Grant Thornton
An instinct for growth™

Risk frameworks

Driving business strategy with effective risk frameworks

Integrating risk management with business strategy

Each year, a board begins its planning period with a set of strategic options balanced against a wallet of finite resources. Each of these options carries with it a profile of varying risks, therefore a robust and effective risk framework is designed to assist boards with a pragmatic assessment of competing strategy options versus the firm's financial resources.

While in today's business environment the need for effective risk management is a forgone conclusion, the heightened focus on risk management in recent years is a reflection of the increasingly complex operational and regulatory environment facing all firms. In light of these increasing complexities, a streamlined risk framework can enable firms to realise their objectives by providing:

- a technical sounding board
- an independent view
- an advisory partner.

The business strategy drives an organisation's risk appetite; therefore, tailored to the firm's needs, a risk function can reduce uncertainty and improve organisational learning and resilience. Most importantly, by acting as a facilitator, a well designed risk function can help drive business outcomes and support organisations in achieving their firm-wide objectives.

The PRA has eight Fundamental Rules which they expect all firms to abide by. Rule number five says a firm must have effective risk strategies and risk management systems. In addition to PRA guidance, firms can reference ISO 31000 and COSO which encapsulates a best practice approach with a comprehensive list of core principles that guide a firm's risk management process. Acknowledging and incorporating these core principles into a robust risk framework is a move towards academic best practice.

Risk is the 'effect of uncertainty on objectives'. This effect can either be a positive or negative deviation from what is expected (ISO 31000).

Risk management refers to a 'coordinated application of resources to minimise, monitor, and control the probability and/or impact of unfortunate events or to maximise the realisation of opportunities' (ISO 31000).

A risk framework

- converts a set of ideas into strategic options for the board's consideration
- outlines the risks undertaken in relation to the firm's risk capacity
- sets out the firm's risk profile in implementing the firm's strategy
- provides the board with a complementary horizon scanning capability
- acts as a toolkit for monitoring risk taking.

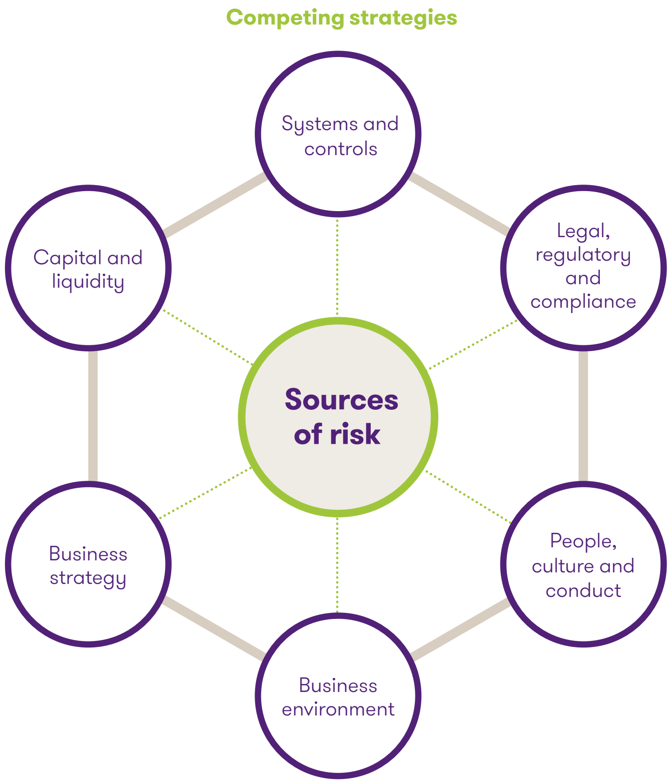
ISO 31000 core principles

Risk management:

- creates value
- is an integral part of organisational processes
- is part of decision making
- explicitly addresses uncertainty
- is systematic, structured and timely
- is based on the best available information
- is tailored
- takes human and cultural factors into account
- is transparent and inclusive
- is dynamic, iterative and responsive to change
- facilitates continual improvement and enhancement of the organisation.

