

Hands up! Who's responsible for risk management?

Get up to speed*



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Many companies are spending big bucks on risk management – only to see it fail. So how can you maximise the effectiveness of your investment and build a business in which risk management is integral to everything your employees do?

There was an important job to be done and Everybody was sure that Somebody would do it. Anybody could have done it, but Nobody did. Somebody got angry, because it was Everybody's job, but Nobody realised that Everybody wouldn't do it. In the end, Everybody blamed Somebody when Nobody did what Anybody could have done.

'Who's to blame?' is a question on many people's lips these days. But, if as some would argue, risk management has failed, why has it done so? We believe that it's because most companies have relied too heavily on risk models that are necessarily limited, rather than making everyone personally accountable for managing risk.

There's no doubting the sophistication of the risk models that have been developed (think of Black-Scholes options pricing and Value at Risk). But risk models are essentially simplified versions of reality and deal only with

foreseeable risks. Moreover, when people use them, they typically focus on 'high impact, high likelihood' events rather than 'once in a lifetime' events. Yet experience shows that 'once in a lifetime' events occur far more often than risk models predict – and more often than most people like to believe. One recent study identified 17 extreme economic and financial incidents that have occurred in the past two decades, from the stock market crash of 1987 to the recent meltdown in the sub-prime mortgage market.

It's only when risk management is an integral

element of day-to-day business that you will get the results you want, within the risk parameters you can live with. So how can you ensure that risk management is part of the daily activities of everyone in your organisation?

Highlights

- 1. Focus on personal accountability:**
Spell out the responsibility, authority and accountability of every individual in the organisation.
- 2. Hold your business units accountable:**
Get the managers of your business units to assess the maturity of their risk processes, rectify any flaws and sign off on the risks they've assumed.
- 3. Lead from the front:** Show your business unit managers that you're serious about risk management by regularly reviewing key risks, rewarding those who manage risks well and punishing those who don't.
- 4. Re-focus your risk management function:** Reposition your risk management function to do the job it's supposed to be doing – i.e., providing information, advice and assurance.

Making the business units step up to the plate

- Most companies have responded to more regulation and increasing scrutiny from stakeholders by establishing separate risk management functions. In doing so, they've unwittingly created new problems. When you transfer responsibility for monitoring the controls your business units use to manage risk to a standalone function, the business units typically assume that it will also be responsible for *ensuring the effectiveness* of those controls.
- But when the business units abdicate responsibility for risk management to a separate function, some risks inevitably fall through the cracks, with potentially devastating results. Moreover, when things go wrong, people are often quick to blame others, rather than recognising that they might have contributed to the situation themselves. Being a passive bystander and failing to speak out when you see someone else doing the wrong thing is often as damaging as doing the wrong thing yourself.
- In fact, everyone has a role to play in managing risks. A company's business units should be responsible for the decisions they take, how

their employees behave and the effectiveness of the controls they use. But every individual who works for the organisation also has a duty to ask: 'How can I help to choose the best risks and manage them properly, so that we can capitalise on the opportunities they offer?'

- Senior management's job is to provide visible support for the business units and individual employees alike, and thus to reinforce their efforts. By insisting that they pay constant attention to key risks – and rewarding or punishing their performance accordingly – it sets the tone for the entire organisation.
- The risk management function's role, by contrast, is to design a risk framework, develop risk models and identify and interpret new laws and stakeholder expectations; to help the business units understand the risks they're taking and how best to mitigate them; and to assist the company in staying on course by periodically checking that it's taking the right steps to manage the risks it faces.

So how can you get accountability back where it belongs? As Figure 1 shows, there are four key measures.

Figure 1: Getting accountability back where it belongs



Re-focus the role of your risk function

Source: PricewaterhouseCoopers

1 Focus on personal accountability

- **Clarify responsibility, authority and accountability.** Before you ask people to do something, make sure you have given them the authority they need to complete the task and made it clear how they will be held accountable. Many organisations make the mistake of allocating responsibility without giving people authority over the staff, systems, facilities and other resources required to get the job done. Alternatively, they fail to specify when and how someone will be held accountable for completing a task, in terms of outputs, quality and other essential measures of success. But it's only possible to manage risks effectively by addressing all three elements – responsibility, authority and accountability – and ensuring that everyone understands exactly how they've been apportioned (see Figure 2).
- **Encourage your staff to question the allocation of responsibility.** Many people accept responsibility for doing something, even though they haven't been given the necessary resources. Individual employees must question the allocation of

responsibility, where their authority and accountability haven't been fully articulated.

- **Watch out for blind spots.** Seek out independent thinkers to challenge the status quo and identify any blind spots in your organisation's risk management processes. Get external help, if you need more – or more objective – input.
- **Keep the door open.** Invite employees to speak out, if they suspect something's wrong. By the time someone reports a problem to an external party, it's often deeply entrenched. Conversely, encouraging people to report their concerns internally enables you to solve problems while they're still small.
- **Reward the right behaviour.** Show that you value employees who behave responsibly and honestly, by recognising the contribution they make. Many people are wary about reporting mistakes or misconduct, for example, because they fear that they'll be seen as 'informers'. But when problems are concealed, they don't get solved. So it's important to treat employees who expose such issues as saviours rather than 'telltales'.

