



Chapter 10

Enterprise Risk Management (ERM)

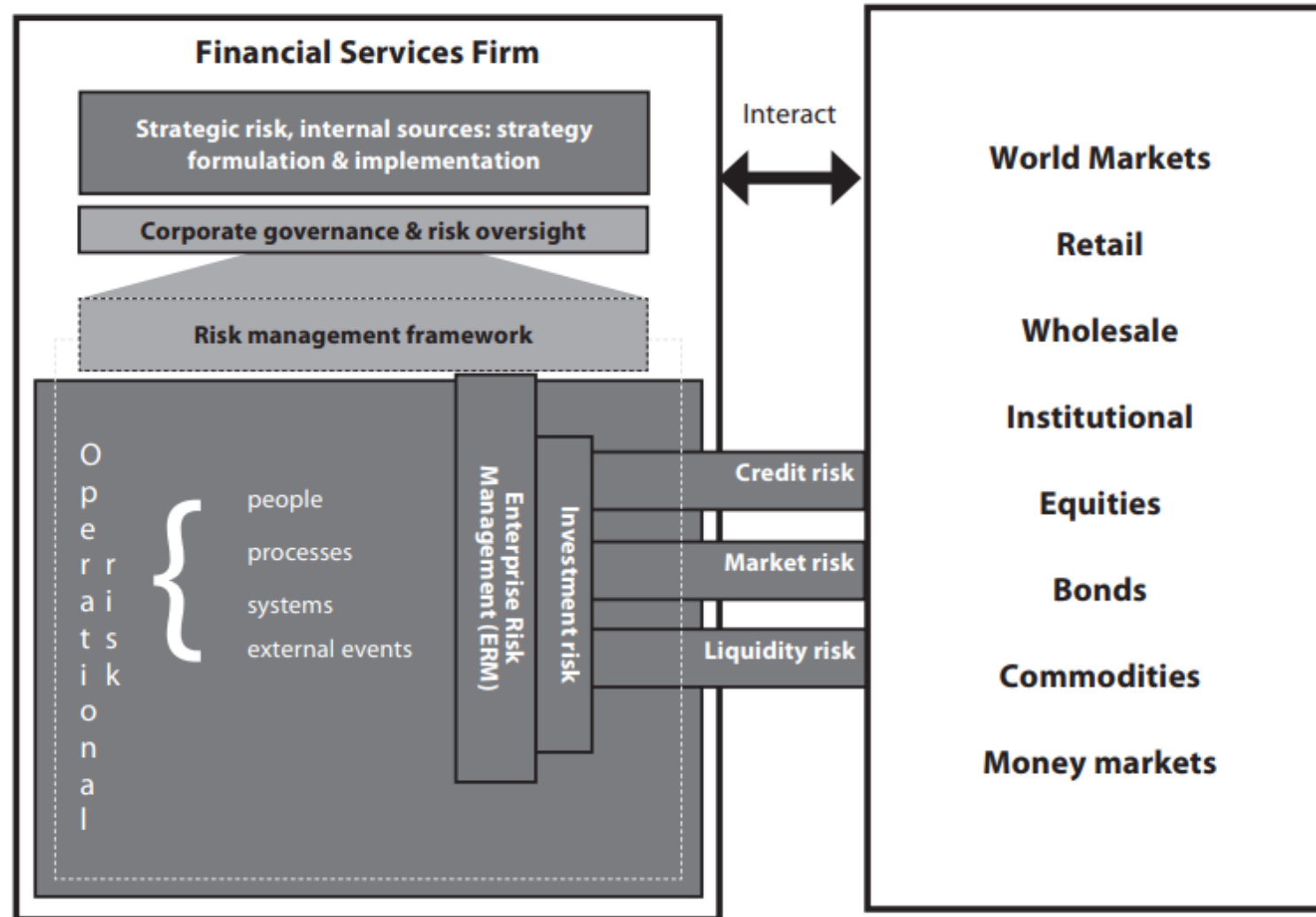
Questions - 5

Overview of Enterprise Risk Management

- Definition
- Sound practices and challenges
- Participating business functions

Enterprise Risk Management (ERM)

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Enterprise Risk and ERM

ERM is the process of applying the discipline of risk management to all the risks a firm faces to understand and manage them, **not only individually**, but also in the way that they **relate to each other**.

ERM is also known as integrated risk management or firm-wide risk management.



How Enterprise Risk Relates to Corporate Governance

Risk Management is the responsibility of the board and senior management (often delegated to a risk committee)

The difference with an ERM approach is that because it **integrates the management** of all risks, those with corporate governance responsibilities are able to see a single view of the firm's risk profile.

Industry Regulation and Sound Practice

Industry regulation, such as Basel Pillar 2 (ICAAP), is currently driving firms towards an enterprise risk management approach without necessarily referring to it as **ERM**.

- Sound practice approaches to risk management already recognise that **operational, credit and market risks** are often linked, and so should not be considered in isolation.

Goals and Challenges of Establishing an ERM Programme

The goals of an ERM programme

Designing and implementing the methods for collating firm-wide information on all **risk types, asset types and business lines**

Enabling **decision-making** through **aggregated risk reporting**

Allowing comparison of the firm's risk profile to the available **risk capital**

Setting clear accountability and incentives across the firm to **control risk exposures** and concentrations in accordance with the stated risk appetite

Cultural Aspects of Implementing and Establishing an ERM Programme

- An effective ERM programme requires the active involvement of several different areas of the firm including **credit risk, market risk, operational risk, compliance, finance** and others.



