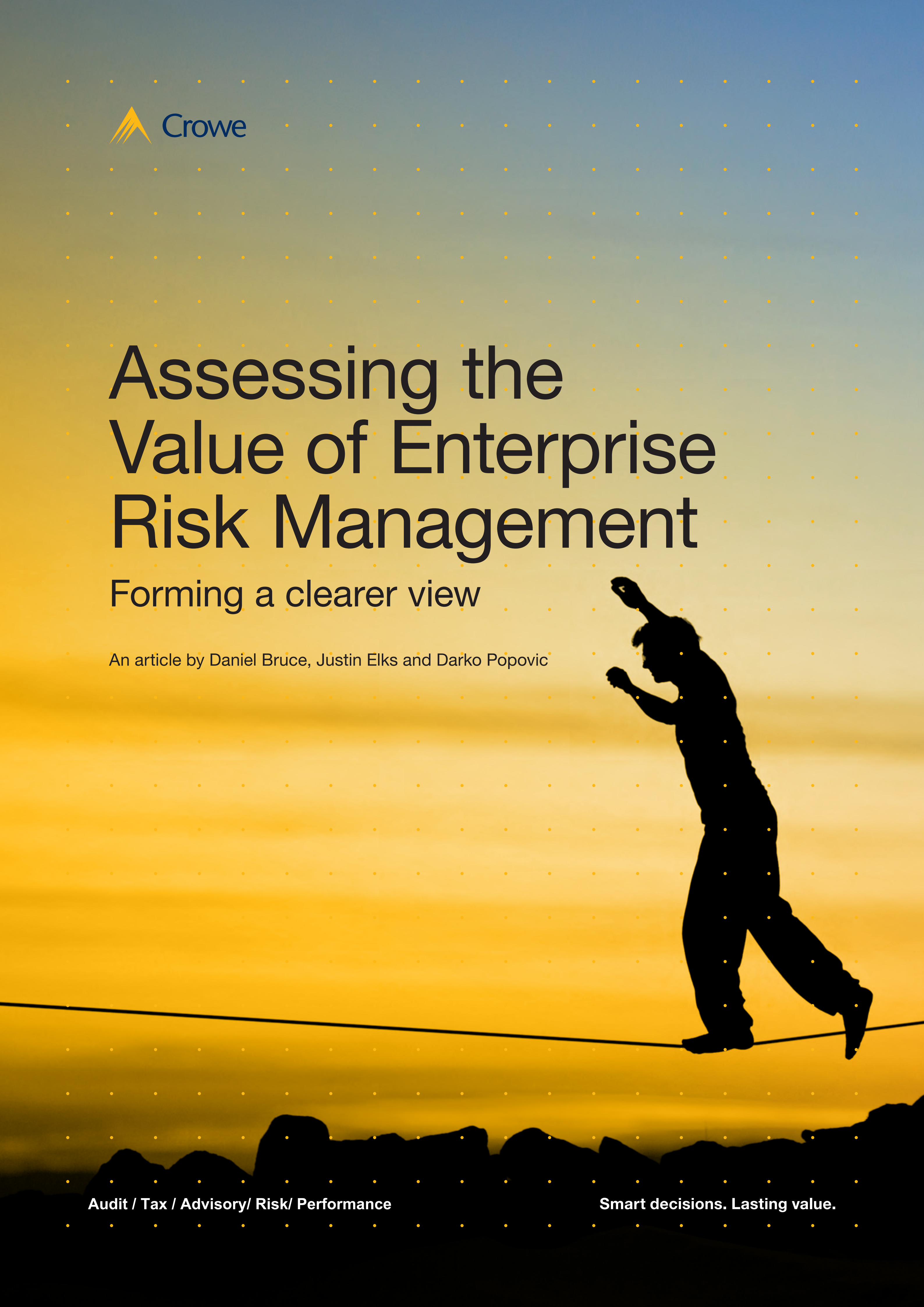


# Assessing the Value of Enterprise Risk Management

## Forming a clearer view

An article by Daniel Bruce, Justin Elks and Darko Popovic

In an earlier article, entitled "Risk management – making it work for your business", we focused on how insurance firms were seeking to convert compliance activity into practical business results, building on the recent significant spend on the new risk and capital management regulations, Solvency II.

Our enterprise risk management work with Financial Services companies in general has further highlighted to us that there continues to be a focus on meeting regulatory standards, but this is not necessarily the same as delivering better business outcomes.

