A FRESH APPROACH TO RISK MANAGEMENT

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Webinar

Tuesday, 2 March 2021, 10:00am GMT

A Word From Today's Chairman

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Today's Agenda

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- 10:00 – 10:05 Chairman's Introduction
- 10:05 – 10:25 Keynote Address:
  - Chris Burt
  - Peter Neville Lewis
- 10:25 – 10:45 Questions & Answers

Today's Speakers

Chris Burt

Principal, Halex Consulting

Co-founder, Risk Coalition

Peter Neville Lewis

Founder & Lead Consultant, Principled Consulting

Co-founder, Risk Coalition

The Risk Coalition
Leading Risk Thinking

A Fresh Approach to Risk Management

Peter Neville Lewis

Chris Burt

March 2021

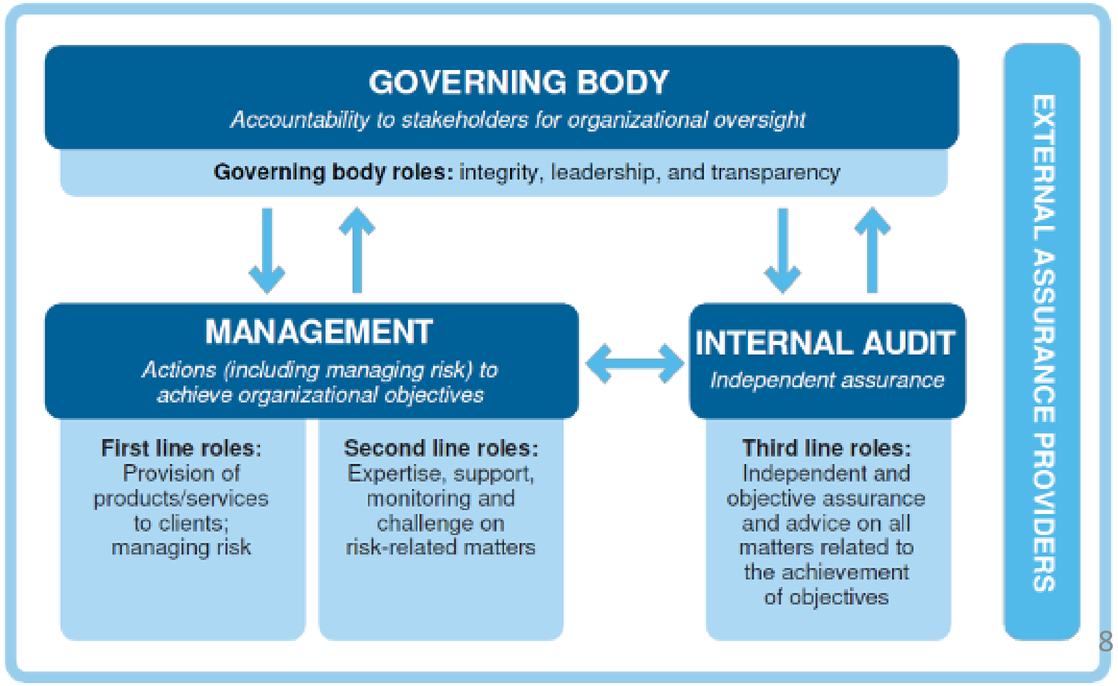
The Risk Coalition
Leading Risk Thinking

The Three Lines of Defence is dead…

- While many of us would like to celebrate the demise of the three lines of defence model, the Institute of Internal Auditors has given it a breath of new life as the 'Three Lines Model'
- Widely implemented by FS organisations post Global Financial Crisis to prevent unconstrained management risk-taking.
- The basic premise behind 3LoD remains sound: Does it make sense to have someone outside the risk-taking / decision-making process to provide robust, independent challenge?
- Essentially it's an extension of the 'Four-eyes' principle.

…Long live the Three Lines (Model)!

- In their revamped 'Three Lines Model', the IIA has largely left the first and third lines alone, focusing most of the change on 'better' defining the role of the second line.
- Unfortunately, the new model is inconsistent with EU regulation requiring the heads of the risk and compliance functions to report directly to the management body. (e.g. EBA/GL/2017/11)
- Furthermore, the IIA does not own this model. For example, the Basel Committee issued a consultation paper on 'Revisions to the principles for the sound management of operational risk' in August 2020 which leans heavily on the Three Lines of Defence model.



Poll

Q1. Would you ditch the three lines model in your organisation if you could?

- Absolutely – it’s the devil’s work(!)
- Probably – it just creates confusion without any real business benefit
- Probably not – it’s not perfect but it has its uses
- Definitely not – it keeps management on their toes and encourages robust challenge

The Three Lines of Assurance

In our view, since the basic premise behind the 3LoD model is sound, it should be retained but refocused.

Renaming it the Three Lines of Assurance provides a better description of the model and drives towards ‘integrated assurance’.

The recipient of this (integrated) assurance is the Board.