Sources of risk

A large part of risk management is cognisance of potential risks and the design of mitigation and contingency plans to address threats, if and when they arise. Below is a selection of financial services risks:



"Measured risk-taking is at the centre of all commercial activity. It then follows that effective risk management through good corporate governance underpins commercial success."

Common causes of business failure:

While each financial services firm experience its own array of business failures, common causes of corporate collapse include:

- ineffective risk assessment strategy
- managerial inefficiency and ineffectiveness
- strategy over-reach and resource inadequacy
- deficient metric performance
- ineffective 1st line capacity
- cost-benefit biases
- poor financial management
- socio-cultural factors
- political risk
- macro economic volatility
- cultural confusion/conflict
- bottom line focus overriding corporate policies
- lack of pertinent information.

Real life examples

Macro environment

The vote for Brexit has added a new dimension to an already complicated world where monetary policy and quantitative easing are being used to stimulate weak aggregate demand.

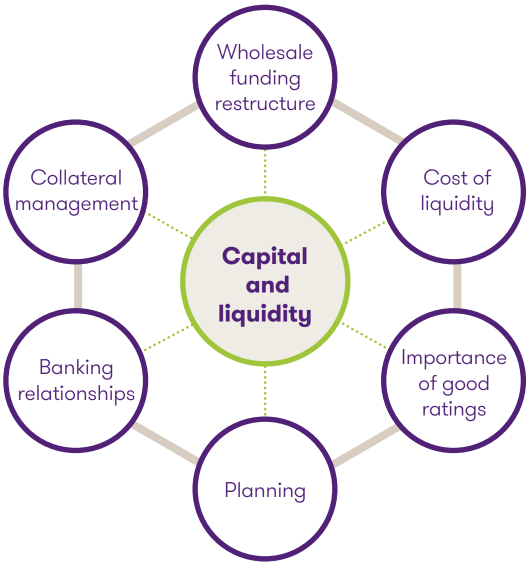
The current undefined way in which Brexit is unfolding and the timing of execution brings uncertainty and paralysis to decision making. Influencing the government with a wish list and making arrangements for different scenarios of the trade deal is required.

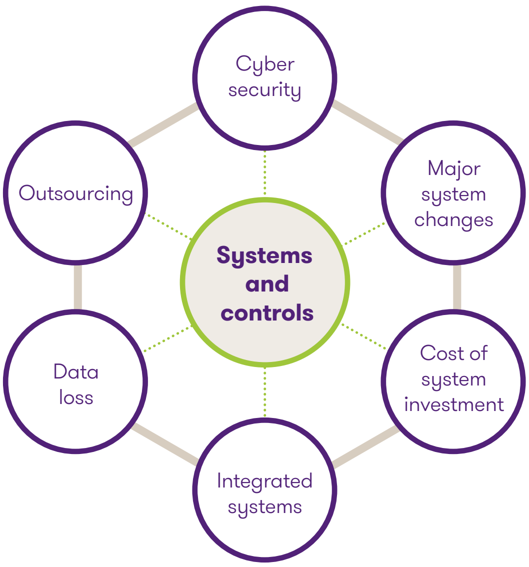
International banks operating in the UK are having to consider passporting rules and are evaluating the possibility of different locations, both for themselves and the possible future shape of the market.

Cost of liquidity

The Bank of England's low interest rate policy, quantitative easing and the funding for lending scheme have been injecting liquidity and lowering the cost of borrowing.

Two implications are immediately faced: What do you pay depositors? Do you charge them? How do you price increased working capital facilities provided today, when the corporate credit ratings may change in the event of a 'slow down', where liquidity will be required?

