Enterprise Risk Management

What Securities Professionals Are Saying About the Challenge, the Process and the Future

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Overview

With increasing regulatory demands and ever-changing requirements, what impact will an increased focus on risk management have in a securities organization? How are executives, risk managers and compliance officers thinking about risk and managing challenges?

Wolters Kluwer Financial Services recently conducted a risk management survey in the securities industry, receiving responses from 184 financial firms. The majority of the respondents were Chief Compliance Officers, Chief Risk Officers and Operations personnel. Their responses provide some insight to how securities firms view and respond to risk management challenges in light of ever-changing regulations and regulators' calls for greater transparency.

Enterprise Risk Management

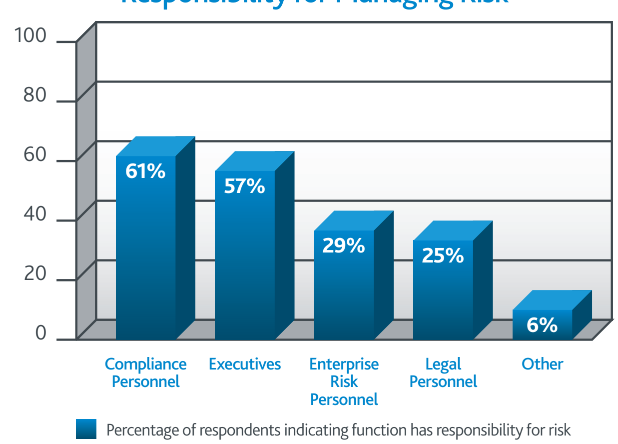
Enterprise Risk Management (ERM) includes the methods and processes used by organizations to identify, measure, manage and report on risks relevant to their business.

ERM provides a framework for risk management that typically involves defining an organization's tolerance for risk, identifying particular incidents or areas of exposure, assessing them in terms of likelihood and magnitude of impact, determining a response strategy and monitoring progress. By identifying and proactively addressing risks and opportunities, business enterprises protect and create value for their stakeholders, including owners, employees, customers, regulators and society overall. ERM can also be described as a risk-based approach to managing an enterprise, integrating concepts of internal control, strategic planning and the Sarbanes–Oxley Act. ERM is evolving to address the needs of various stakeholders, who want greater transparency into the broad spectrum of risks facing complex financial organizations. Regulators and debt rating agencies have increased their scrutiny on the risk management processes of companies across the industry leading to an increased focus on risk throughout organizations.

Responsibility for Risk

When it comes to defining the risks their organizations face, 79% of respondents indicated they had done so. However, there was a statistically significant difference for those who felt that overall enterprise risk was most relevant to their job responsibilities. CEOs were more likely than the directors/managers and "other" respondents to feel that they were more responsible for ERM within their organization.

Responsibility for Managing Risk



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Enterprise Risk Management

While multiple areas can and do have responsibility for risk management, among the firms surveyed compliance personnel are viewed as having the most responsibility for managing risk. It is interesting to note that 61% of our respondents believe compliance is accountable for firm-wide risk management and only 29% believed risk management professionals are responsible for firm-wide risk.

While risk should generally be approached as firm-wide, a major assumption in the financial services industry is that enterprise risk management conveys that only one individual, usually a Chief Risk Officer (CRO), has the main responsibility for managing risk across an organization. Survey respondents disagree and indicate that they believe that all associates have responsibility for managing risk, with a central figure ultimately accountable for it. For the majority of respondents, that person is the Chief Compliance Officer (CCO). As a senior compliance officer remarked, "the Securities and Exchange Commission (SEC) requests to meet with the CCO to discuss risk management, not the CRO." In her organization, enterprise risk management is only an aggregator of firm-wide risk for Board reporting purposes—there are no consolidated risk management tools available that appropriately view enterprise risk.

The Challenge

Risk management is becoming more and more difficult for securities firms to control with the extensive regulatory changes. Thirty-six percent of respondents are concerned with maintaining compliance in the midst of the many new and changing regulations. Additionally, they anticipate the following risk-related challenges over the next 12 months:

- The ability to identify and manage risk
- Maintaining compliance with the many existing regulations
- Having adequate systems in place to manage risk
- Having adequate procedures/processes in place to manage risk

Dodd-Frank will certainly not make this any easier; in fact it will bring significant challenges. As we are seeing across the industry, survey respondents are fearful of implementation requirements related to new regulation. Many are already struggling with existing day-to-day responsibilities and have not yet adjusted to the loss of headcount over the last few years. A significant number of compliance professionals have not regained resources, yet they must comply with new regulations. As a consequence of additional regulatory expectations and limited resources, the identification and mitigation of risk, prior to a regulatory inspection, is even more of an imperative.

How do you manage unforeseen risk in your own organization? That question keeps not only risk officers awake at night, but also compliance officers. Regulators have the luxury of being "Monday Morning Quarterbacks" because regulation, by its very nature, is reactive. Usually there is a crisis and regulators have the opportunity to study the crisis after the fact, examining the cause and effects of actual events. Risk Officers and compliance officers do not have the "luxury" of viewing actual events from an academic prism. They must be able to instantaneously act in real time because the existence of their companies may hang in the balance.

The Tools of the Trade

The SEC is focusing on overall risk management in financial services organizations and Dodd-Frank concentrates on systemic risks in the marketplace. Securities organizations must be more vigilant than ever in their risk management to not only satisfy regulators, but also their board of directors. Indeed, with these new and more stringent regulations, Boards are becoming more attentive to their previous oversight of firm-wide risk management and control.

