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2011 ERM Symposium

Deriving Value from ERM: the process of embedding

Catherine Jourdan
Brian Paton

Agenda

Appetite and limit framework

1. What is risk appetite?
2. How does it fit?
3. 4 key elements
4. Risk limits
5. Appetite and limit MI

Risk reporting

1. Challenges in risk reporting
2. Use of performance metrics

Appetite and limit framework

What is risk appetite?

Amount

1

Risk appetite is the amount of risk, broadly speaking, that an entity wants to take in pursuit of value.

Willingness

2

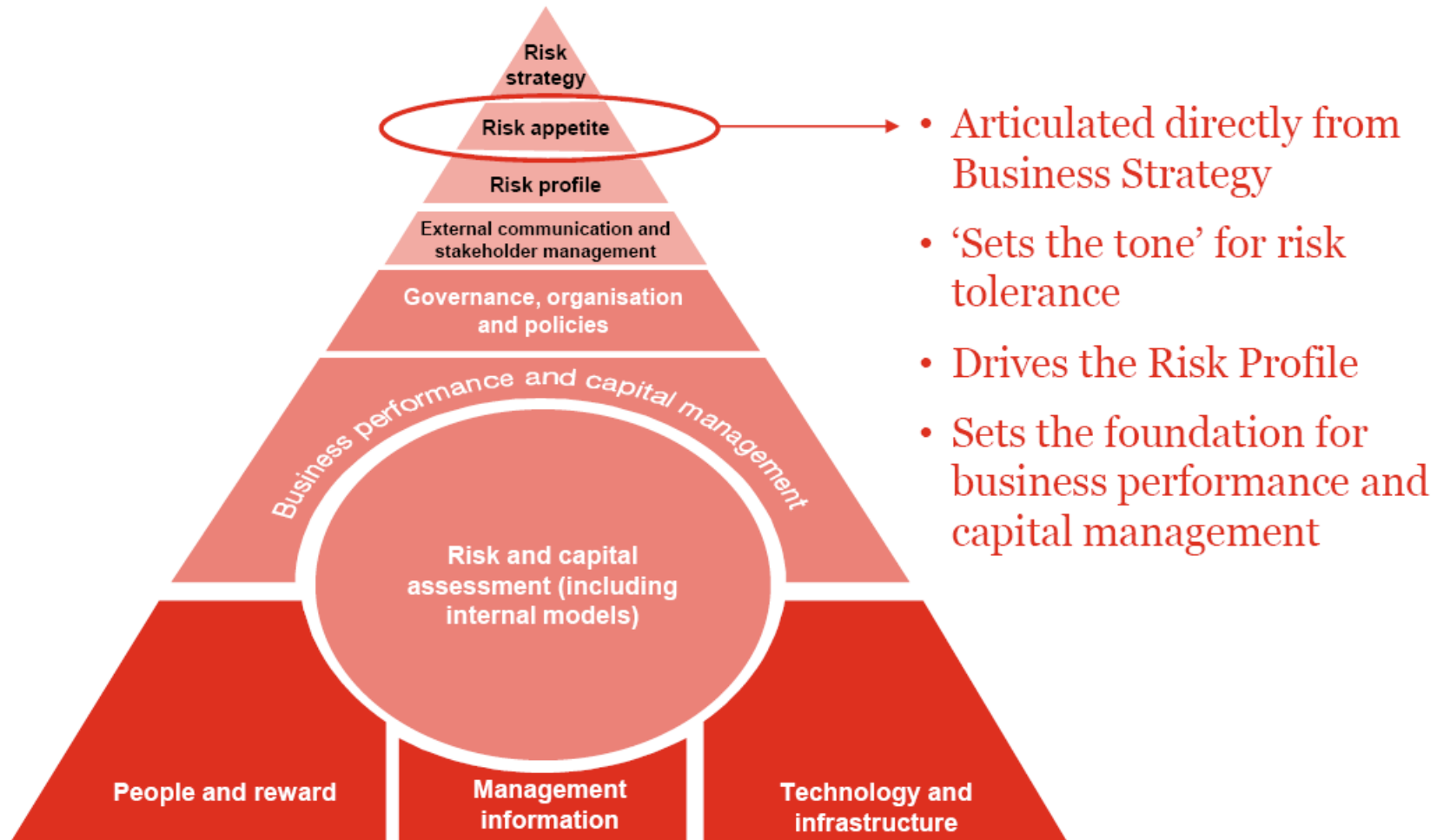
It is an expression of the willingness/capacity of an organisation to tolerate high/low levels of exposure to risk and volatility in order to achieve its strategic objectives.

Responsibility

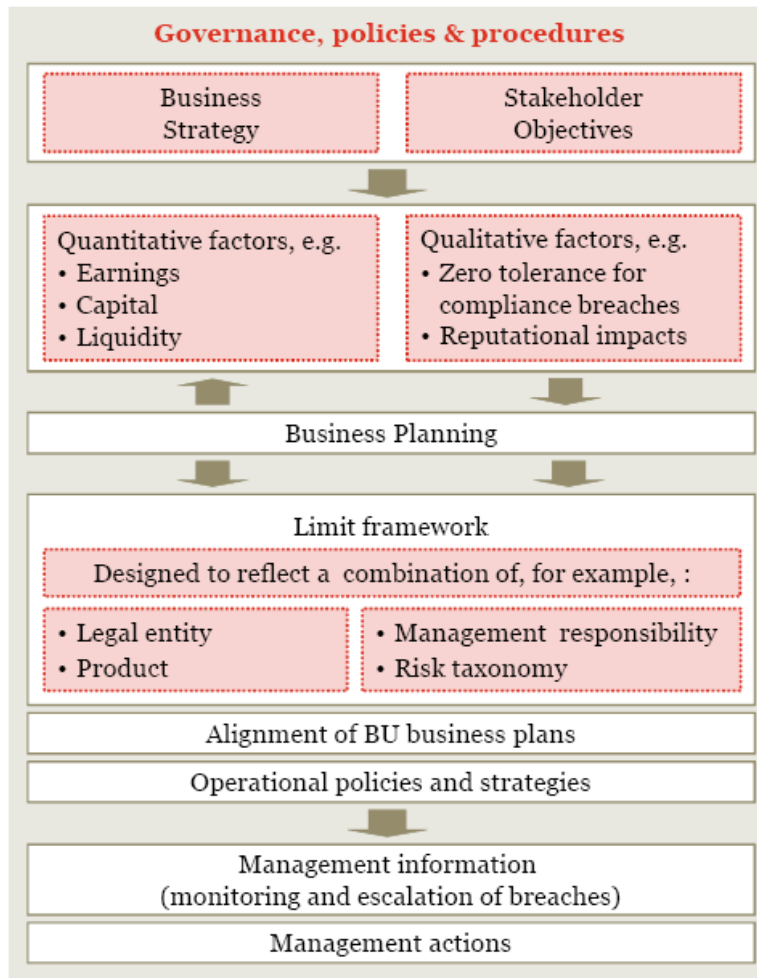
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Risk appetite is typically set by the board and should reflect the aspirations and expectations of various stakeholders through a mix of quantitative measures and qualitative statements.

