



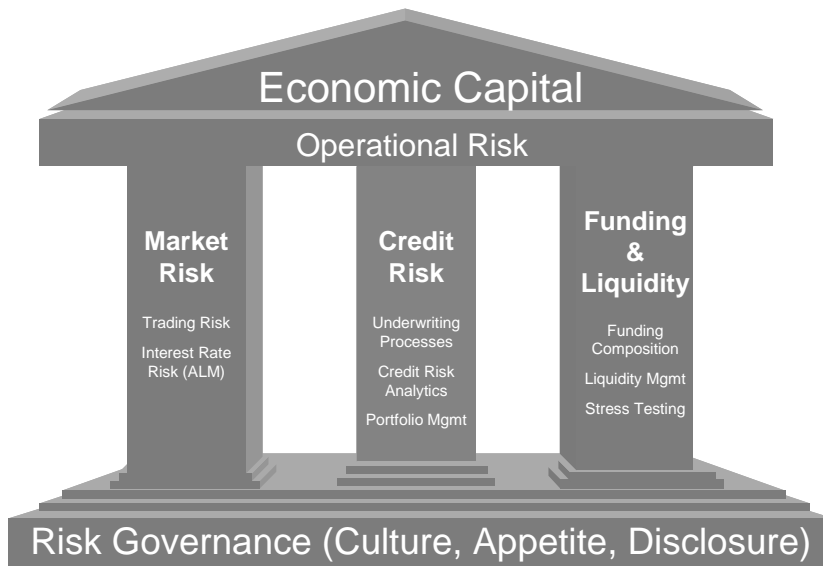
Enterprise Risk Management: Financial Institutions Ratings

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Evolving Risk Assessments From TRM to ERM

- Improve the depth and consistency of our risk management analysis.
- Build on the TRM exercise and expand to other risk areas
- Move to a “top-down” approach.
- Apply to all financial institutions globally.
- Flexible framework that can be tailored to each institution.

In short, we want to expand on our existing work on risk management using a more structured, coherent approach

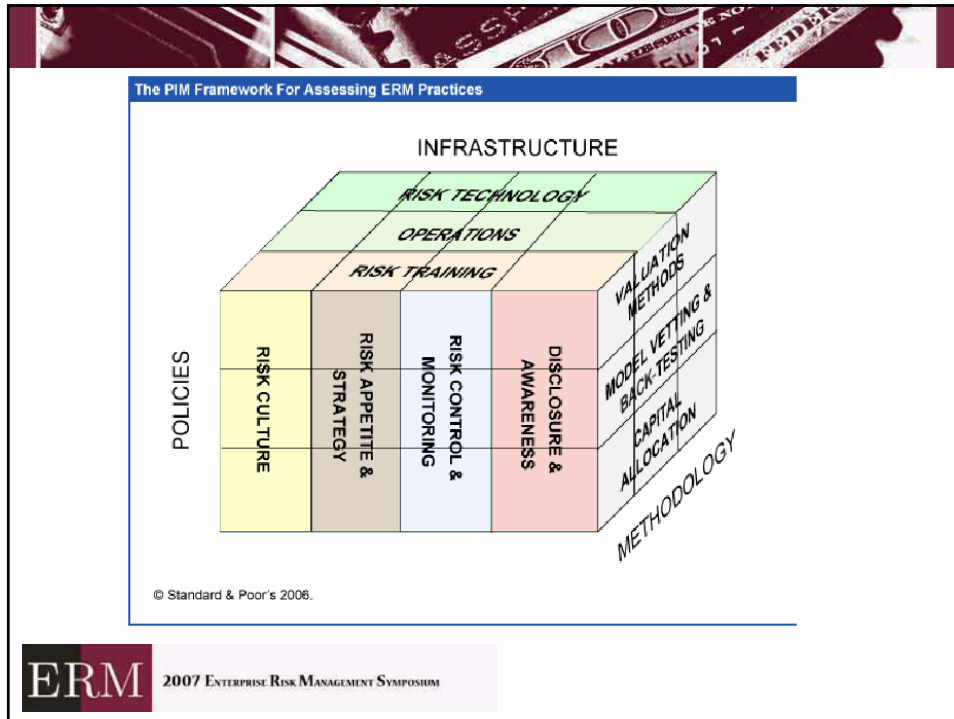
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PIM Component

- Initiated the process with the PIM approach for assessing trading risk management practices in financial institutions in Fall 2004.
 - PIM = “Policies, Infrastructure, and Methodology”
- Identified and reviewed the TRM practices for about 22 financial institutions globally.
 - TRM = “Trading Risk Management”
- Developed and published criteria relating to the assessment of trading risk management practices.
- Extended the PIM framework to insurance companies, corporates and utilities.