First line

- Owns, and is responsible for taking and managing, the organisation’s risks within risk appetite.
- Should be able to ***demonstrate*** that risks are appropriately managed, ***and that objectives will be achieved***
- Becomes the ***principal source of (non-independent) assurance*** to the Board

Second line risk function

- Responsible for providing independent oversight and challenge of first line management risk-taking
- Provides ***risk assurance**** to senior management and the Board

Third line internal audit function

- Provides ***independent assurance*** to senior management and the Board on the adequacy and effectiveness of the organisation’s governance, risk management and internal control systems

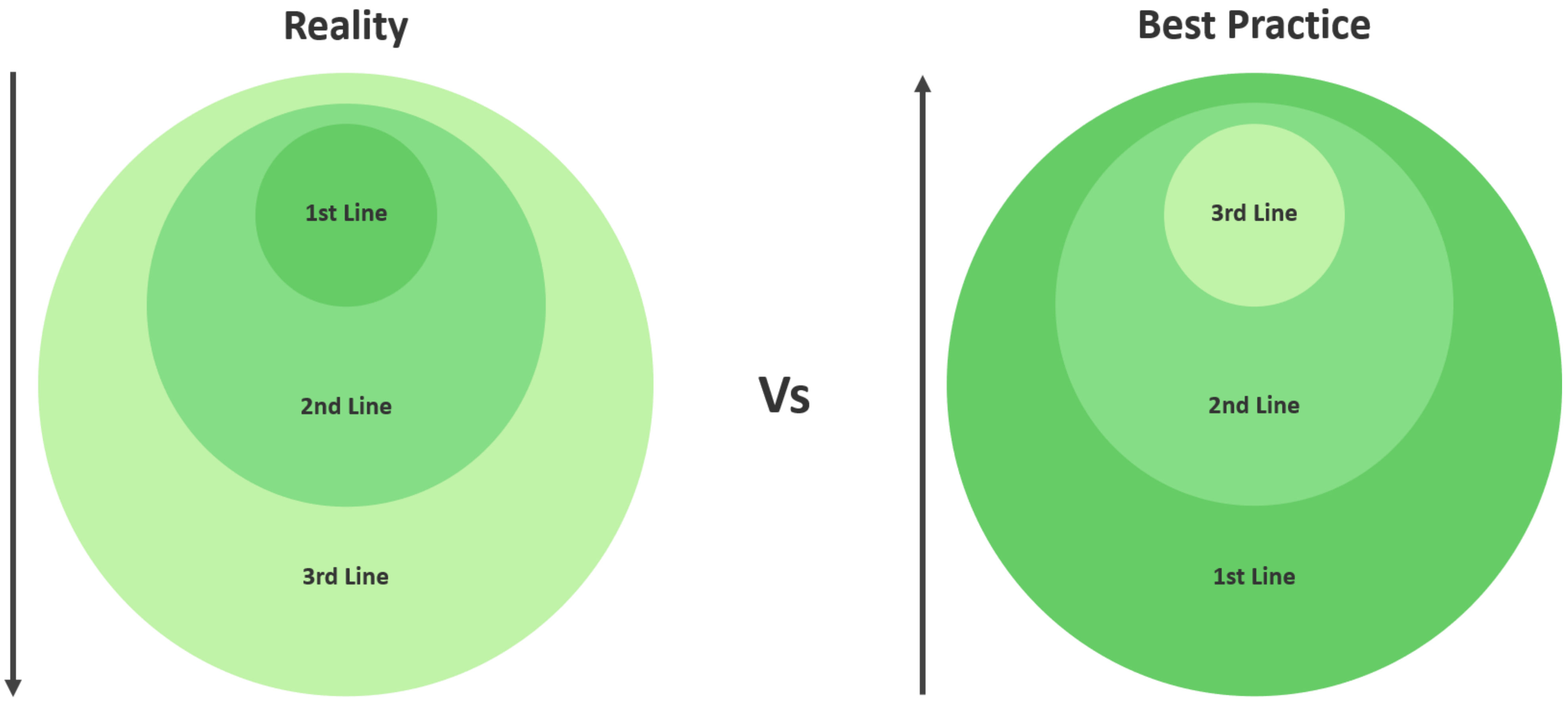
*Risk assurance – assurance that reported risks are complete and fairly stated, and aligned to strategic objectives

Integrated assurance

Integrated assurance
reflects the revised aims of:

- Alignment
- Collaboration
- Accountability
- Objectives

First line accountability



The view from GABI

Issues flagged by GABI respondents as 'we need to improve'.

75% Embedding first line risk-related decision-making responsibility	**72%** Clarifying first and second line risk management responsibilities	**59%** Clarifying when the CRO should approve or authorise management decisions	**59%** Considering NED CPE/development needs	**52%** Spending more time focused on emerging risks	**50%** Co-ordinating risk culture work across the lines of defence

Data from the Risk Coalition's Gap Analysis and Benchmarking Insights (GABI) service

Poll

Q2. Is the traditional approach to risk appetite helpful in running your business?

- Absolutely – it’s a thing of beauty
- To some extent – it has its merits
- Not really – it gets mentioned but doesn’t really impact decision-making
- Definitely not – it’s totally meaningless in the real world

A fresh approach to risk management?