Risk appetite framework: How does it fit in?



Risk appetite framework: Four key elements



- Articulation of key stakeholders expectations
 - What kinds of risks are we expected to bear
 - How much of that risk can we take

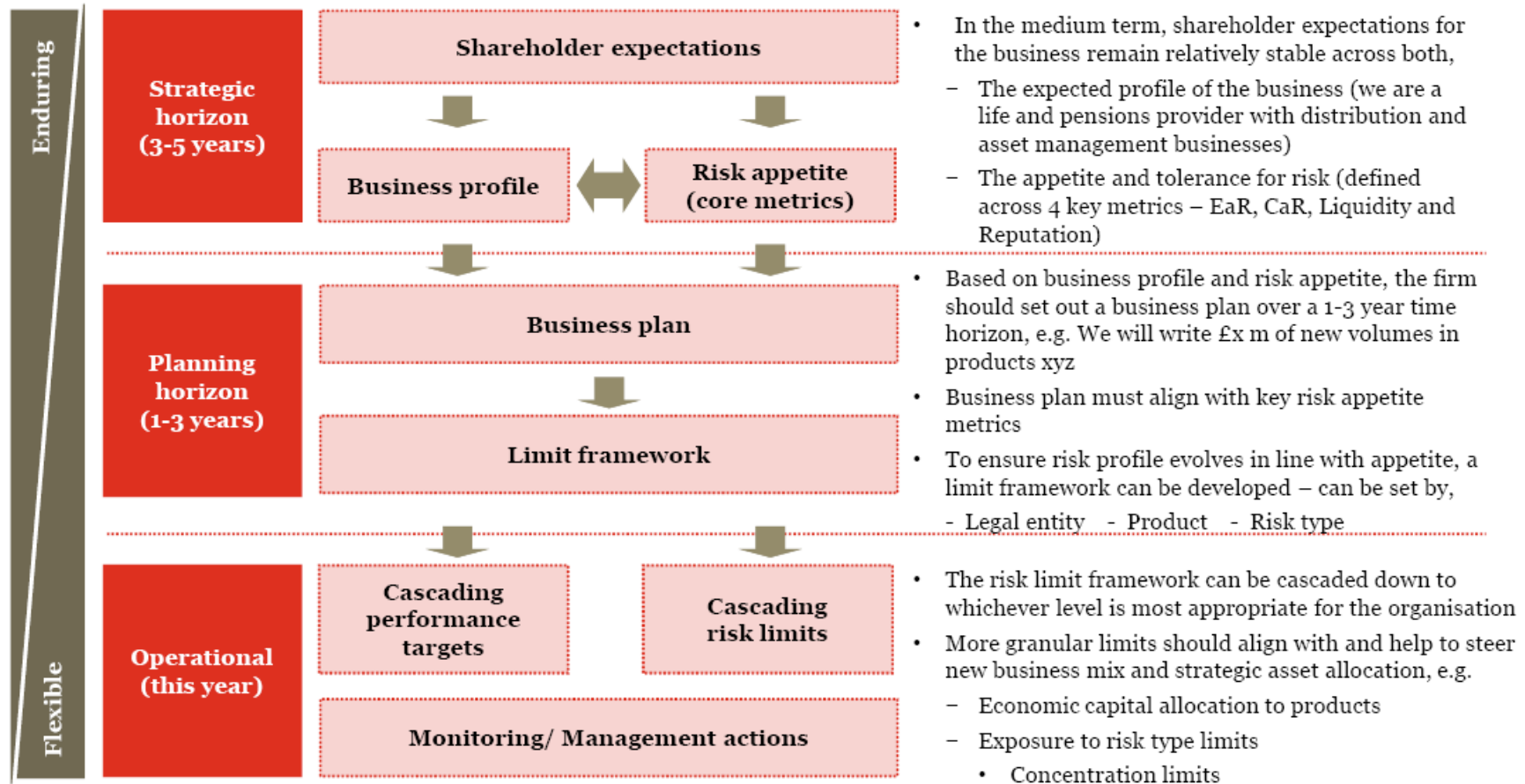
- Define risk appetite statement at a group level along dimensions defined by stakeholder expectations and business strategy
 - Risk : return expectation
 - Capital strength

- Embed risk appetite into group and divisional planning
- Implement appropriate limit framework to cascade risk appetite in to the business
- Update management process and policies to embed 'zero tolerance' thresholds

- Regularly monitor risks against thresholds and limits
- Ensure "management actions" are taken, ideally prior to breaches occurring