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- ## Implementing PIM to Assess TRM Practices
- PIM* – Policy & Governance –
- How is the stature of the risk management function evaluated and how important is this in the aggregate assessment?
 - Independence of the risk function
 - Partnership and strategic role with the business
 - CRO reporting to the CEO
 - In assessing the process by which an institution establishes its risk appetite, what criteria is applied?
 - Process for establishing the risk appetite (qualitative and quantitative) that consider tactical and strategic objectives
 - Quality of the process for approving new products (NPA committees, clear definitions, documentation, tracking, follow-up)
- ERM** 2007 ENTERPRISE RISK MANAGEMENT SYMPOSIUM



Implementing PIM to Assess TRM Practices (2)

PIM – Policy & Governance –

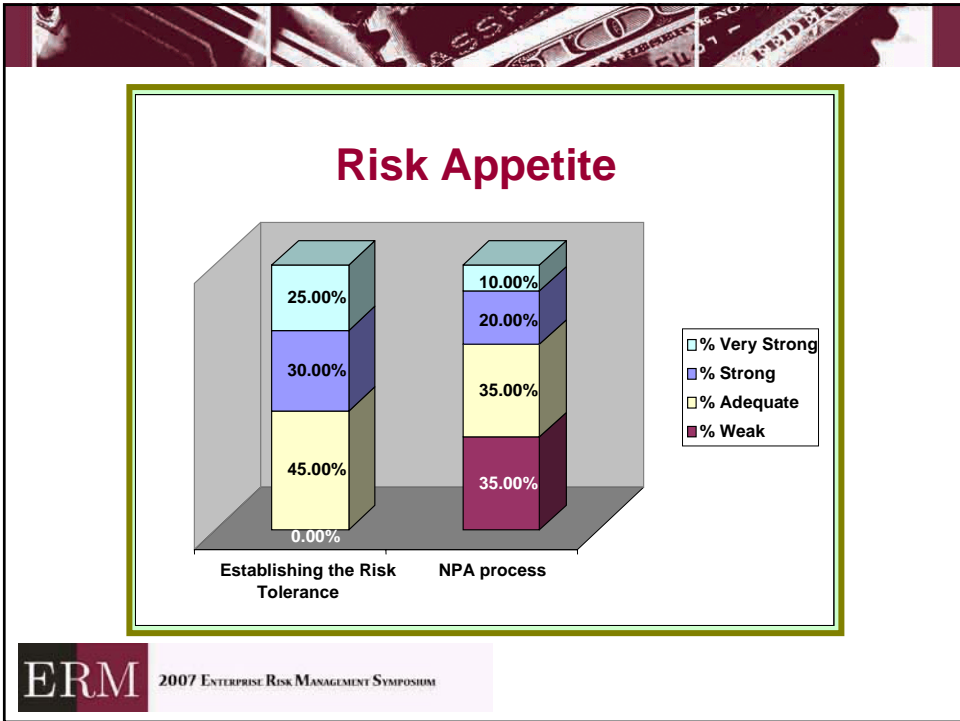
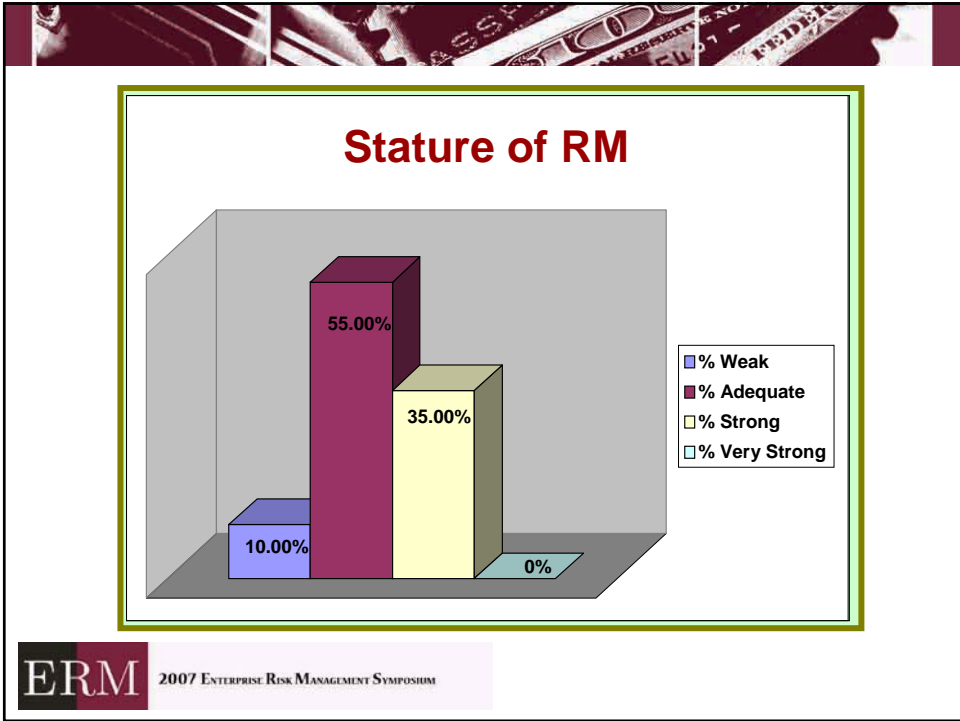
- Is it Standard & Poor's goal to lead financial institutions to disclose more than required by the SEC? What criteria is applied with respect to disclosure?
 - No! (That is not the intent)
 - However, strong practices would dictate that institutions take a leadership role and articulate the relevant risks to their shareholders that go beyond what is required by regulation
 - Assess the quality of both internal and external disclosure
 - Internal reports to senior management should summarize financial and non-financial risk