Figure 2: Three elements essential for effective risk management



Source: PricewaterhouseCoopers

Remember, too, to reward individuals who take considered risks that support your corporate strategy and deliver good returns. Making wise choices about which risks to assume is as important as managing risks effectively – and without their efforts, the organisation would never succeed.

2 Hold your business units accountable

- **Make your business units measure the maturity of their risk processes.** Most organisations don't manage risk very effectively because their underlying risk management processes are immature. Ask your business unit managers to assess the relative maturity of their risk management processes, identify potential areas for improvement and act on them, using a model such as the one set out in Figure 3.
- **Get your managers to sign on the line.** Insist that your business unit managers sign off on the risks they've assumed. Let them know that, as part of this process, you require confirmation that they have updated their assessment of major risks; devised action plans to address these risks; ensured that their plans are being implemented; and notified senior management of any new issues.
- **Create robust controls.** Task each business unit with creating robust controls that reflect the company's risk appetite, taking into account the legal and regulatory regime (including any imminent changes from impending laws or geographic expansion) and the operating challenges they face. These controls should be efficient, effective and tailored to the needs of the individual units.

Figure 3: A model for measuring the maturity of an organisation's risk management processes.

Level of Maturity	Framework	Commitment	Ownership	Processes	Communication & Training	Measurement	HR Support	Oversight
Ad hoc	No structured approach	Risk management seen as unnecessary expense	No interest in using risk management	No tracking of risk management	No formal risk management training	No risk assessment performed	No HR support	No standard reporting
Initial	Policy/process defined	Rules-based approach	Partially defined roles	Risk management champion drives implementation	Risk management material circulated	One-off requirements announced	New staff trained	Monitored by exception
Repeatable	Practical guidance provided	Proactive approach	Clearly defined roles	Managers drive implementation	Co-ordinated training provided	Repeat measurements reported	Risk management integrated into all training	Business units monitor own risks
Managed	Managers confirm compliance	Risk management embedded	Centre of excellence model	Business units drive implementation	Business units drive tailored training	Risks measured consistently	Risk management ability impacts hire/promote decisions	Single view of risk across organisation
Excellence	Risk management central to decision making	Risk management used for strategic advantage	Managers pursue risk unconsciously	Board and CEO drive risk agenda	Training focuses on best practice	Risk-adjusted performance measures used	Risk management seamlessly integrated into HR	Business driven with key risk indicators

Source: PricewaterhouseCoopers

Note: Figure 3 depicts a relatively simple model for measuring the maturity of an organisation's risk management processes and is thus a good starting point. In one study we conducted using this model, between 63% and 91% of the participating organisations had risk processes that operated within the first three levels of maturity. However, some companies obviously have very complex risk management processes that require a different approach.

3 Lead from the front

- **Make your presence felt.** Show your business unit managers that you're serious about risk management by regularly reviewing how they address important risks – including strategic risks, market risks and reputational risks. Balance this with encouragement for those who pursue viable commercial opportunities that could generate sustainable profits.
- **Look at the big picture.** Ask your business unit managers which processes can be simplified or safely eliminated. Many large organisations have grown through mergers and acquisitions; they comprise a complex web of people, business practices and IT systems that have never been fully integrated. There may be good reasons for some of this complexity, but it also adds to the risks companies face.
- **Capitalise on technology.** Encourage your business units to adopt new tools – such as business intelligence dashboards, scenario-planning software and data-mining technologies – to keep track of what's happening. Most business units collect a lot of information (e.g., operational reports, exception reports and customer and staff feedback). Such tools can help them make better sense of the data they already get and

identify what else they need to know. (We'll talk about how to build an integrated platform for managing information about key risks and performance indicators in our next paper.)

- **Keep things consistent.** Ensure that the information each business unit gives senior management is consistent. Different business unit managers may have different risk appetites and different perceptions of risk. So you could end up paying too much attention

to minor risks and too little to the risks that really matter. Call on your risk management function to help the business units develop a consistent reporting framework.

- **Dig down to the roots.** Insist that any breakdown in a core process or breach of an internal code of practice is analysed in depth to identify the root cause and correct it. Identify the individual or individuals who are responsible and hold them accountable.

Learning from other industries

When one bank ran into trouble during the recent financial crisis, it realised that it needed a new approach to risk management. So it drew on the experience of 'high-reliability organisations' (HROs) in the energy and mining industries. HROs typically have five key characteristics:

- A system for performing ongoing checks to spot unexpected problems
- A process for regularly analysing 'near misses' and failures
- A reward and incentive system that recognises the cost of failure as well as the benefits of reliability
- A clear understanding of different degrees of risk and the ability to change people's behaviour accordingly; and
- A clear structure, with open communications, a decision-making hierarchy that values expertise over rank and a single point of accountability.