We believe there is still a pressing challenge for risk functions across financial services companies to demonstrate value and improve the effectiveness and efficiency of enterprise risk management to turn risk management activities into tangible, measurable business improvements.

In response to new regulations and requirements, organisations in the highly regulated Financial Services sector have sought to develop and implement Enterprise Risk Management (ERM) frameworks and ensure that people across the business are equipped with the necessary risk management capabilities.

However, our experience is that the sheer pace of change, coupled with the increasing demands of regulation, has left many Boards feeling that the return on the investment is unclear.

In this, our latest, article in our "Smarter Business Decisions" series, we broaden our focus, to consider the perceived value-add of enterprise risk management in the Financial Services industry as a whole.

Boards and Senior Executives are now taking stock of enterprise risk management development effort and associated spending, in order to understand whether it was all worth it. The challenge they are facing is the difficulty in measuring how much "value" has arisen from implementation of ERM Frameworks and capabilities, across the three lines of defence.

## The issue at hand

Although we are certainly seeing more second line of defence being deployed in enterprise risk management oversight activities within businesses, there is a question around the extent to which this involvement is adding any demonstrable value in terms of the decisions made and actions taken by the organisation.

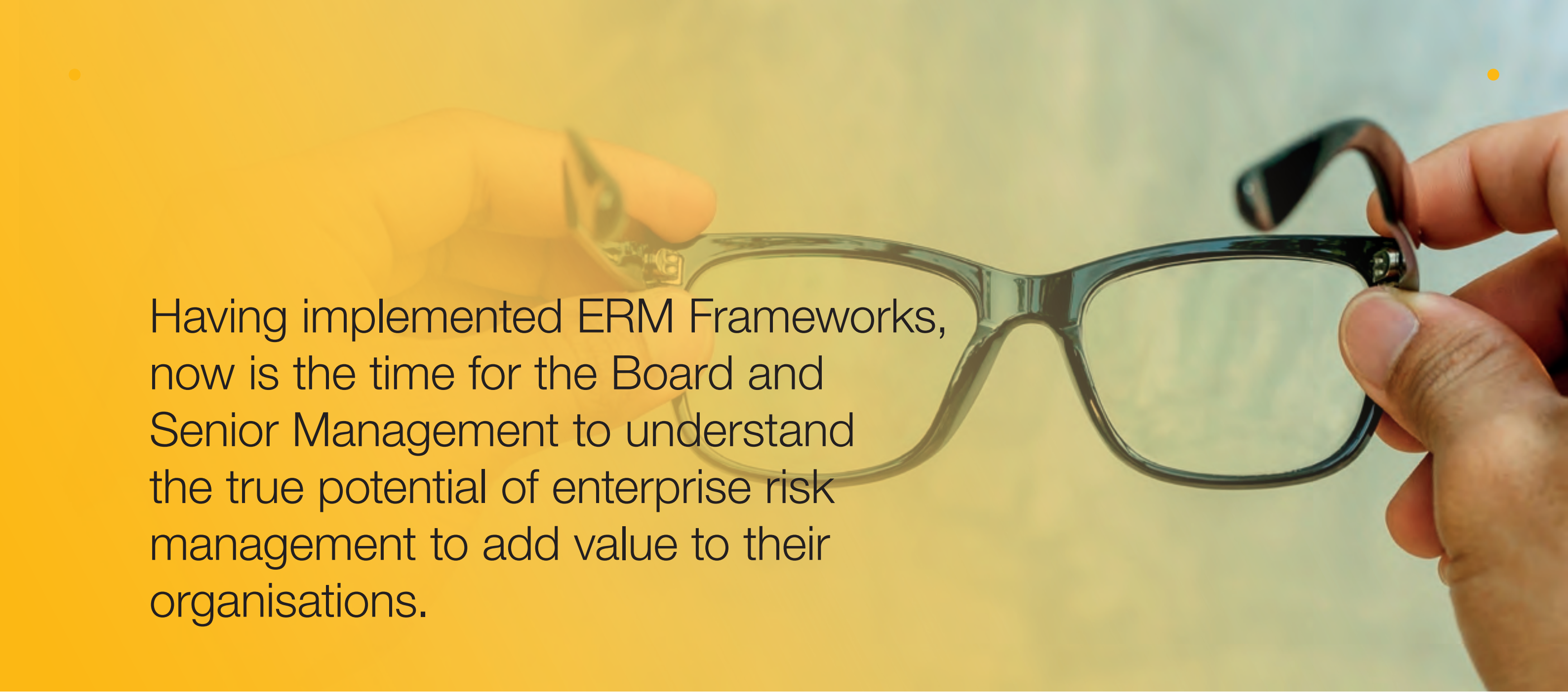
Furthermore, decision making in companies still tends to be designated to a handful of key individuals, who don't always seek input on risk considerations from others who may be able to provide an additional perspective.