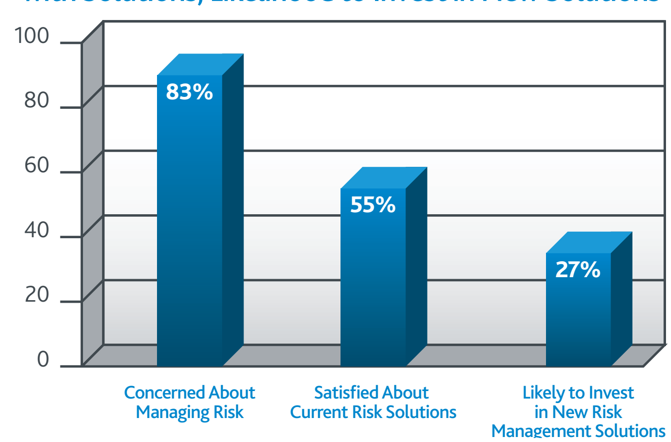
In the wake of increased attentiveness of and mandates surrounding firm-wide risk management, how are firms managing firm-wide risk in a changing regulatory environment? The majority of survey respondents are still managing risk on a manual basis—namely using Excel spreadsheets to track, identify and manage risks across their organizations. Some are using a combination of manual and in-house developed risk management tools.

There appears to be significant anxiety regarding managing risk within organizations and having a tool to manage those risks. Eighty-three percent of the firms surveyed are concerned about managing risk within their organizations. Consequently, approximately one-third believe that within the next 12 months they will invest in a new risk management solution.

The Process

Only 55% of the firms surveyed reported that they are satisfied with their current process. The remaining 45% are dissatisfied. These low levels could indicate that the market is in need of improved risk managements solutions.

Risk Management: Level of Concern, Satisfaction with Solutions, Likelihood to Invest in New Solutions

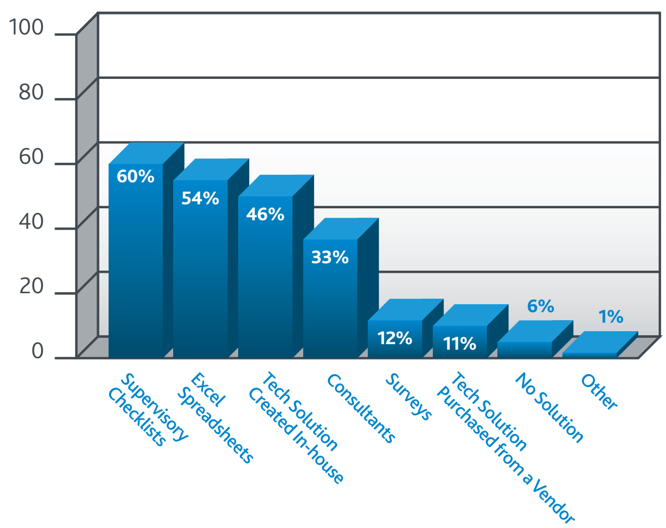


Regardless of how firms define risk management and who is ultimately responsible, regulators are focused on their internal risk management structure and framework. With the adoption of the Dodd-Frank Act, we will see an increased emphasis on examination and rigorous testing of firm-wide risk management.

The Investment

To meet internal expectations from senior management and the Board, as well as external expectations of regulators, firms must employ a robust system to manage risk. These systems must be able to not only identify, capture and manage risk, but also aggregate information that will provide "actionable intelligence" for the Chief Compliance Officer, Chief Risk Officers, Audit Committee members, and other stakeholders.

Types of Solutions Used to Manage Risk



Our survey indicated that 54% of respondents are managing some portion of firm-wide risk using Excel spreadsheets. Using spreadsheets is not the most efficient or robust of enterprise risk management systems. The more complex an organization is, the more cumbersome and inefficient spreadsheets become. It is very difficult to obtain "real time" reporting using manual processes. With increased pressure to provide greater transparency and demonstrate effective risk management approaches, firms are investing in resources to help them achieve better results. Investment in risk management is expected to continue, with many having plans for investment in the next 12 months. About one-third of survey respondents expect to spend approximately $75,000.00 in risk management solutions during the year.

The Future

Firms are wrestling with the question of managing risks and allocating appropriate resources to improve transparency and control. Embracing risk management is no longer an option, it is a regulatory imperative. The SEC and other regulators are demanding, through inspection and examination, programs that provide transparency on firm-wide risk management plans. Institutional customers are demanding and asking relevant questions regarding firm-wide risk management, as well as asking questions about the risk-management tools being implemented. Firms must be prepared to answer these questions. Here are three questions you should consider:

1. Are we truly prepared to manage firm-wide risk in a comprehensive, actionable and intelligent way?
2. Can we effectively explain our risk management program to the Board, regulators and institutional investors ?
3. Are we confident that our current risk management framework is effective at providing for the needs of all stakeholders and will achieve a favorable review from regulators?

The most successful firms will leverage industry best practices and technology allowing them to holistically manage risk across their firms. Silos between risks types, business units and departments will be broken down in favor of a centralized management system. These firms will focus on providing the transparency and control that their management, regulators and investors alike are demanding. The way risk is viewed in the organization will begin to make a transition from a risk mitigation philosophy to a strategic risk management approach. Firms that are able to make this transition will be well positioned to meet not only more stringent demands of regulatory obligations, but also the rising expectations of their Boards and investors.

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