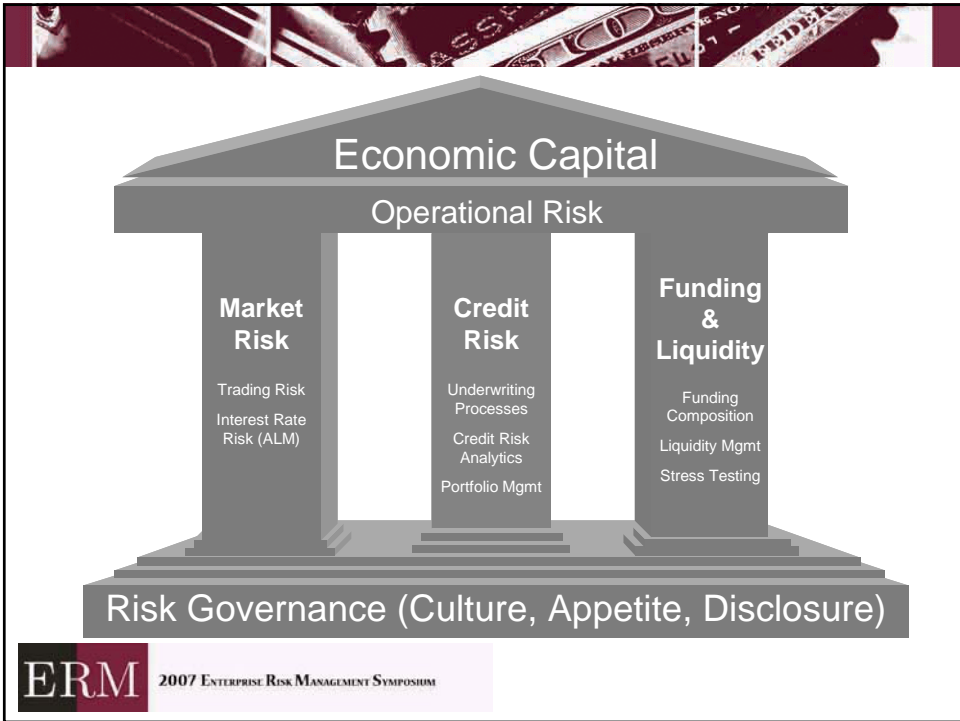
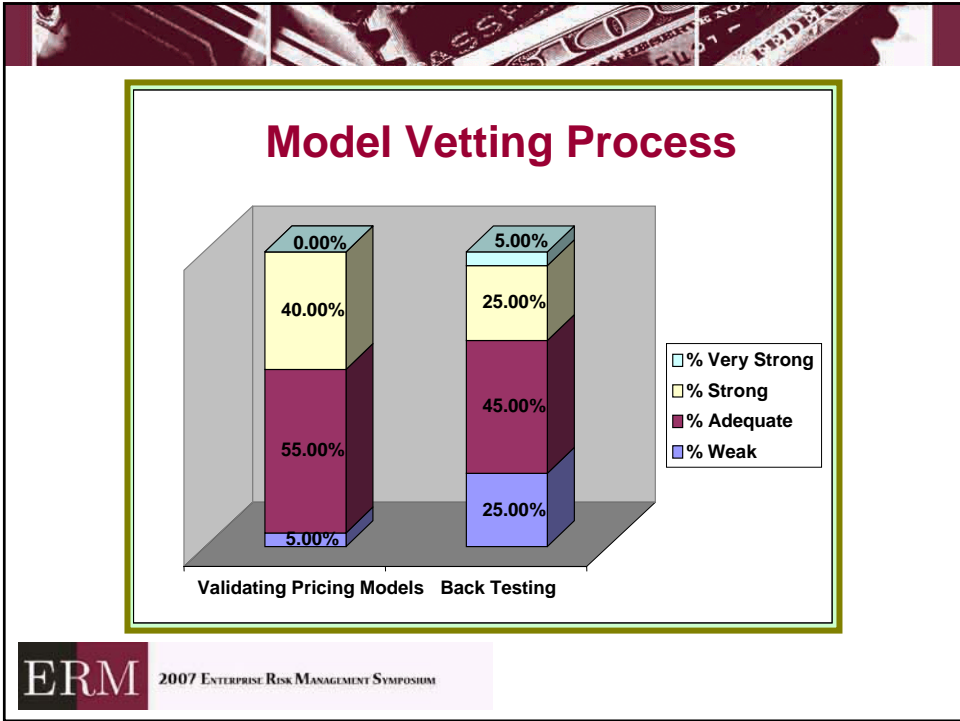