In light of the above, it is difficult to form a consistent and holistic view of the value-add of enterprise risk management across the organisation, including by the 1st line teams.

Attempts to improve effectiveness of enterprise risk management have tended to be ad-hoc and siloed, typically driven by individuals within the more pro-active business units, rather than driven from the Board and / or Senior Management level with an overall strategic perspective in mind.

**Key questions for the Board and Senior Management to consider are:**

1. Across which areas can enterprise risk management make the biggest, most valuable impacts on our decision making and hence make a strategic difference to our business?
2. How do we assess the value added by our ERM Frameworks?
3. How do we further enhance our ERM Frameworks in order to add even more value to the organisation?



## Having implemented ERM Frameworks, now is the time for the Board and Senior Management to understand the true potential of enterprise risk management to add value to their organisations.

### The solution

Crowe helps clients to have a clearer view of the value of enterprise risk management, including how to incorporate (i) the perceived efficiency across the organisation and (ii) those aspects where effectiveness is more difficult to quantify objectively. For example, the value arising from improved confidence in decision making, or indeed from the positive risk culture which arises from well-embedded risk management capabilities.

More specifically, we believe that organisations can assess the value added by their enterprise risk management though focusing on the extent to which it is being used to facilitate and improve decision making across the organisation.

We recommend that organisations assess the value-add of enterprise risk management through a structured risk effectiveness assessment, starting with a top-down view of the organisation and identifying the main uses of risk management during the decision making processes.

Putting enterprise risk management value-add in the context of the strategy of the business will help identify the extent to which the full potential of risk management is being realised. This focus helps organisations to delve deeper into their key decision making areas, in order to understand from a practical perspective how risk considerations are influencing business decisions.

It is important to structure the effectiveness assessment in a way that facilitates the comparison of the value-add of risk management across different decision-making areas of the business, in a consistent manner. This in turn helps companies to form a bottom-up view of the value-add of enterprise risk management in decision making activities.

# Crowe Framework: Risk Effectiveness Assessment Approach.

To holistically evaluate the value of enterprise risk management across a client's entire business, Crowe has developed a modular assessment approach, which considers risk effectiveness through a number of different lenses.

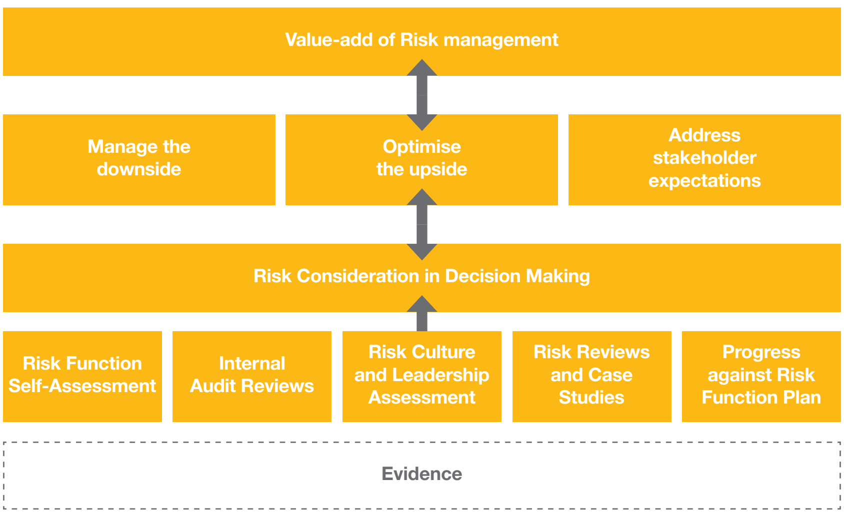
The top-down view of perceived value-add of enterprise risk management is supplemented by a modular bottom-up approach in order to arrive at a holistic view of risk management effectiveness.

