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8 Step Guide to Implementing ERM

Enterprise Risk Management provides the board and senior management with reasonable assurance that the company's business objectives will be achieved

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Enterprise risk management assists management with the alignment of risk appetite and corporate strategy, improves the process for risk identification, measurement and management, enhances the ability to seize opportunities, and improves the deployment of capital.

All companies have some form of risk management activities in place. However, these activities might be at best informal and at worst totally undocumented, uncoordinated and misaligned with the overall strategy. Greater transparency into how a company manages its risk is being demanded by board members, senior management and regulatory bodies. Companies are therefore being forced to provide a much more robust approach, but such a daunting task is often met with questions ranging from "Why do we need ERM" to "Where do we start?"

There are many good answers to the first question including:

- Improved regulator, investor and rating agency confidence
- Enhanced corporate governance: ERM and Governance, Risk and Compliance (GRC) are inextricably linked
- Improved ability to respond to changing business demands
- Ability to evaluate the likelihood and impact of major risks
- Provides an integrated as opposed to silo approach
- Promotes an open, positive, risk-aware culture

Top tips for a successful ERM initiative

Get support from the top

Embed ERM into the company's culture

Evolutionary not revolutionary: take small steps and repeat successes

Focus first on a small number of critical risks

Take stock of existing risk management activities to leverage processes and talents

Encourage input from representatives throughout the company

Remember that risk management is a continual process, not a one-off event

Provide regular updates to reinforce ERM as part of the culture

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The second question is answered by the remainder of this whitepaper. We provide an 8-step approach that will help a company move from ad-hoc risk management to a more robust level of ERM using an incremental approach. We know that no two companies operate in exactly the same way and the suggested approach is not the only way to embark on such an initiative. Cognizant of these facts the approach is designed to be flexible and adaptable.

Step 1: Obtain Board and Senior Management Support and Involvement

The tone for the company's risk culture is set by the board of directors (board) and senior management whose buy-in, involvement and ongoing support is critical to the success or the ERM effort.

The board and senior management should:

- determine overall business strategy and objectives
- make resources available
- establish target dates
- communicate their support for and importance of the ERM effort and their desire for enhanced risk awareness throughout the company

Benefits of ERM

Better alignment of the company's risk appetite and strategy

Enterprise-wide view of risks and controls

Better informed strategic decision making

Reduced operational surprises and losses

Improved deployment of capital

Step 2: Appoint a Strong ERM Leader

Although ultimate responsibility for risk management resides with the board, it is essential to identify a strong leader to head the initial ERM project to ensure its requirements are being executed and to ensure the acceptance and success of the initiative. It is usually best to appoint an internal person such as the Chief Risk Officer. If such a role does not exist then another typical choice is the Chief Audit Officer or Chief Financial Officer. The chosen leader may not be the person to head ERM in the long term, but will be responsible for laying the foundation, garnering involvement and acceptance, and moving the initiative to the next level. It is essential for the ERM leader to have sufficient stature and authority, be a member of senior management with an understanding of the company's structure and risks, and to be viewed as a peer by fellow senior managers.

Typical qualities of an ERM leader include:

- broad understanding of the business and its core strategies
- strong working relationships with the board, executive management and senior management
- broad understanding of the company's business and its core strategies
- knowledge of the company's risks
- credibility and respect across the company

Step 3: Establish a Risk Committee

In order to provide strong support for the ERM effort a senior-level committee should be created. This committee will be the vehicle through which the ERM initiative is implemented and it will engage appropriate people from across the company to ensure the ongoing success of its efforts.

The committee should be comprised not only of "C-suite" executives but also key business line managers and representatives to ensure that:

- there is visible top-down support from senior management and bottom-up buy-in from the business lines
- risk management efforts are being embedded into the company's core business activities
- objectives, risks and controls are discussed from multiple perspectives to increase awareness and understanding of their impact on the company (e.g. something that is thought of as a high risk to a line manager might only be considered a medium or low risk from an overall company perspective)
- several sought-after benefits and mile-stones are defined to help evaluate each step of the process

Step 4: Conduct a Risk Assessment

An initial Risk Assessment should be performed in order for the Risk Committee to gain an understanding of the company's top risks and how well they are managed. This initial assessment will provide a top-down view of the most important strategic risk exposures and serve as the starting point for additional and ongoing assessments:

Risk Identification and Classification

The company's overall business strategy should be broken down into its components and each one examined to identify exposures to each major risk category (e.g. Credit, Market, Operational, Legal, Financial, IT). An assessment of existing risk mitigation techniques or monitoring activities should also be performed at this stage. The data required for this part of the exercise can be obtained through:

- Risk Committee meetings
- Facilitated Workshops
- Interviews
- Surveys

Assessment and Analysis

The meetings, workshops, interviews and surveys will probably result in a long list of potential risks. Care should be taken not to focus on too many of them for the initial Risk Assessment. Those most likely to prevent the company from achieving its objectives should be tackled first and subsequent Risk Assessments (as part of the continual ERM process) should be scheduled to address the other less critical issues. In order to obtain an agreement on the most critical risks the results should be reviewed and prioritized. The prioritization could be accomplished with a simple ranking according to the perceived inherent risk; however we recommend a more detailed assessment of the probability and impact of each risk. A basic scale of High, Medium and Low for each inherent risk is typically used for the initial assessment. As the ERM process becomes more widely accepted throughout the company this step should be expanded to focus on residual as well as inherent risks and should include additional factors such as risk velocity or the level of preparedness. Focusing on too much detail in the early stages will impede the adoption of ERM therefore it is recommended to keep it simple in the beginning.

Inherent Risk

This is the risk that exists prior to any action or control to modify the circumstances

Residual Risk

This is the risk that remains after actions or controls have been implemented

Another important part of the ERM process is to document and articulate the company's appetite for risk. For example, senior management might decide that trading certain types of products or entering into certain activities will not be allowed because the risks are perceived as being too high.

Step 5: Review Existing Risk Management Practices, Augment Controls, Implement Action Plans

The ERM process not only assists the company in mapping risks to underlying business objectives, it also provides management with an opportunity to review its existing risk management practices, assess the adequacy of those practices, identify areas of strength and weaknesses and implement action plans to improve or enhance controls.

As companies move away from silo-based approaches to a more enterprise-wide view the knowledge gained from a thorough review of existing risk management activities will help management assess connections between existing processes and identified risks, and will also highlight gaps in the process. A high-level documented inventory of the company's existing risk management activities serves as a valuable baseline for the company as it continues to enhance its ERM process. Such an inventory should also provide details of measurable, attainable, attributable and time-constrained Action Plans that were prepared to address gaps or weaknesses in the risk management processes.

Step 6: Implement Risk Reporting

It is important to monitor progress and communicate the status of the ERM process throughout the company. Reporting should be simple, clear and concise and the formats should be tailored to specific audiences. The types of reports can range from:

- simple lists which display details of the top risks in rank order
- graphical reports with high-level details
- detailed reports that monitor and track the implementation of action plans
- drill-down reports that display, for example, the Category, Ranking, Appetite, Control, Current Risk Assessment Result, Risk Owner and Associated Action Plan for each risk
- progress reports that compare the actual results and benefits of the ERM initiative with original objectives

Step 7: Communicate Results

The implementation of ERM is an evolutionary process that will continue to improve over time. When the initial ERM process has been completed the Risk Leader (see Step 2) should publish a list of accomplishments to date along with details of the next stage of the implementation. A presentation should be made to the board and senior management on completion of the initial implementation highlighting the benefits achieved, obstacles overcome, and challenges ahead. Similar presentations should be communicated throughout the company in order to raise awareness of the successes and further strengthen the acceptance and understanding of the ERM process. Regular communications from senior management will help reinforce the importance of ERM. Those responsible for managing the process should remember that risk is dynamic in nature which means that controls and risk management processes that work well today might need to be enhanced or replaced in the future. ERM is not a one-time event: it's an ongoing, evolutionary process.

Step 8: Review, Enhance, Repeat

The completion of the initial ERM process does not mark the end of the initiative but the start of an ongoing process that will become part of the very fabric of the business. Having identified the top risks and put in place strong risk management controls to safeguard the company it is now time to move on to the next stage. The processes used in the initial implementation can be re-used and enhanced with the results of lessons learned along the way. In addition to the ongoing alignment of strategic objectives and risk exposures and reviews of risks, risk drivers, accountabilities, processes and controls, the following activities will also help increase the success rate of the ERM implementation:

- Communication of the company's risk management philosophy
- Regular company-wide communications explaining different types of risk and the risk management process
- Internal training to inculcate risk policies and practices into the minds of new and existing employees
- External training courses and seminars to help employees further develop their risk management skills
- Integration of risk management processes into the annual budgeting and planning processes

- Publication of planned and achieved benefits as a result of ERM implementations

Summary

Building an ERM environment that can satisfy a diverse set of stakeholders is neither a quick nor an easy process. It is essential that the needs of each stakeholder are properly balanced and carefully thought through before implementation. All companies have some form of risk management process in place, and it is important that the good aspects of these existing, perhaps disjointed or overlapping processes are included in the official ERM implementation. We should remember that risk is dynamic in nature and even the best risk management processes in use today will need to be enhanced or indeed replaced over time as strategies and objectives change and new risk arise.

No two companies are alike therefore each one must develop its own approach to ERM. It is critical to the success of the implementation that strategic objectives and risk exposures are aligned, goals and objectives are clearly communicated, appropriate people are involved, and realistic timeframes are set. We recognize the fact that there are many approaches to implementing an ERM process, and we hope you found the ideas in this paper helpful to you as you determine your particular approach.