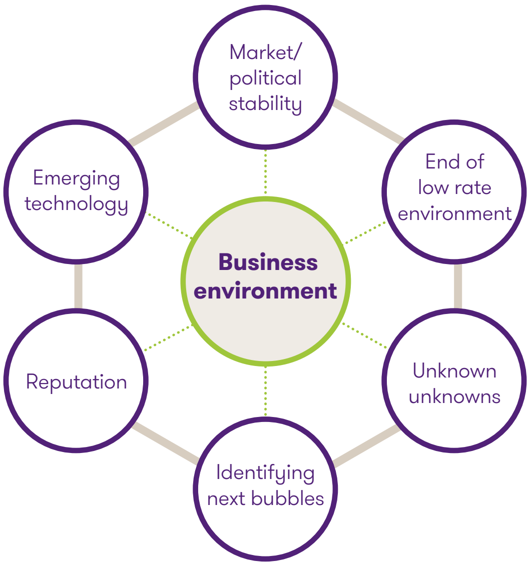




Cyber security

Cyber security is an ongoing race that requires continuous investment by financial institutions combating criminal organisations.

Recently criminals forced their way into a country's central bank system and were able to steal US$81 million. The criminals overcame the sub-standard IT security at the institution using custom-made malware to manipulate the local instance of the SWIFT system.



Emerging technology

The effect of fintech solutions is increasingly being seen in the markets. In response to the UK competition authorities' review into how the banking market could work better for consumers and small businesses, the regulator recently announced that mobile apps could provide a digital cure for inertia and boost account switching.

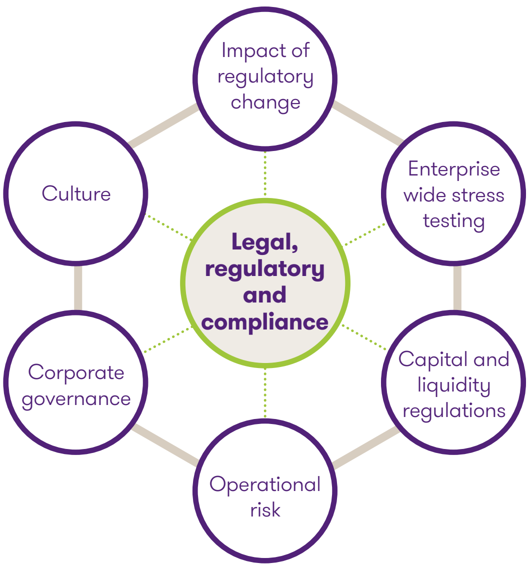
A common platform known as open banking will enable sharing consumer data with an app that can better help manage finances.

Competency

In recent times, it was difficult for the regulators to convict senior employees in high profile banking failures as well as scandals such as the benchmark manipulation.

To tackle this the Senior Managers Regime has been established to strengthen accountability in banking. This regime places onus on key managers who can be held responsible if things go wrong.

Similarly the certification regime holds organisations responsible to ensure that their staff have the competency to do their job and are continuously assessed.