Implementing PIM to Assess TRM Practices (3)

PIM – Infrastructure & Methodology:

- What is evaluated in terms of Risk Technology and Back Office operations?
 - Should be independent of the Business
 - Should track KRIs (“Key Risk Indicators”)
 - Quality and level of systems integration
- How important is VaR as a risk measure in Standard and Poor's criteria for assessing the trading risk management practices of an institution?
 - Unfortunately not much!
 - Stress Testing and “What-If” scenario analysis is important
 - And other measures beyond regulation








Risk Governance

Risk Culture –

- Assessing the stature of the risk function within the organization
- Risk function’s role and relationship with the business units

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Risk Governance

Risk Appetite –

- How is at the aggregate level of risk established?
- Who gets involved in this process and what role does RM play?
- Is it consistent with the business strategy?
- How does the firm translate that appetite into a tangible quantitative metric?

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Operational Risk

- How does the ORM function of the institution define operational risk?
 - Is this definition consistent across business lines?
 - What educational programs are in place to ensure this consistency of understanding?
- What is the process that the institution employs to understand and analyse its operational risks?
 - How does it differentiate between cause, event and impact (or effect) of the loss event?

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Operational Risk:

- What are the different components of operational risk that the institution has categorized as material to the ORM process?
 - How does this map in with the cause, event and impact process that is employed by the institution?
 - Is there a clear mapping of Legal/Compliance and Reputational risks?
- Does the ORM function of the institution have a well defined process for prioritizing the components of OR?
 - Is there a cost benefit analysis (CBA) in prioritizing both external and internal events?

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Market Risk - Trading: What is being assessed?