The bank is now using these principles to create an organisation in which everyone routinely assumes responsibility for managing risk.

4 Re-focus your risk management function

- **Clarify the risk management function's role.** Once your business units are in control of the risks they're taking, you can concentrate on getting the risk management function to do what it should be doing: namely, providing information, advice and assurance. You'll need to start by defining its remit and making sure that it doesn't continue to assume the responsibilities your operational managers should be handling.
- **Listen and learn.** The risk management function's first task is to identify and interpret any changes in the external environment, including changes in the expectations of your shareholders. Ensure that it keeps abreast of all new developments.
- **Assess and advise.** The risk management function also has a key role to play in developing a risk framework, giving the business units feedback on the effectiveness of the controls they're using and helping them modify those controls, where necessary. At this stage, you should therefore ask the risk management function to assess how the risk management processes the business units have established are performing. What progress have they made? What gaps remain and how should they be closed?
- **Tell the truth.** The risk management function's final duty is to check that the business units are doing what they claim and let you know what's really happening. That, in turn, means ensuring it has sufficient clout to talk to senior management on an equal footing and challenge the existing order when necessary.
- **Get it right.** Putting risk management back where it belongs – with your business units and individual employees – enables you to create a lean risk management function with lower overheads. More importantly, it helps you build a business that's as bullet-proof as you can possibly make it – a business that's more effective and efficient.
- **Never forget the importance of culture.** Remember that this approach won't succeed unless you have the right culture (the subject of our previous paper). Rules are meaningless, if they go against the grain of the organisation as a whole.

Resolving questions of accountability

The directors of a major insurance group had set up three committees and five subcommittees to manage its assets, liabilities and risks, but the chief executive was still concerned. He believed that it wasn't sufficiently clear who was responsible for each of the group's key risks. He also thought that he didn't have all the information he needed to manage the business properly.

So he launched a comprehensive review of the insurance group's governance arrangements, during which he appointed a specific 'owner' for each key risk and clarified the accountability of the various managers, committees and sub-committees by differentiating responsibility for each risk from oversight of those risks. The review panel then redefined the management information everyone needed to do his or her job, distinguishing between routine reports and those required to respond to new and fast-moving risks. By the end of the review, individual responsibility and accountability for each of the group's biggest risks was clearly established – and back where it belonged, with the business units – leaving the risk management function free to focus on providing advice and assurance.

How PwC can help

Insisting on accountability – at every level in the organisation – is the only way to get the results you want.

- Is accountability for assuming and managing every risk clear? Do you hold individuals accountable if they fail to deliver?
- Are your business units taking sensible risks and addressing them properly? Or are they passing the responsibility to the risk function?
- Is top management giving top risks enough time? Is it leading by example?
- Have you missed any major market opportunities?
- How much is risk management costing your company? Are you getting value for your money?

PricewaterhouseCoopers works to solve complex business issues – locally and globally. Our teams draw upon skills in risk, regulation, people, operations and technology to capture opportunities, navigate risk and deliver lasting change across business networks.

We have advised many companies on how to embed accountability for risk management in their operating divisions and reduce their risk management costs. We can help you to:

- Benchmark your risk management processes against industry practice, assess their maturity, pinpoint any gaps and formulate solutions;
- Develop a consistent reporting framework for monitoring risks in your business units;
- Survey your employees to assess how they perceive their own roles in managing risk;
- Establish a system for ‘good faith reporting’;
- Embed your risk management strategy in your entire organisation;
- Integrate your risk management, compliance and governance functions; and
- Reposition your risk management function to concentrate on the provision of information, advice and assurance.

If you would like to discuss how to create an organisation in which everyone is accountable for risk management, please contact one of our partners (whose details are listed on the next page) or visit pwc.com/getuptospeed

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Other topics in this series:

Crisis management

An unanticipated crisis can cause immense disruption, cost a lot of money to rectify and damage your company's image if you end up on the front page of the newspapers. This paper examines how companies can take sensible precautions, recover control and extract value from the situation.

Risk appetite

Most risk management systems aim to avoid risk. But if a business doesn't take risks, it can't grow. This paper looks at how you can make risk work for you and how to take the right risks and manage them successfully.

Risk culture

Establishing a culture in which the right people do the right thing at the right time, regardless of the circumstances, is critical to an organisation's ability to seize the right risks and avoid the wrong ones. This paper explains organisational culture, how it can support your business strategy, goals and risk appetite and how important it is to get this balance right.

Risk performance management

Many companies could enhance their corporate performance dramatically by using key risk indicators that look forward, rather than focusing on the past. This paper provides guidance on how to eliminate reporting silos and build a more rounded picture of what's happening in your business.

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