Editorial

Risk Management – It's about Culture

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Risk Management is at the top of the agenda for banks and regulators worldwide following the turmoil in the markets. The loss tsunami which swept over the financial industry prompts a couple of questions:

Given the enormous efforts put in, promoted by both the industry and the regulators over the last years (Basel II), was it worth it? Why – with all the risk management around – wasn't the crisis avoided altogether or, at least, the effects dampened?

When looking across the industry, one thing becomes clear fairly quickly: less risk management is not the answer! Market participants with swift comprehensive risk management performed significantly better than others. Nevertheless the talk of the town is how to go about risk management in the future.

Comparing the current situation with history, the resemblance with previous events like the Asian crisis in the late 90's or the Latin America debt crisis in the 80's is striking. Common denominator is the vicious cycle of risk, i.e. first excessive growth assuming infinite prosperity, then sudden losses followed by tightened risk standards to avoid future losses, then market share losses, then expanded marketing to (re)gain market share by (excessive) growth.

Only if risk management acts as a cornerstone of the business (process) rather than as box-ticking exercise appeasing the regulator can the vicious cycle of risk be broken.

But how to go about it?

Simply investing in more cumbersome governance, risk management and control systems will not help if the industry continues to override these checks and balances when crucial decisions are made.

In other words it is not about technology, not about modeling, not about governance, although all these are essential risk management elements.

IT IS ABOUT CULTURE!

The leadership challenge is to establish a consistent risk culture across the firm, making risk and risk management a business responsibility at all levels, with decisions that are in line with the approved risk appetite set by overall business strategy. A solid risk culture permits more delegation down the line without jeopardizing the agreed risk/return balance. Furthermore, it provides the common basis for business and IT to fully explore advances in technology for risk management.

To foster a consistent risk culture across the firm requires three basic steps:

1. Communicate risk management objectives into business strategy,

2. Create/maintain a core competence in risk management in all key business lines,

3. Develop track record of decisions in line with the risk framework (no exceptions).

Risk Management needs to move from a support function often split by risk category into a core business function integrating across all risk categories. This is also the key finding of BearingPoint's recent risk management study.

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