- How is the market risk tolerance for the firm established?
 - Is it consistent with the business strategy?
 - Is there a well defined process for the approval of new products?
- How do risk limits get assigned?
 - Who assigns them?
 - At what levels are the limits set? (e.g. Region, Desk, Book, Portfolio, Trader).
 - What type of limits are used?
 - Who has the authority to grant exceptions?

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Market Risk - Trading

- Do pricing models exist for all transactions?
 - How are complex transactions valued?
 - How frequently are models reviewed?
 - How is CPY credit exposure as it relates to the trading book calculated?
 - Are credit derivatives integrated into the exposure measurements?
 - How are stress tests constructed?
 - How frequently is stress testing conducted and revised?
 - Can adhoc/"what-if" scenarios be run through the daily process if required?

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Credit Risk

Underwriting Process and Portfolio Management


- Clarity of underwriting policies and the process for establishing the relative risk appetite.
- What is the degree of segregation between origination and underwriting staff/processes?
- What are the criteria and internal approval structures that the institution has adopted in the delegation of its underwriting processes?



Credit Risk

Underwriting Process and Portfolio Management

- What is the structure of on- and off-balance sheet exposures?
- What is the process for monitoring outstanding exposures for early warning signals of potential problems?
- What is the level of diversity in the portfolios (by geography, collateral, maturity, borrower type, etc)?
- What is the tolerance for large exposures to individual names and/or sectors and the process for collections and recoveries?




Liquidity & Funding Risk

Management, Stress Testing

- Are there well-established and documented funding policies?
 - Does the institution place a premium on maintaining diverse funding sources (by product, investor type, geography, etc)?
- How is this managed and monitored?
 - How does the institution monitor and manage its day-to-day funding position?
 - To what extent has it conducted behavioral analysis of its assets and liabilities?

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Liquidity & Funding Risk

Management, Stress Testing

- How does the institution model the expected impact of a liquidity crunch?
- How severe/realistic are the liquidity stress scenarios and the net outflows that would result from them?
- Does the institution maintain sufficient liquidity capacity (unencumbered liquid assets, secured bank facilities, etc) to raise emergency liquidity?

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ERM Quality Classifications

<i>Excellent</i>	<ul style="list-style-type: none"> ▪ Advanced capabilities to identify, measure, manage all risk exposures within tolerances ▪ Advanced implementation, development and execution of ERM parameters ▪ Consistently optimizes risk adjusted returns throughout the organization
<i>Strong</i>	<ul style="list-style-type: none"> ▪ Clear vision of risk tolerance and overall risk profile ▪ Risk Control exceeds adequate for most major risks ▪ Has robust processes to identify and prepare for emerging risks ▪ Incorporates risk management and decision making to optimize risk adjusted returns
<i>Adequate</i>	<ul style="list-style-type: none"> ▪ Has fully functioning control systems in place for all of their major risks ▪ May lack a robust process for identifying and preparing for emerging risks ▪ Performing good classical "silo" based risk management ▪ Not fully developed process to optimize risk adjusted returns
<i>Weak</i>	<ul style="list-style-type: none"> ▪ Incomplete control process for one or more major risks ▪ Inconsistent or limited capabilities to identify, measure or manage major risk exposures



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Institution Name	Assessment & Comments			
	1=Weak	2=Adequate	3=Strong	4=Excellent
Overall ERM Assessment				
A. Risk Governance	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<i>Risk Culture</i> <i>Risk Appetite</i> <i>Risk Quantification/aggregation</i> <i>Risk Reporting and Disclosure</i>				
B. Market Risk	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<i>Trading</i> <i>ALM</i>				
C. Credit Risk	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<i>Underwriting Processes</i> <i>Portfolio Management</i> <i>Credit Risk Analytics/Modeling</i> <i>Reserving & Risk Mitigation Policies</i>				
D. Operational Risk	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<i>Definition</i> <i>Measurement</i> <i>Managing & Reporting</i> <i>BO Infrastructure & Operations</i>				
E. Funding & Liquidity Risk	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<i>Funding Composition</i> <i>Day-to-day Liquidity Management</i> <i>Liquidity Stress Testing</i>				



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