



Where do we go from here?

"It's a fascinating time to be working in risk management." This statement was made by a chief risk officer (CRO) participating in a recent CRO panel hosted by Ernst & Young at the 2008 Risk Europe conference in Stockholm

It is difficult to argue against this sentiment, especially in these turbulent times. But it also alludes to a time of opportunity if we are prepared to learn from the experience. Risk management has never had such a high profile at the top of groups.

So what lessons can be learnt and how can risk managers seize the opportunity offered to them?

It was argued by the panel that recent market events have exposed flaws in the current regulatory regime. They were of the opinion that the principles-based approach of self regulation under a statutory framework – where organisations are expected to adopt a prudent view of excess capital – works well in the boom years. But, when times are hard, self interest becomes more prevalent and the challenge process fails.

The panel thought that taking an alternative approach to regulation, such as the Sarbanes-Oxley regulatory framework – which would push risk management sign-off both down and through an organisation – also has its potential pitfalls. Such a framework can fall down because it can stifle intelligent debate as managers become more consumed by the risk sign-off process.

Both routes to management and control appear to have shortcomings. Like any good recipe, success in risk management should contain a mixture of ingredients.

On reflection of the financial challenges of 2007, it was clear from the panel discussion that risk managers need to be able to identify and bring potential risk issues to those at the right level within organisations.

Questions were posed at the roundtable about the standing of risk management:

- How do risk managers work within institutions?
- How do you manage the powerful departments within institutions?
- How do risk managers highlight potential flaws in the assumptions/models in boom profit-making departments?

The panel consensus was that risk managers need to have a set of principles that are clear and articulated throughout the

business. This may mean that some organisations are more conservative in what they do. However, the key and major learning point from the recent market issues was that clear risk management principles need to be set and enforced in practice. This is a crucial aspect to take away from the credit crisis. As one panel member said: "How can two institutions trade a derivative product and both post a profit?"

Past performance is not a guide to future returns

The panel also discussed the criticism from regulators about the recent market turmoil, which has focused on the perceived weakness of risk stress testing, which the regulators saw as not being creative or robust enough.

But is this a valid criticism? Not according to the panel. They argued that the creativity of stress testing is adequate, and that there does not exist a lack of creativity in scenario generation across the financial sector.

However, the panel did identify a failing in the ability of organisations to aggregate risk factors across the organisation. It seems it is not the stress testing itself that is difficult, but the aggregation of data across the organisation, and – ultimately and fundamentally – the learning and the changes suggested as a result.

Financial services chief risk officers are undoubtedly living in interesting times. It is clear that, if we understand and can act on the learning points from recent events, there is an opportunity to raise the benchmark for risk management and transform the position of risk management at the heart of business decision-making and success.



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