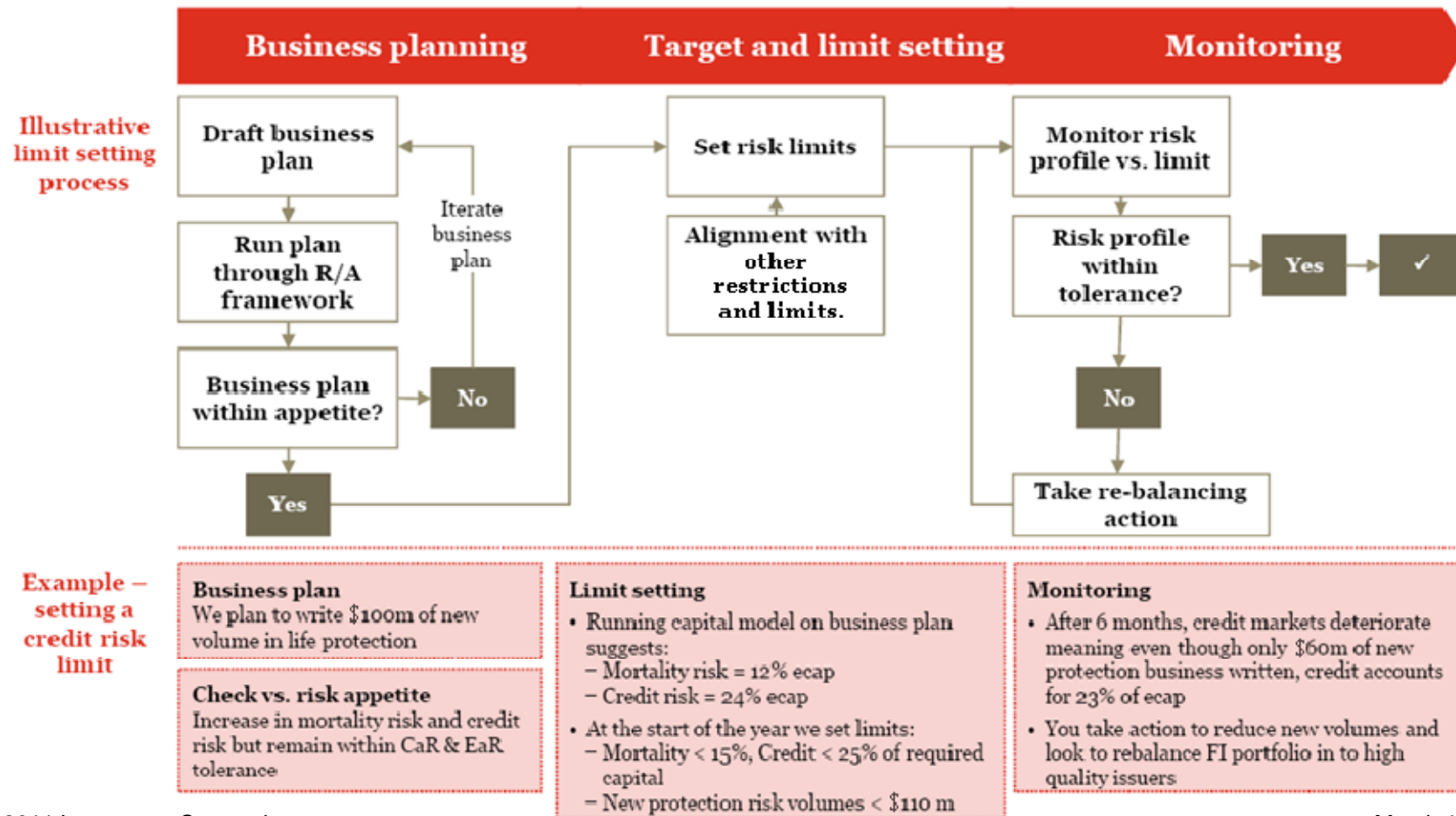
Risk appetite framework: Risk limits

Interaction between “shareholder promise” and limit framework – Illustrative



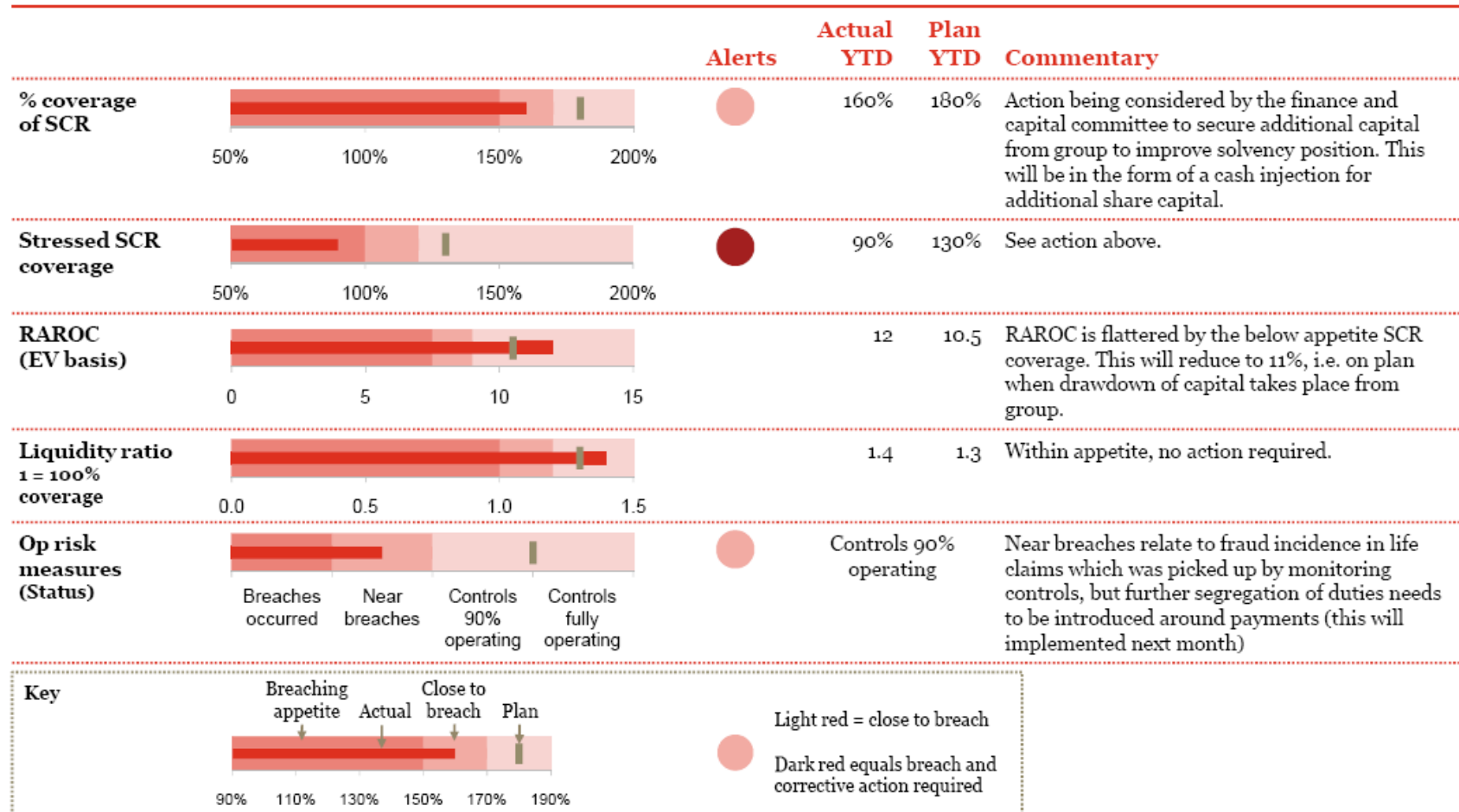
Risk appetite framework: Risk limits

Developing limits within the business planning process



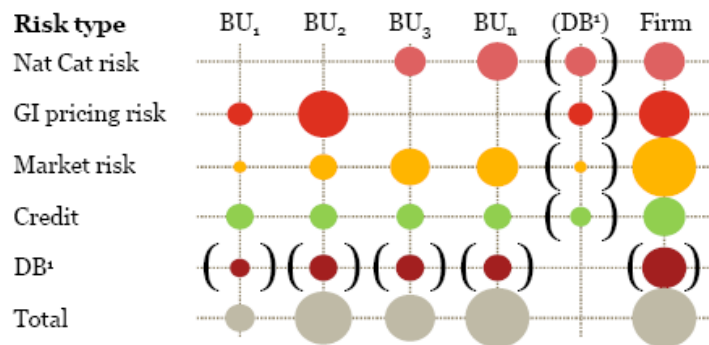
What risk appetite MI could look like

