

KPMG DF020

RISK MANAGEMENT 2011? Version 3

A Personal View

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AUDIT • TAX • ADVISORY

Is risk management important in the Financial Sector?: Banks DF020

It would be a mistake to conclude that the only way to succeed in banking is through ever-greater size and diversity. Indeed, better risk management may be the only truly necessary element of success in banking.

Alan Greenspan, Chairman, US Federal Reserve
October 5, 2004

Banks that wish to remain competitive must keep up with the latest developments in risk measurement and management ... one of the most important sound practices for a banking organisation is the tying of risk exposure to capital ... by more clearly defining risk exposures and identifying the causes and controls for their losses, bank management can more effectively integrate decisions about risk-taking into their strategic and tactical decision-making.

Governor Bies, US Federal Reserve
March 29, 2006

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Is risk management important in the Financial Sector? : Insurance DF020

Management problems appear to be the root cause of every failure or near failure, so more focus on underlying causes is needed.

firms ... need to anticipate how risks can interact in complex ways, including casual links between different types of risk ..., and unexpected correlations....

moving to a risk-based (supervisory) approach brings benefits

it is important to strike the right balance between prescriptive rules, principles, incentives and diagnostic tools

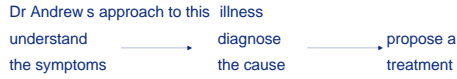
FSA occasion paper 20: Practical lessons from recent failures of EU Insurers.

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Risk Management is one of the most important concepts in early 21st Century Culture DFR20

But
 in reality there is little agreement (in general) as to
 what risk management really is/means
 what one should be trying to achieve with it



Agenda DFR20

Understand the symptoms

- Diagnosis
- Propose a treatment
- What does success look like

Example (1): UK Banking Groups DFR20

2001	PBT/Assets (%)	Total Provisions/Assets (%)
	1.05	0.27
	1.03	0.78
	0.96	0.64
	1.17	1.15
	1.87	0.77
	1.19	1.02

Who has the best risk management?
 Who has the worst?

Why is there a problem (1) DFR20

Risk management – controls – governance – Internal Audit – Compliance- governance?
 Risk management – business management?
 Risk management – costly insurance rather than value added activity?
 Risk management – Risk Analysis?

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Why is there a problem (2) DFR20

Risk management often lacks alignment and objectives to support business plan
 Too much focus on technical matters so that different areas of RM appear more different than they are and RM appears different to business management
 Insufficient measures of the value of RM
 Few firms have a clear and consistent view of risk across the organisation or meaningful risk aggregation a single view

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Embedding Risk Management is a widespread problem DFR20

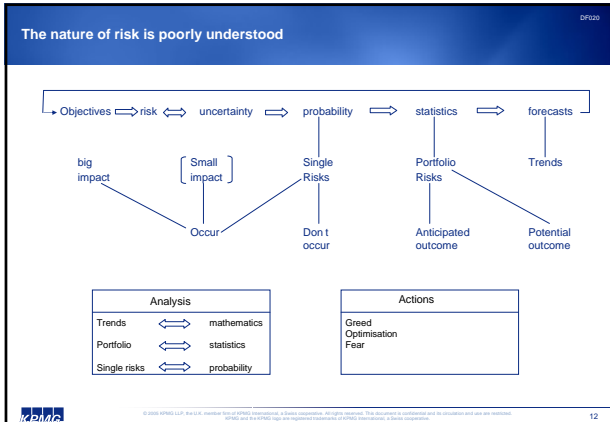
People / Organisations	
Will	Wont
Do what is important to them Do things which demonstrably and measurable add value	Take seriously regulatory initiatives that they don't believe in Keep doing things unless the value arising is evident

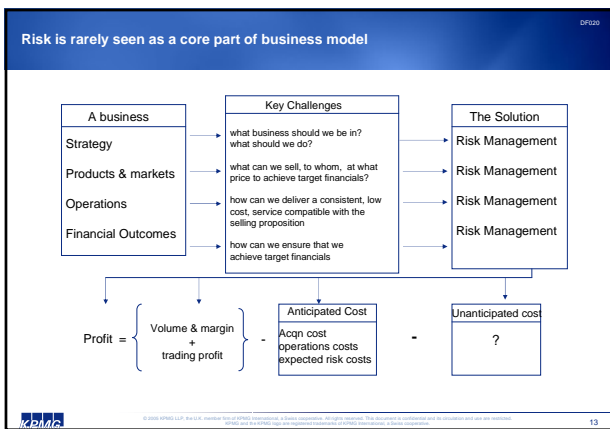
Can only achieve an **effective risk management** when

- there is **alignment** between the goals of risk management and the Goals of the organisation
- tools, techniques and infrastructure are **customised** to the specific circumstances of the organisation and its business mix