More specifically, the top-down view includes perspectives on how enterprise risk management activities help the organisation to:

- manage the potential downsides
- optimise the potential upsides, and
- address the full range of stakeholders' expectations.

The bottom-up view of the efficiency and effectiveness of enterprise risk management is formed by carrying out a number of shorter modular assessments of the performance of relevant activities across the three lines of defence. Each module focuses on assessing a specific aspect of effectiveness, as follows:

- The Risk Culture and Leadership assessment helps inform the company-wide view of how risk is managed (predominantly a 1st Line of Defence view)
- Understanding the quality of Self-Assessments, Risk Reviews and Risk Function Plan progress tracking help to inform the extent to which risk is considered in the key decisions made by the business (predominantly a 2nd Line of Defence view)
- Internal Audit reports provide an independent perspective into the operation of the Risk Function through their reviews (predominantly a 3rd Line of Defence view);



Ultimately, both the top-down and bottom-up views inform the extent, and consistency, of risk consideration in decision making across the organisation. The modular assessments are supported by gathering evidence to help demonstrate risk consideration in practice.

Based on our industry knowledge and expertise, Crowe has produced maturity continuums for key decision making areas across organisations – such as Business Planning – which qualify the level of risk consideration relative to industry best practice.

This allows organisations to identify key areas for further development, in order to close any perceived gap in risk effectiveness in relation to their peers.

Having followed the Crowe approach to assess risk effectiveness, organisations should be able to focus their developments in areas where there is most value to be gained from enterprise risk management activities in supporting the business strategy. This provides real opportunities to improve the return on the investment in risk management processes.

For example, enterprise risk management practices within the context of liquidity risk may consider only the downside and have very limited focus in optimising the upside. By contrast, an organisation could confirm that the risk considerations within its product development process appropriately focus on both the downside as well as the upside potential, resulting in effectiveness gains being identified.

## The case study below provides an overview of how the Crowe Risk Effectiveness Assessment Approach was applied on a recent client project.

**Case Study: Link to Strategy**

A newly appointed insurance company non-executive director was frustrated at the lack of effective consideration of risk in their firm's strategy development, prior to Board approval. They asked Crowe to undertake a review of the process and make recommendations for future enhancements.

What was evident from our review was that the engagement and involvement of enterprise risk management was too late in the process. This left the CRO in an uncomfortable situation - either identifying significant challenges to a strategy that was felt to have been "agreed", or identifying limited risks and concerns and being accused of not adding value.

Crowe assisted the firm in re-designing its process to integrate more timely consideration of all risk types into strategy development, including:

- risks arising from the external environment
- review and analysis of strategic options, and
- full consideration of the risks to the execution of strategy (as part of the organisation's business planning).

This helped the Board and Senior Management to understand the key areas of potential improvements in the efficiency and effectiveness of ERM.

It also helped the Board Risk Committee to deliver on an important aspect of its mandate; to annually assess risk effectiveness.

As the organisation was required to undertake an Own Risk and Solvency Assessment (ORSA), we also advised on how the ORSA process could be better aligned and integrated with the strategy process.

Overall, the impact of this work was evident in subsequent reviews, and the consideration of risk became a more natural part of the business planning and strategy processes.

The organisation was able to clearly articulate and evidence how risk considerations added insight and challenge to the strategy development in a timely manner.

In addition, the process was increasingly efficient - for example, savings in production time were made, through a closer alignment of the financial outputs needed for both strategy development and the ORSA.

## In conclusion

Financial Services firms have invested heavily in ERM frameworks, but we often hear from Board members that they are not clear whether enterprise risk management is adding real value to the business.

Seeking to objectively assess the value of ERM, by focusing on the impact on business decisions and actions that help a firm achieve its business strategy, can assist firms by helping to form a clearer view on where value is being added, and how ERM Frameworks can be further enhanced to drive increased value.

**Highlights from the article series on "Smarter Business Decisions"**

Next in our series of articles on "Smarter Business Decisions", we will focus on specific challenges in key areas of ERM such as cyber risk, operational risk, and risk culture as follows:

- outlining a practical and pragmatic approach to managing cyber risk in the context of the wider ERM Frameworks and decision making process of an organisation
- improving the value-add from Operational Risk management by helping the organisation focus on, manage and build resilience to its most significant risks
- helping organisations to ensure that a strong risk management culture is embedded into the culture of the whole business.

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Our UK office helps financial services clients to make pragmatic, practical, proportionate improvements to how their businesses work.

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