Illustrative risk appetite dashboard



What risk appetite MI could look like

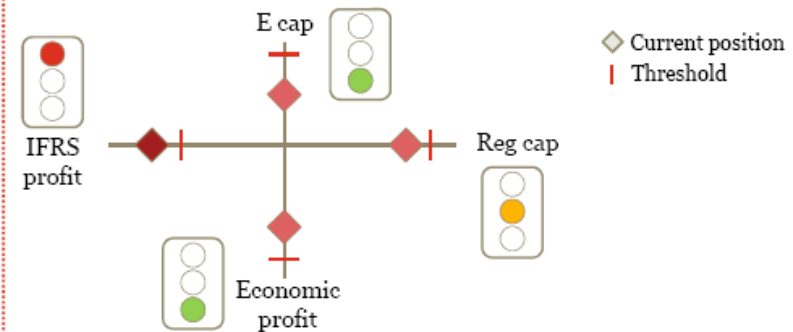
Risk profile as at...



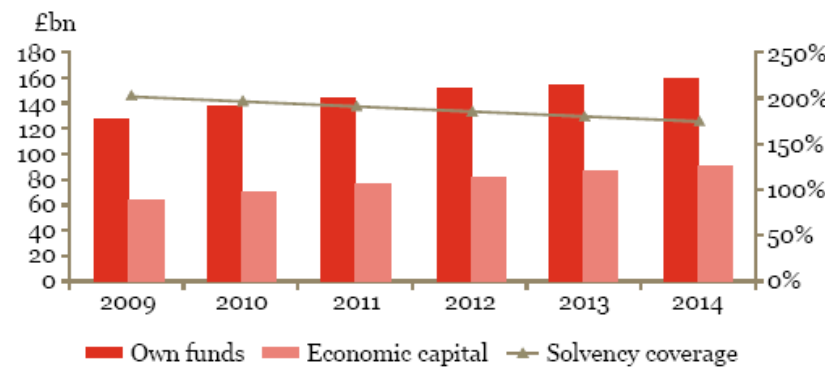
¹ Diversification benefit

Risk position relative to appetite as at...

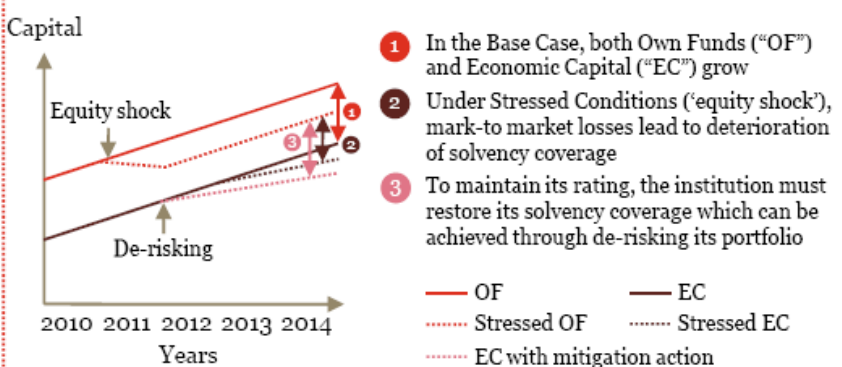
Current position against firms group risk appetite