Regulatory changes

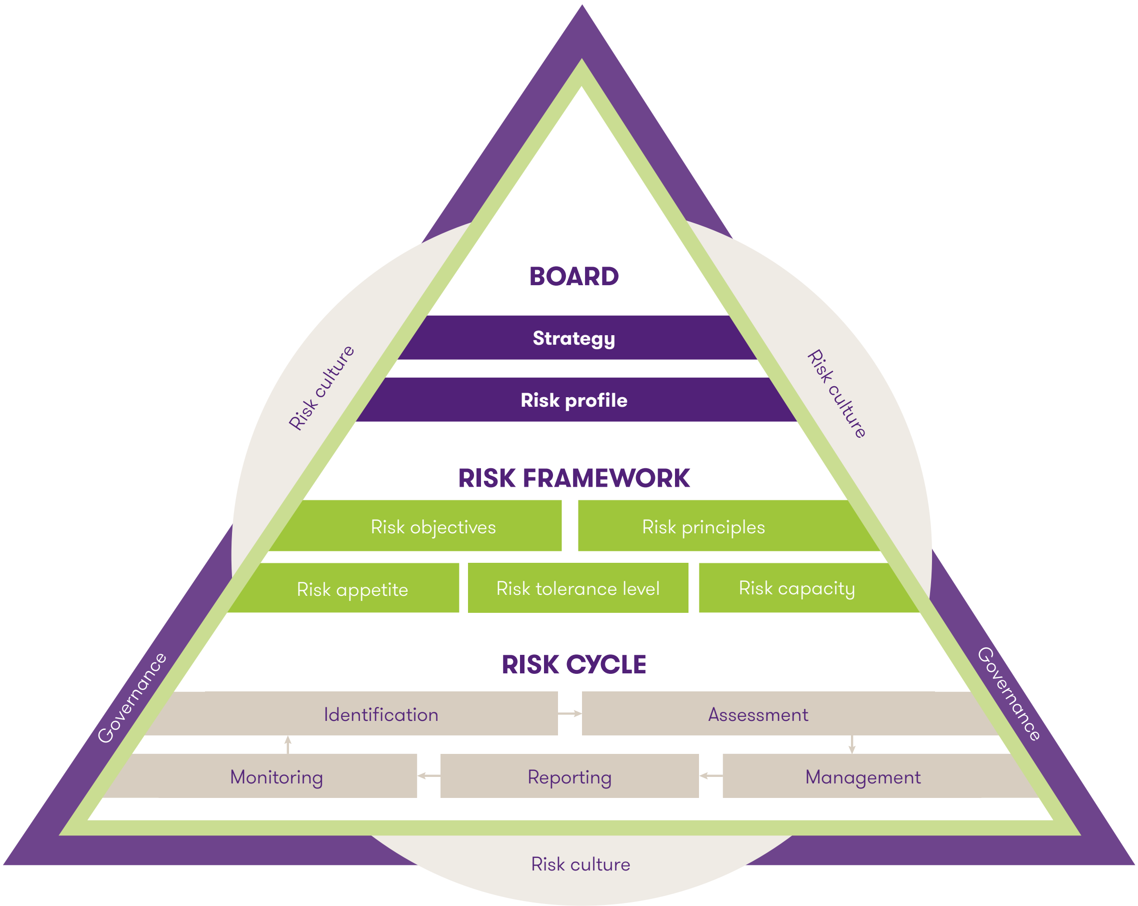
The pace of regulatory change post the financial crisis has been continuous at a national, European and international level. Organisations need to ensure that their internal teams have the capacity and capability to capture the new rules and prepare for them.

Regulatory change has increased the cost of doing business and non-compliance will result in huge fines and loss of reputation.

In the UK, the regulators have increased the use of Skilled Person Reviews (S166) which have a big cost in time and financial resource to action and implement associated remediation programmes.

How does an effective and robust risk framework help you?

In light of the new demands facing firms of all sizes and from all sectors, robust risk frameworks that enable organisations to effectively manage and mitigate risks have never been so important.



An effective and well implemented risk framework will:

- increase the likelihood of achieving firm objectives
- improve the identification of opportunities and threats
- improve mandatory and voluntary reporting as well as overall governance
- comply with relevant legal and regulatory requirements
- effectively allocate and use resources for risk treatment
- maximise sustainable value
- enhance health and safety performance, as well as environmental protection
- improve organisational learning and resilience
- improve loss prevention and incident management
- establish a reliable basis for decision making and planning
- improve stakeholder confidence and trust.

Integrating risk culture within your organisation

A risk framework built upon a foundation of poor risk culture will produce conflicting messages within the organisation. A company with a strong risk culture that incorporates shared values, on the other hand, provides clear guidelines and a platform to facilitate the achievement of common business objectives.

An effective risk culture, therefore, is one that enables and rewards individuals and groups for taking the right risks for the organisation, its customers and shareholders.

Risk culture is the set of acceptable behaviours, discussions, decisions and attitudes toward taking and managing risk, encouraged by the tone from the top.

Such attitudes and behaviours comprise, but are not limited to, timely, transparent and honest communication, a common purpose, values and ethics and the active promotion of learning and continuous development.

The board has a responsibility to establish, communicate and put into effect a risk culture that aligns with the strategy and objectives of the business and thereby supports the embedding of its risk management frameworks and processes.

To achieve an effective risk culture, the board must ask the following questions:

- What is the current risk culture in our organisation?
- How do we want to change our risk culture?
- How are we able to improve risk management within that culture?
- How do we realise that desired change?