The ***certainty management*** approach to risk management requires the organisation to ***define a framework of top-level objectives*** covering both the things it chooses to do (e.g. strategic aims) and those activities the organisation is obliged to do as part of its licence to operate (e.g. comply with law and regulation).

Example objective categories might include:

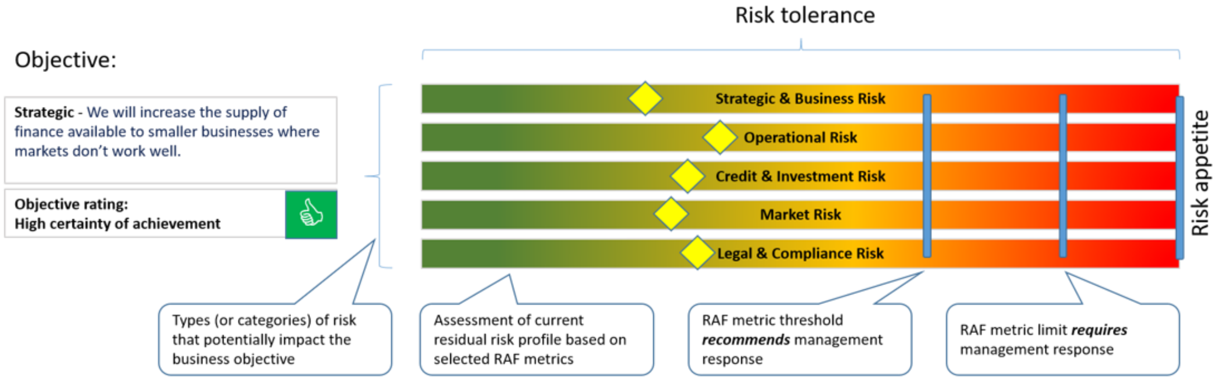
- Strategic aims
- Operational efficiency and resilience
- Financial performance and reporting
- Culture and conduct
- Compliance (legal, regulatory and policy)
- ESG
- Continued viability

A fresh approach to risk management?

The Board ***defines the criticality of each strategic objective*** and ***what level of certainty*** the Board requires for its delivery.

The more critical the objective, the more certainty the organisation needs that it will be achieved - and therefore the less residual risk that can be accepted in trying to achieve it.

Illustration – Risk Appetite and the Risk Appetite Framework



Key elements of 'certainty management' approach to risk appetite:

- **Risks** are presented in the **context** of the objectives the organisation is trying to achieve - helping the Board and Senior Management **focus** on what needs to be done to increase the certainty of achieving them
- The more **critical** the objective, the more **certainty** is needed that it will be achieved - and therefore the less residual risk that can be accepted in trying to achieve it
- The Board and Senior Management regularly consider the risks associated with achieving each strategic objective

Key elements of the Risk Appetite Framework:

- Risk appetite is the **maximum** level of risk the organisation chooses to tolerate
- The Risk Appetite Framework takes overall risk appetite and translates this into **meaningful** thresholds and limits that are **embedded** across entities, activities and business lines. RAF metrics provide management with a practical means to assess, monitor and report on **risk profile**
- The Risk Appetite Framework also reinforces **linkages** between key activities such as Strategic Planning, Budgeting, Stress Testing, Crisis Management and Recovery.

A fresh approach to risk management?

Senior Management regularly assesses and reports to the Board ***their level of confidence in achieving the organisation's strategic objectives*** - based on an assessment of the risks associated with each objective and across objectives.

This step can be extended to include an opinion from both the second and third lines also – ***INTEGRATED ASSURANCE***.

For those objectives ***where the current certainty of achievement is lower than that required, the organisation is implicitly above its risk appetite*** - in effect, running more residual risk than desired.

Objective category		Criticality	Certainty assessment		
			First	Second	Third
Strategic aims		High			
Operational	Resilience	Very high			
	Efficiency	Moderate			
Financial	Performance	High			
	Reporting	Moderate			
Culture & conduct		High			
Compliance		Very High			
ESG	Environmental	Very High			
	Social	Moderate			
	Governance	High			
Viability		High			

A fresh approach to risk management?

The major advantages of this approach are that:

- ***there is no need to set an arbitrary risk appetite***. Residual risk is always set at the lowest reasonably practicable level
- risks and KPIs attached to sub-objectives give a direct indication of the certainty of achieving the primary objective to which they are linked, ***enabling an effective roll-up or consolidation of key risk-related information***
- it ensures appropriate ***strategic alignment throughout the organisation*** and enables the Board to focus resources on achieving the organisation’s most critical objectives

The Risk Coalition

Leading Risk Thinking

riskcoalition.org.uk

Meet GABI

The Risk Coalition's online
Gap Analysis & Benchmarking Insights tool

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Questions And Answers

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- Fri, 5 Mar (11:00-11:45) How To Be Happy
- Tue, 9 Mar (09:00 - 09:45) Achieving Sustainability In Developing Markets: A Case Study With Serious Shea & Cleo Organics
- Wed, 10 Mar (12:00 - 12:45) Positive Income, Positive Purpose - Listed Fixed Income Opportunities With Positive Social Impact

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