Economic capital & solvency forecast



Stress and scenario testing



Risk reporting - Challenges in risk reporting

Effective risk reporting can help business performance management

Characteristics of good risk management practices*

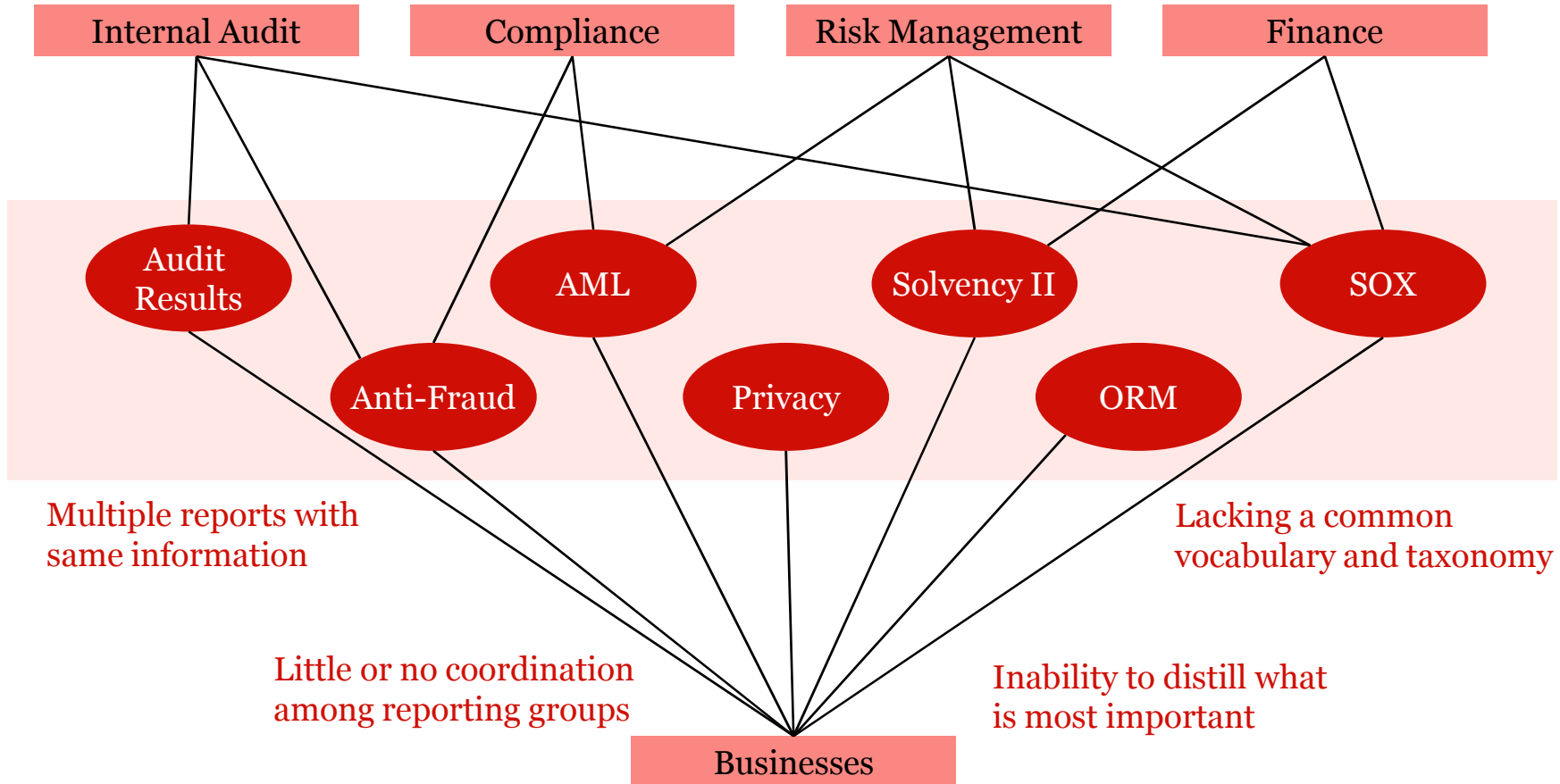
- Portfolio view of exposures and risks
- Balance between risk appetite and controls
- Scenario modeling capabilities and risk quantification
- Sharing of qualitative and quantitative information
- Enforcement of controls
- **Wide range of risk measures and tools for credit and market risk**
- **Timely reporting of risk to board and senior management**

Key questions risk reporting should answer:

- Do current risk/position reports facilitate timely and informed management decision making?
- Do current risk/position reports capture key risk factors associated with structured finance transactions?
- Is risk/operations technology appropriate given the complexity of the business and type of risks being assumed with these deals?

