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RISK MANAGEMENT:
A Challenging Work In Progress

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Enterprise **RISK MANAGEMENT** Discipline in *Action*

By David B. Sidon

As a follow-up to an article that I wrote on enterprise risk management (ERM) last year, the folks at the Connecticut Bankers Association asked me to put on a reporter's hat and find out how the industry is responding. Once I got over the fact that this was not an article for me to spout my opinions as I usually do, I set to the task of talking to risk experts in the trenches.

One of the dichotomies in play is the big bank/small bank dynamic; the billion dollar asset-sized institutions with more resources, but with more requirements (FDICIA for example) and a wider organization chart, compared to the smaller banks, with a more condensed organization and little available time to wear yet another hat. Bert Knotts, CEO of Darien Rowayton Bank, pointed out that "with just 24 employees, everyone is responsible for ERM." The three chief risk officers (CROs) that I spoke to echoed the same philosophy, but also described the organizational machinery required to pull all the various disciplines together into a cohesive risk program. Case in point, Mike Schweighoffer, CRO at Farmington Bank, says "the biggest challenge is managing all the components," adding that Farmington's risk motto is "Everyone Owns It."

What does ERM mean to you?

So what drives ERM? What does it mean in your institution? As to focus and priority, Gene Shugrue, Liberty Bank's CRO, illuminated the challenge of linking the components as a focus for his bank in 2011. Ditto for Farmington, where Schweighoffer told me that senior management and the board have strategically identified risk management as a main objective, looking to "get everyone involved." As to the meaning of enterprise-wide risk management, Bob Granata, risk manager at First County Bank, was clear about the ERM mission, saying that risk management "is all about information – to all constituents," and that "ERM seeks to put information in the right hands to make effective decisions."

The decision-making focus was echoed by Scott Marble from the FDIC. Marble does some work with directors' education and touches upon ERM during those talks, finding that he is introducing the philosophy in very broad terms and suggesting that directors go back to their institutions armed with a risk question or two. He expressed a personal opinion that there is "a competitive advantage for institutions with good enterprise risk management programs." Good to hear, since all of us in this industry that are toiling at the beginnings of ERM programs have a vision that hopes for efficiencies and benefits.

> "the **biggest challenge** is managing *all* the components"

Is ERM a rule, a requirement, a coming obligation, or so far, just best practice? Marble confirmed the current ERM-as-best-practice standard, and isn't aware of any ERM guidance coming soon.

Where does ERM fit?

Risk management can be a challenging fit in the architecture of an organization. Darien's CEO Knotts could easily foresee growing more risk expertise departmentally, initially in the area of credit risk. CRO Shugrue said Liberty's structure includes the Senior Risk Council, a designated risk committee at the board and management level. Farmington's Schweighoffer reports directly to the bank's audit committee in an organizational line that is similar to the traditional internal auditor model, although he noted that the institution is working toward the establishment of a separate risk committee at the board level. Within my own clientele, I recently assisted an institution (about $750 million in assets) with an organizational restructuring that included the establishment of a risk department consisting of a CRO, an assistant CRO (responsible in part as liaison for outsourced internal audit engagements), a compliance officer and the bank's BSA officer. The CRO reports directly to a newly reconstituted audit and risk committee at the board level (including a revised committee charter with risk responsibilities described). "Best practice" is still maturing – stay tuned.

A well-rounded CRO

I asked each of the banker participants to rank relativity from the risk component menu, weighing their answers based on significance, exposure and the institution's focus level, but before I report their answers, another dynamic should be noted. The "perfect" bank CRO probably is a CPA, with some mortgage lending experience, lots of compliance experience and about 20 years of commercial credit backbone. I haven't figured out who, exactly, fits that bill quite yet, but the folks I interviewed clearly bring the "well-rounded" aspect that is required for the job.

That said, each risk manager brings a certain bias to the question. Farmington's Schweighoffer and Liberty's Shugrue both come with years of credit experience, and so have started their ERM focus with a credit weighting. Both have large segments of credit administration reporting directly to them. First County's Granata comes at this from the finance side of the house, with a Sarbanes Oxley and FDICIA financial reporting risk focus.

I have experienced a similar bias in my own client work, in past years starting an ERM model through a business continuity process mapping effort, and more recently via the financial reporting risk avenue. Similarly, the available software packages, most notably WolfPAC, which is a financial institution-specific product, require a starting point (picking a particular module), which is not necessarily the same for each institution. The three larger banks interviewed each deploy different subsets of the overall WolfPAC model.

Back to the weighing question. Bert Knotts noted that all components are necessary and important, but in this environment would rank the three top priorities as 1) credit; 2) credit; and 3) credit. Bob Granata also listed credit risk as the number-one focus, interest rate risk and liquidity second, and compliance (including GLBA and legal) third. Gene Shugrue starts his list with credit risk, followed by IT/GLBA/Vendor which he views as linked, and compliance third. Mike Schweighoffer's answer delineated "credit and compliance as 1A and 1B, both being extremely important, but with an increasing emphasis on compliance due to the amount and pace of change in the regulatory environment."

This was an interesting exercise, and makes clear that ERM as a discipline and methodology is very much a fledgling work in process. The issues related to organizational structure and efficient linkage of all the risk components remains a seminal question in a maturing model that has come a long way in a short time as best-practice in our industry. The overall theme was consistent throughout the organizations, though perhaps Bob Granata said it best: "Who does ERM? The entire team!" ◆

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