – Integrated Framework. The ‘COSO II ERM Framework’ is designed to provide an effective balance between control, compliance and value creation that enables an organisation ‘to deal more effectively with risk and uncertainty and associated risk and opportunity and so influence its capacity to build value’. This includes helping to ‘align risk appetite and strategy’ and ‘improve the deployment of capital’, while ensuring ‘compliance with laws and regulations’ and helping to ‘avoid damage to the entity’s reputation’ (for more information or a copy of the ERM Framework please visit www.coso.org).

‘Basel II could mislead people’s thinking by encouraging too detailed a focus on the numbers, without seeing the bigger picture.’

Participant CRO

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9 ‘Banana Skins 2005’, a survey of the risks facing banks, which was published by the Centre for the Study of Financial Innovation in association with PricewaterhouseCoopers. To order a copy please visit www.csfi.org.uk
CROs are being called upon to provide expert counsel in areas ranging from mergers and acquisitions to the launch of new products. Clearly, this not only calls for business sense and strategic awareness, but also for an acute understanding of how decisions are made and enacted around the organisation. Indeed, it is clearly only a matter of time before a CRO rises to become a CEO.

The profile of people coming into the risk profession is also changing in the wake of rapid technological and organisational developments. It is perhaps telling that a new breed of risk officer is as likely to hold an MBA as an MSc. However, the age-old expertise and experience of risk professionals remains an essential element of stable and successful businesses. In particular, even the most sophisticated systems can only go so far in identifying risks to the organisation and may indeed create a false sense of security. CRO oversight therefore remains the ultimate line of defence.
The evolving nature of the profession will create challenges in areas ranging from training to career development. Devising effective incentives is a particular issue in a profession whose benchmark for success has been ‘no news is good news’. This is changing, however, as the interviews with participants highlighted. One bank, for example, now bases its rewards on consistency of earnings. Such trends may begin to pave the way for the use of shareholder value-added metrics in risk bonus structures.

**Changing focus for CROs**

- Management to leadership;
- Loss avoidance to value creation;
- Reporting to communication;
- Decision-support to decision-making;
- Data management to information sharing; and
- Alignment of incentives to business performance metrics.

‘You can drive best practice and the desired culture into the organisation through links to compensation and performance assessments.’

Participant CRO
What differentiates you from your peers?

The participants’ views reveal a surprising lack of consensus on risk management best practice.

Clearly, there can be no one-size-fits-all risk management profile among participants with such a varied array of structures and strategic priorities. Nonetheless, the participants’ overriding aims were broadly comparable, including the avoidance of unpleasant surprises and instilling risk awareness into the strategic and tactical DNA of the business (see Figure 8).

However, the means to these ends were often very different. This includes the sharply contrasting approaches to reputational risk and economic capital. There were also divergent views on the desired level of empowerment versus centralisation in risk control, authorisation and communication.

The relative pace of development also varies. Some banks have already set up enterprise-wide risk management programmes; others are only just beginning to look at data across risk types/territories and bring harder to measure non-financial risks onto the radar.
Some of the larger institutions may be leading the way with their investment in sophisticated scenario modelling and macroeconomic analysis. Yet the cutting-edge innovations often appear to be coming from the smaller participants in areas ranging from risk-related compensation to firm-wide intelligence networks and escalation capabilities.

### Little common ground
- Little consensus on best practice;
- Varied levels of attainment; and
- Many smaller groups leading innovation.

‘Our upstream risk management structure, identifying an array of external factors impacting our risk management approach, is the envy of our competitors.’

Participant CRO

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10 ‘The Journal’ – Special risk management edition. To download or order a copy please visit www.pwc.com/banking
The interviews with CROs elicited a wide range of perspectives on how to manage risk and add value to the business.

Risk teams are developing a more proactive and holistic approach to risk management in keeping with the challenges and opportunities of a fast-changing marketplace. They are also putting in place the reporting and organisational frameworks needed to underpin effective risk management. Yet, risk appetite, an important way to translate risk metrics and methodologies into decision-making, has yet to gain widespread understanding and acceptance within the business. In other areas, including economic capital and the management of reputational risk, there appear to be two competing schools of thought.

The contrasts, and in some cases, frustrations, are perhaps a reflection of the introspection among risk teams that has resulted from the need to implement new regulation and preside over the rapid expansion of the function. While the desired profile of the risk team naturally needs to reflect the nature and priorities of the organisation, increased dialogue...
in the future may raise awareness of the different options available and how to maximise the benefits. Hopefully, with the introduction of new regulations set to recede over the next few years, now is the time to move forward.

CROs’ move from ‘gatekeeper’ to business partner requires a broad outlook and expanded set of skills. In particular, a more responsive and proactive approach to threats/opportunities and their impact on the business, demands ever-more creativity and innovation.

It is telling that financial services CROs are now increasingly drawn from fields as diverse as internal audit and marketing, reflecting the breadth of the challenges they face and the capabilities they require.

Institutions need to be able to provide the rewards, recognition and involvement in key business decisions, which will attract the brightest and best into the risk profession and inspire them to want to become CROs. In particular, the graduate talent is unlikely to want to enter a profession mired with the bureaucracy of credit reports and other routine aspects of regulation. One key aspect of the way forward is therefore effective organisation that enables companies to manage control and compliance, while still allowing risk professionals the time to devote to analysis, development and providing counsel to the Board. Ultimately, they will need to be able to offer an attractive and challenging career path that enables top risk professionals to gain seats on the Board and eventually move up to CEO and Chairman positions.
If you would like to discuss any of the issues raised in this publication in more detail please speak to your usual contact at PricewaterhouseCoopers or call one of the following.