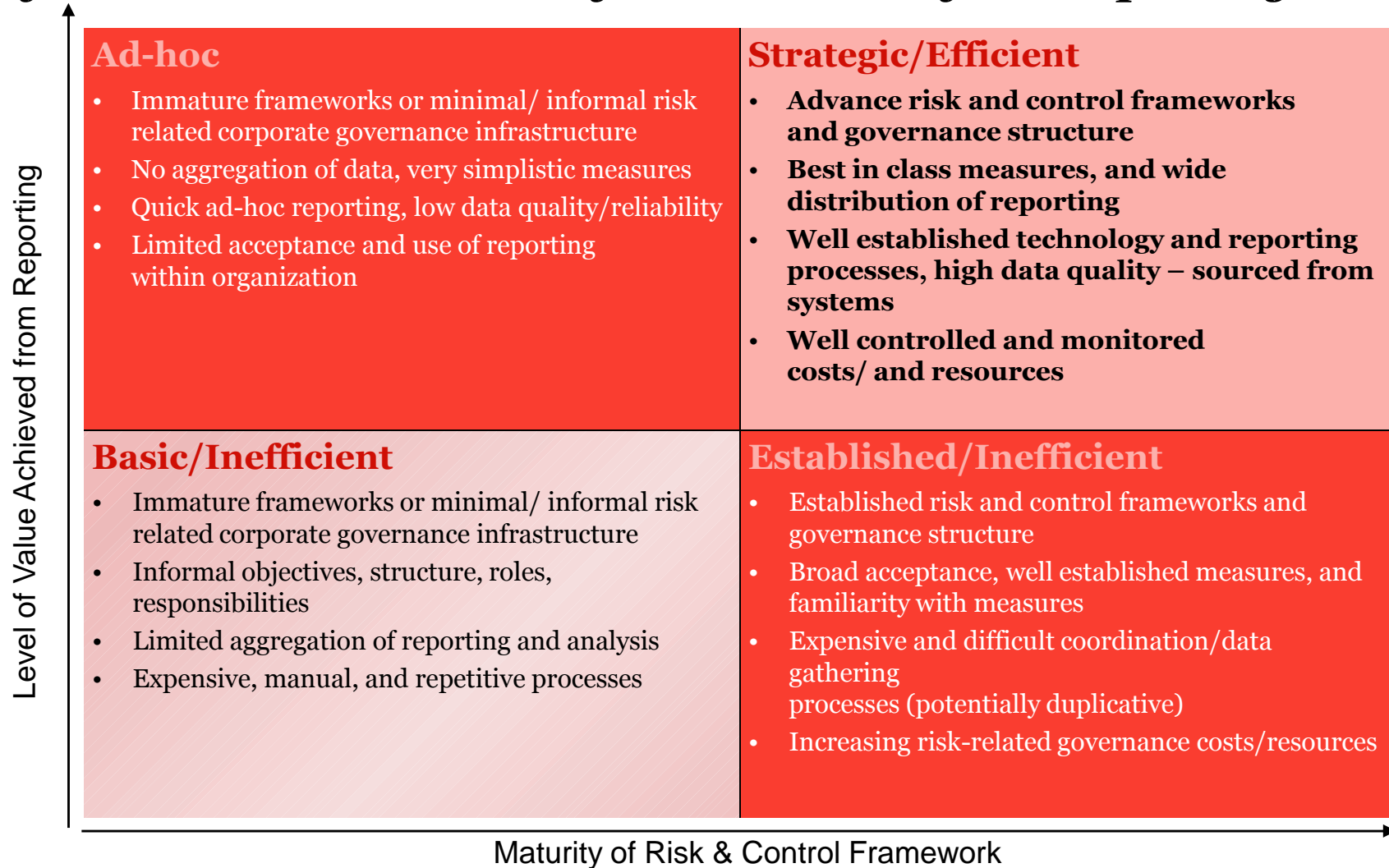
(*) Per Senior Supervisory Group Report

***“Water, water everywhere and not a drop to drink” –
Businesses are being inundated with data but struggle to
make sense of it***



The result is a lot of information in a lot of places, with little ability for users to take action

Companies vary in their maturity of risk and control frameworks and extent of value derived from reporting

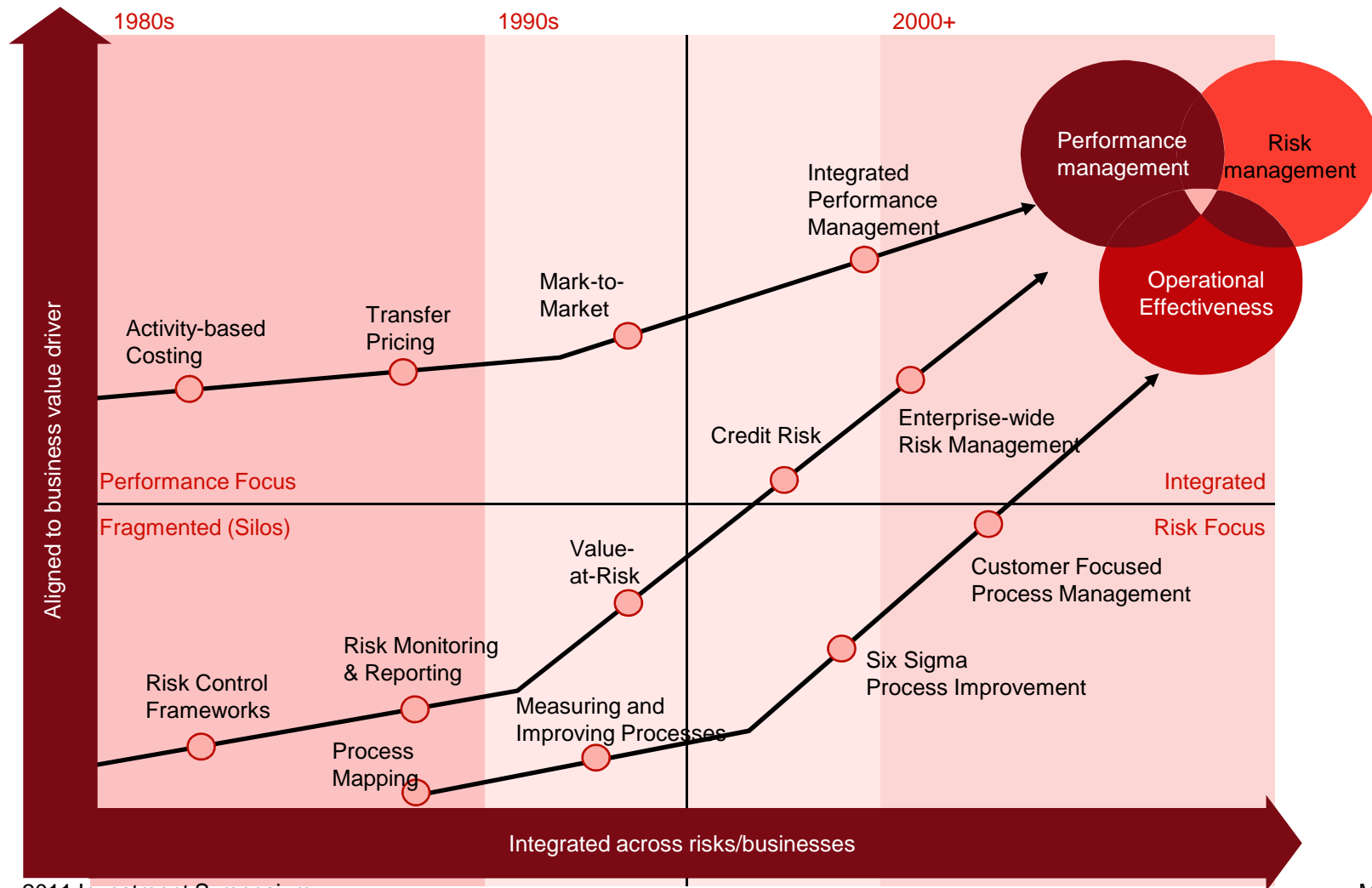


Risk and control leading practice maturity model

Maturity Levels

	1	2	3	4	5
1. Roles and Responsibilities	Invest to meet externally imposed requirements only	Rules based	Proactive posture	GRC embedded	Source of business
2. Mindset	No definition of roles	Partially defined roles	Clearly defined roles	Center of excellence model	Focus on strategic leadership
3. Policy	Standard policies	Minimal supporting corporate standards & operating procedures	Some integrated policies	Policies fully supported by corporate standards	Integrated enterprise wide policies linked to change management
4. Controls	Ad-hoc testing approaches	Standardized control definitions and documentation	Coordinated testing strategies and approaches	Standard and shared testing strategies	Controls and assurance/attestation fully integrated through technology
5. Data	Multiple non-standard data	Limited standardized data	Reference data and data standards	Libraries of controls risks, processes, reference data	Libraries of controls risks, processes, reference data integration standards
6. Processes	Limited tracking of effectiveness	Regular manual reporting of effectiveness	Semi-automated tracking of effectiveness	Automated tracking of status work load issues and remediation	Integrated tracking of GRC process, issues and resolution
7. Reporting	Manual and non-standard reporting	Partial automation reporting, non-standard pockets exist	Partially automated reporting with standards and LOB engagement	Full automation of reporting with LOB	Integrated reporting with day-to-day management tools
8. Technology	No technology standardization	Some standardization	Partial use of workflow	Standard tools deployed	Real-time monitoring of events