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Separate, but link analysis, management and clean up of risk

Controls
<ul style="list-style-type: none"> Process elements which establish levels of consistency, or quality Rules which set acceptable tolerances
Governance
<ul style="list-style-type: none"> The collection of policies, infrastructure, limits, controls, risk reports, reporting lines, plans, delegated powers, committees, and resources which establish tolerance for acceptable activity in a firm overall
Risk appetite
<ul style="list-style-type: none"> The collection of policies, standards, limits, reporting within the governance framework Risk taking powers delegated to the executive to carry out the business plan
Economic capital
<ul style="list-style-type: none"> A judgement assessment of the level of financial resources required to support the (risk taking implied by the) business plan

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Real organisation risk management concepts

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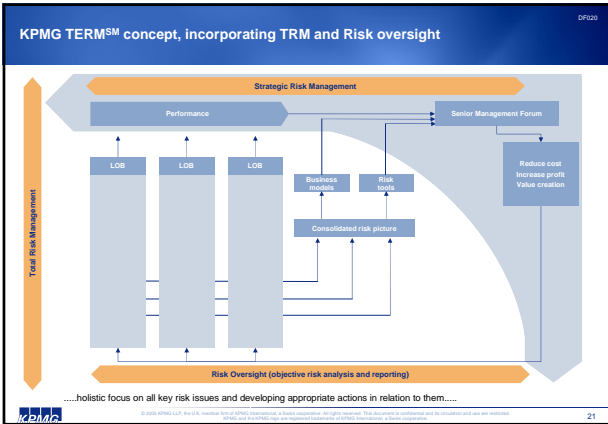
Governance Structures

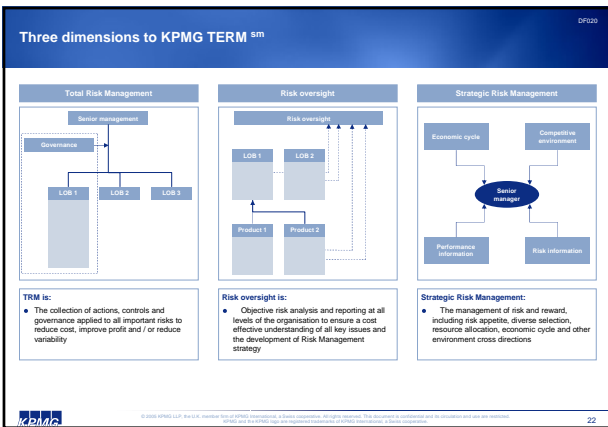
Task 1 Action	Task 2 Assessment, Analysis & Appetite	Task 3 Assurance
<ul style="list-style-type: none"> Actions which transform the risk profile Actions consistent with policy & regulation Actions to generate profit 	<ul style="list-style-type: none"> Objective, relevant accurate risk analysis and reporting Formulation of policy, governance and controls framework Debate and prioritisation Optimise overall performance 	<ul style="list-style-type: none"> Have things taken place within the internal and external rule sets? Quality review

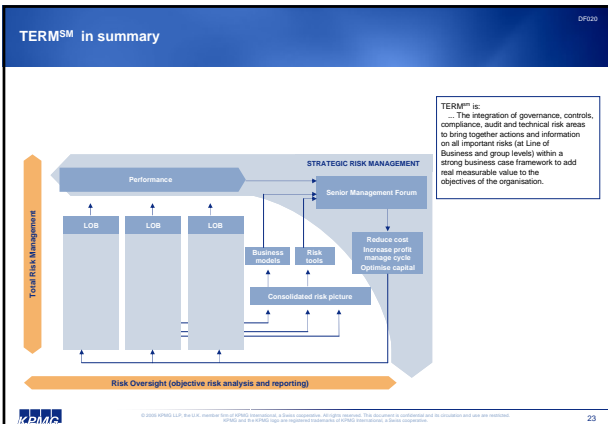
Three lines governance concept developed by William Higgins and presenter at KPMG in mid 1990 s
Three lines governance models now the most common in financial service industry

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Agenda

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- Understand the symptoms
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What does success look like



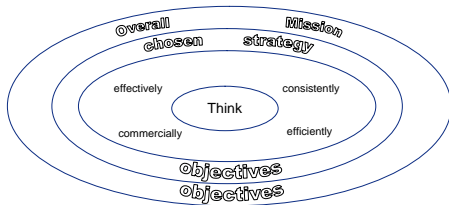
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What does success look like?

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Strategy, Infrastructure and processes which encourage colleagues to



When **accepting** or **maintaining** risk on behalf of the organisation



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The actuary of the Future?

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- ▶ Actuarial science/action = Risk Management
- ▶ Risk Management = More/Better Profit



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