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Delivering effective solutions

Grant Thornton will partner with you to ensure your risk management framework complements your firm's strategy.

By setting meaningful metrics, constructing effective reporting infrastructure and improving information flows, we will ensure a consistent approach is applied to risk management to satisfy stakeholders. By identifying, managing and mitigating risks today, a coordinated risk management framework can increase risk capacity and enhance horizon scanning capabilities.

As a result, to demonstrate a robust framework to regulators, internal processes and governance is essential to financial services firms, to fulfil the management of financial resources such as capital and liquidity and to ensure robust recovery and resolution planning.

Board Committees

Senior Management

First line of defence
- Affecting firm strategy
- Abiding by regulations
- Maintaining risk tolerance
- Implementing first line internal controls
- Raising risk awareness and culture.

Second line of defence
- Building risk register
- Reporting/monitoring risk exposures
- Risk advisory and sounding board
- Stress testing
- Setting limits and monitoring triggers
- Risk mitigation.

Third line of defence
- Providing assurance that governance and first and second lines of defence are operating effectively.

Internal capital adequacy assessment process

Internal liquidity adequacy assessment process

Recovery and resolution plan

Our experience

Our Risk Management Advisory team comprises subject matter experts with backgrounds in senior positions in a number of high profile organisations. They have advised businesses of all sizes across a variety of sectors and are able to draw on deep and varied industry and product knowledge. Examples of successful financial services engagements include:

Case study 1

Nature of the work

- The Risk and Finance team worked closely with an international private bank that was experiencing significant regulatory scrutiny, and re-designed their enterprise risk framework to support the business strategy. They also led the implementation of an improved governance model and a new forward looking business plan

What we did

- The engagement was made in scope, covering a complete re-build of the risk framework including appetite statements and risk policies to the full delivery of key regulatory documentation including ICAAP, ILAAP and recovery planning
- An important element of this assignment was working with the senior management teams in coaching and preparing for the regulatory scrutiny of the capital and liquidity frameworks

Value we added

- Application of risk approaches based on best practice methodology ensuring the risk frameworks represented the bank's risk appetite and risk culture

Case study 2

Nature of the work

- We were engaged by the European Commission as a monitoring trustee to oversee a number of systemic European banks
- This work involved oversight of all business practices, strategy, governance, risk framework, structural arrangements around the three lines of defence and ongoing monitoring against international best practices

What we did

- Reviewed the overall strategy and its alignment to risk appetite and overall management of risk and control
- Evaluated the effectiveness of the overall risk management framework
- Evaluated the risk, compliance and internal audit functions for organisational effectiveness and best practices
- Assessment of management of prudential risk ie capital and liquidity management
- Provided oversight of mandatory cost efficiencies as dictated by European Commission

Value we added

- Aligned policies, procedures and practices to the international standards
- Ensured appropriate risk appetite and framework definition and application
- Developed metrics to monitor ongoing performance, all of which is from the basis of reporting updates to the European Commission

Why Grant Thornton?

Regardless of the sector or the size of the firm, Grant Thornton can offer tailored best-in-class advisory and assurance services to facilitate the effective operation of your risk framework. Whether you require assurance concerning your existing risk framework or, rather, the design and implementation of a new robust risk model, we can provide seasoned professionals and practitioners to meet your needs.

Grant Thornton's Risk Management Advisory team can assist in a number of ways, including:

- designing and implementing risk management frameworks, encompassing expertise in market, credit and operational risk – including associated model frameworks
- identifying meaningful metrics and constructing monitoring and reporting infrastructure
- strengthening enterprise-wide regulatory compliance programmes
- improving governance processes and control frameworks
- designing and reviewing capital and liquidity adequacy and allocation
- supporting improvement of business and strategic risk, reputational risk, operational and financial risk, and people risk
- improving information flows across Finance and Risk frameworks
- advising on the IT framework used to manage your Finance and Risk functions (including design, control framework, project management, change management etc).

"Recognising the need for all firms, big or small, to take risks in order to remain competitive, we believe robust risk frameworks that enable organisations to effectively manage and, where possible, mitigate risks, form the bedrock of success."

Notes

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