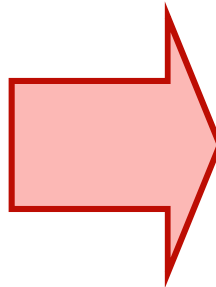
Linking risk reporting with performance and operational effectiveness information for improved decision making



Use of performance metrics

Recent market events have highlighted the importance of adequate risk reporting to management and the board

- Solid discussion of risk matters between the Board Risk Committee, Management, and the independent risk overview function
- Transparency of risk profiles, emerging trends, key exposures, and mitigation
- The Board Risk Committee and management have a common understanding of risk culture and risk management framework



Reinforce dual reporting channels for risk

- Primary responsibility for reporting risks lies with the business
- CRO provides independent perspective and validation

Provide the Board Risk Committee with periodic reporting packages of risk information that is

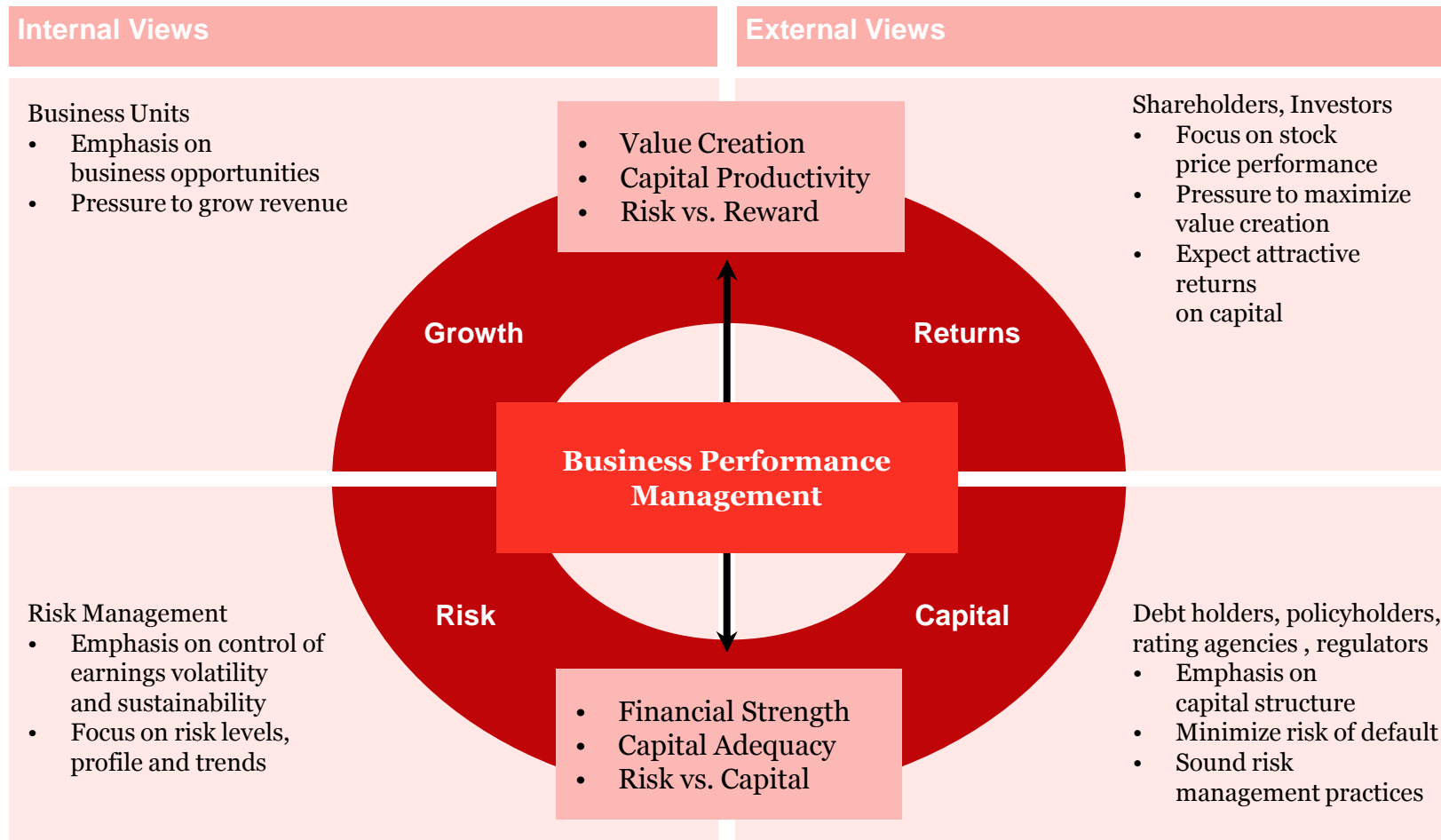
- Timely, concise and accurate
- Comprehensive
- Easy to understand
- Clear in terms of key messages
- Focused on the information contained in the data

Annually assess and report

- Risk culture as assessed through analytical methods such as employee surveys
- Response to limit breaches
- Overall effectiveness of risk management practices across the company and for each business

Performance can be assessed through a combination of returns, growth prospects, capital and risk information

Each of these elements should be evaluated and reported to Management and the Board



Risk adjusted performance measures

- Integrating performance and risk management to make enhanced business decision making has never been more important.
- Few institutions, however, have been able to fully embrace value management.