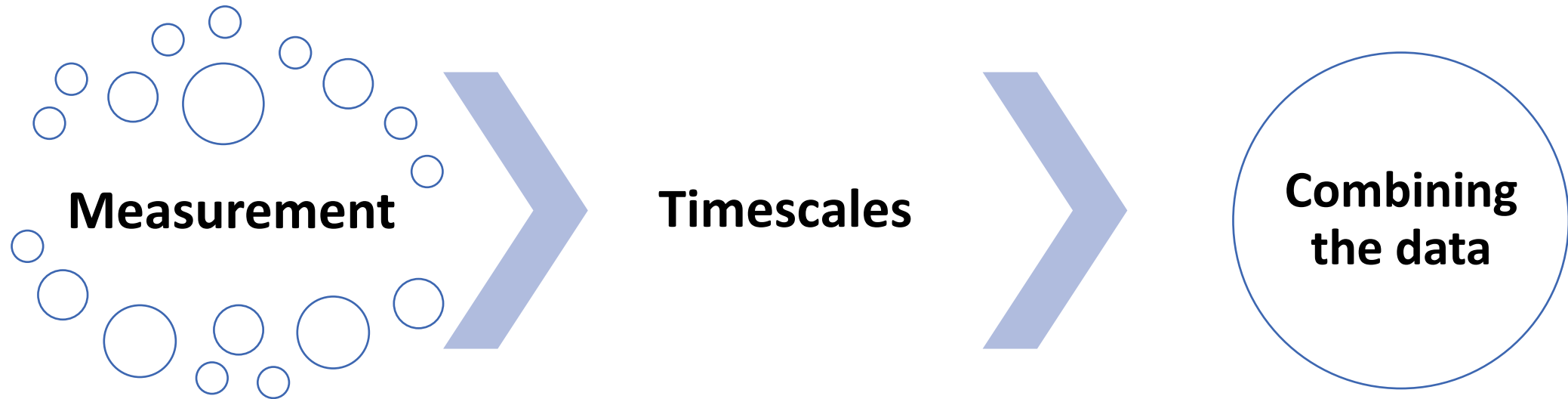
Exception-Based Escalation Challenges

- Managing the different risks to which a financial services firm is subject is key to the firm's success, and for this reason the following types of risk information are reported up the chain of command:
- **Periodic reporting** of risk and control information
- Immediate **escalation of risks** as they materialise, and controls as they fail



Data Aggregation Challenges

Grouping risk data into comprehensive yet manageable reports is clearly a key goal of any ERM programme, but this also presents challenges



The need to ensure that comparisons can be made between the various measurement techniques used across different **risk types**

Linked to the **measurement challenge**, different risk types are normally considered over very different timescales

The data then needs to be **combined and summarised** to enable succinct reports that can be readily understood and acted upon.

THREE MAIN WAYS TO INCREASE ACCOUNTABILITY

Where departments or named individuals are included as **risk or control** owners in the ERM reports seen by senior managers, those departments and individuals become very keen to ensure that they carry out their role effectively.

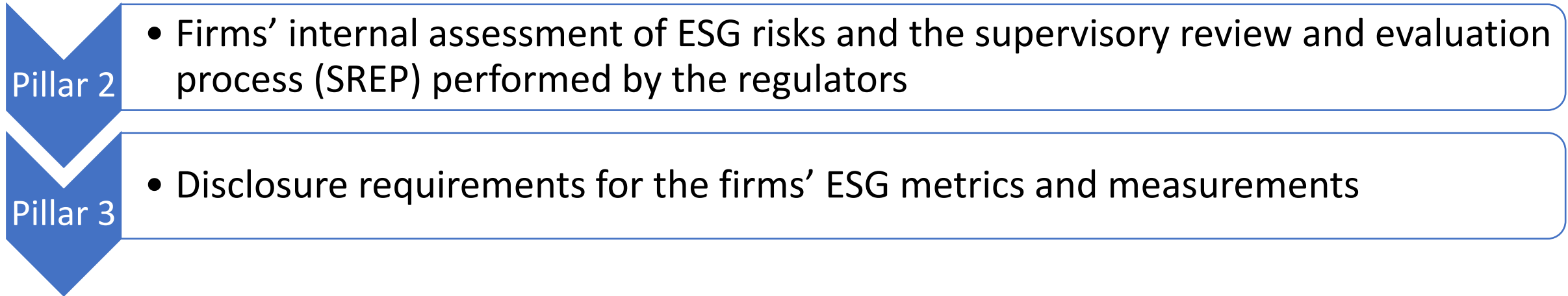
If a **risk materialises**, senior executives know which specific department or individual has responsibility for ensuring its resolution.

As specific accountability becomes **more visible**, other members of staff know they do not need to try to resolve certain issues and can become **more productive** in the areas for which they are accountable



Environmental, Social and Governance (ESG) Risks

ESG risks are currently being incorporated into the three pillars of the banking prudential framework through a revision of the regulatory framework.



In the context of ERM, the management of ESG risks can be carried out in the following way:



In contrast to credit, market and operational risk, ESG risks requires firms to extend their time horizon for strategic planning to **at least ten years**.

The following business functions would typically participate in an ERM programme:

- Strategy team
- The finance department
- The appropriate risk departments

The internal audit team plays a key role.
Its role is to audit the ERM framework to ensure effectiveness