Risk-Adjusted Performance Management Principles

- Finance and risk data should be integrated across all relevant dimensions of the business and supports identification of business risk-reward challenges.
- Metrics should be aligned to the ultimate objective of creating and sustaining shareholder value.
- Risk appetite should be aligned to strategic direction by implementing a top down capital allocation and limit setting process linked to risk/reward analysis, strategic planning and risk-based operating budgeting and forecasting.
- Internal risk reporting should link return and risk data and includes risk-adjusted performance information for senior management.
- Tactical decision making tools should be used by the business, contemplate risk-adjusted based pricing and performance goals consistently with enterprise goals.

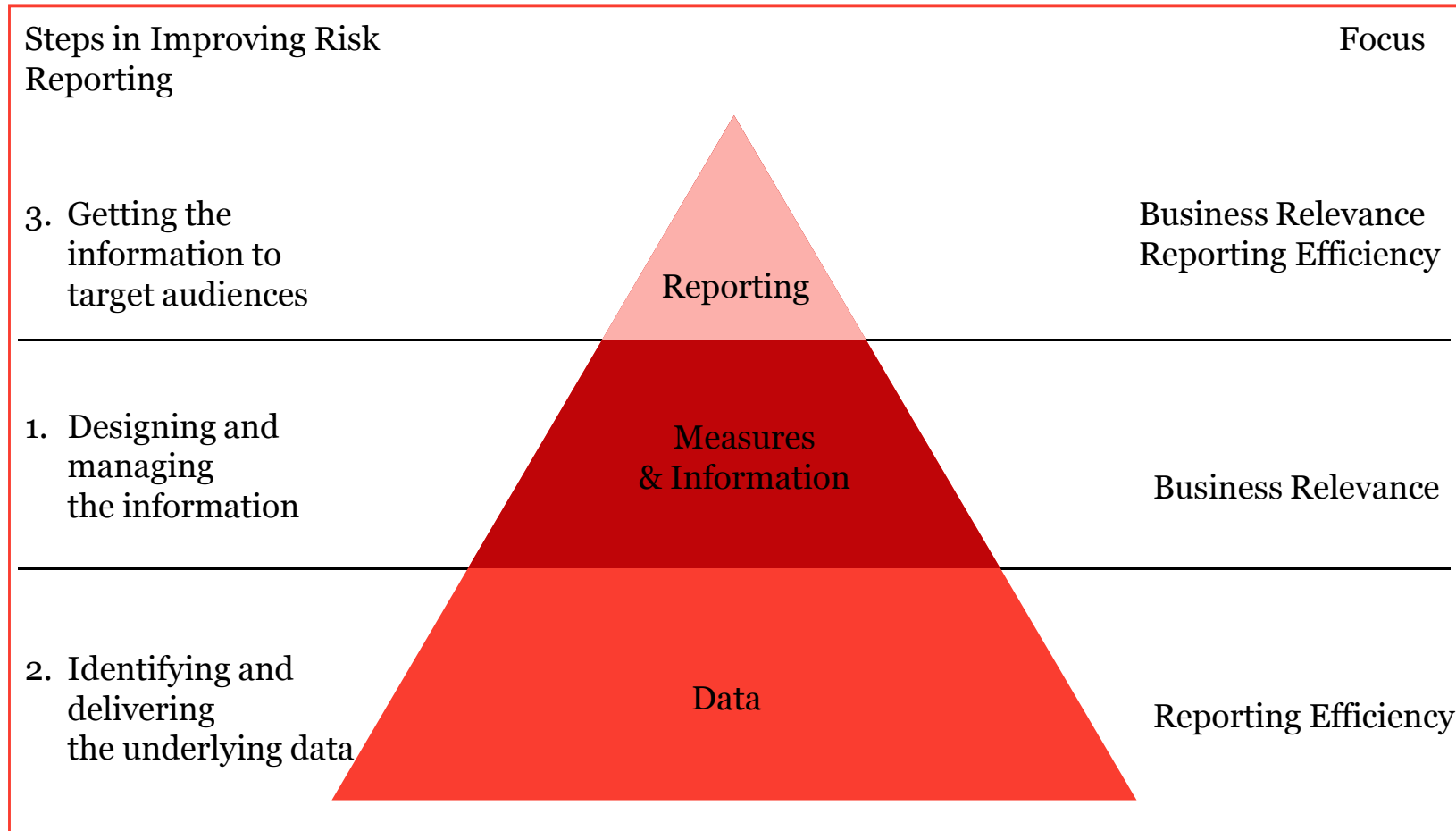
Measuring and tracking Key Risk Indicators (KRIs) is an important component of a robust risk management program

- Having the right focus and capabilities to support KRI reporting is essential to leveraging data and metrics in your environment. The core capabilities to support KRI reporting include:
 - Having a process to determine the key drivers of losses
 - The ability to measure these drivers (sourcing the KRI data)
 - Defining and determining the ranges/tolerances for each KRI
 - Reporting of actual versus tolerance/trends
 - Escalation process when tolerance are outside normal limits
 - Accountability/Corrective actions assigned to people in your organization
 - Change process for KRI'S to keep them relevant (tie to ongoing risk and control self-assessment)
 - Accurate, timely, and relevant reporting of KRI data
 - Highlight areas requiring attention in management reports and dashboards.
- Recognize that key risk indicators should evolve dynamically with changes in the internal and external environment of the company

Risk indicators and reporting often lack efficiency and effectiveness

- The existing environment often lacks efficiency
 - Low automation of data collection, aggregation and report production
 - Inconsistent classification schemes, scales and hierarchies
 - Manual processes increasing need for quality assurance
- Existing reports sometimes fail to trigger the desired dialogue with business leadership
 - Report contents not aligned to mandates/information needs of audiences
 - Time spent on data collection and collation, rather than analysis
 - Reports lead to “so-what” reaction from the business

Improving risk reporting requires consideration of report designs, underlying data and production/delivery methods



Questions

Cathy Jourdan

Director

(646) 471 7389

catherine.i.jourdan@us.pwc.com

Brian Paton

Director

(312) 298 2268

brian.paton@us.pwc.com

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