SNL Knowledge Center

Bank Enterprise Risk Management

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Enterprise Risk Management

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Enterprise Risk Management

Enterprise Risk Management is a ***process*** for the measurement of risk associated with achievement of ***strategic objectives***.

The Committee of Sponsoring Organizations – The Treadway Commission

Strategic Planning & ERM

Strategic Planning

Long Term View = **Day-to-Day Operations** ← ***Opportunities***

- People
- Place
- Products
- Market Share

Enterprise Risk Management

Enterprise Risk Management — Integrated Framework

Executive Summary

September 2004

COSO: Enterprise Risk Management – Integrated Framework

"Enterprise risk management enables management to effectively deal with **uncertainty** and associated **risk** and **opportunity**, enhancing the capacity to build value. **Value** is maximized when management sets **strategy** and **objectives** to strike an optimal balance between **growth and return goals** and related **risks**, and efficiently and effectively **deploys** resources in pursuit of the entity's **objectives**."

Glossary of Terms -

Enterprise Risk Management – A process, effected by an entity's board of directors, management and other personnel, applied in a strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

Risk – Risk is commonly referred to as the chance, possibility, or uncertainty of outcome or consequences.

Risk Capacity – The maximum amount of risk that a firm is able to assume in consideration of its capital position, liquidity/funding and risk management capabilities. A firm's capacity for risk needs to be formally considered in the development of its risk appetite.

Risk Tolerance – The risk exposure an organization determines appropriate to take or avoid taking.

Risk Appetite – The amount and type of risk an organization is prepared to pursue or take.

Risk Profile – A periodic documentation of the key risks to an organization to achieving its stated business objectives over a specified future time period.

Risk Response – Management selects risk responses – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite.

Inherent Risk – The natural risk that exists before any risk mitigation activities are put in place.

Significance – The earnings at risk or capital at risk considering both the organizations capacity and tolerance for risk.

Likelihood – The measurement of the probability of the risk occurring within the organization.

Risk Mitigation – The strength of activities that management has in place to mitigate the identified inherent risks.

Velocity – The speed at which a loss event can occur.

Residual Risk – The risk remaining after risk mitigation.

Composite Risk – A calculation which considers inherent risk and risk mitigation, and then is adjusted for risk trend.

Risk Trends – The measurement of velocity that occurs in the composite risk.

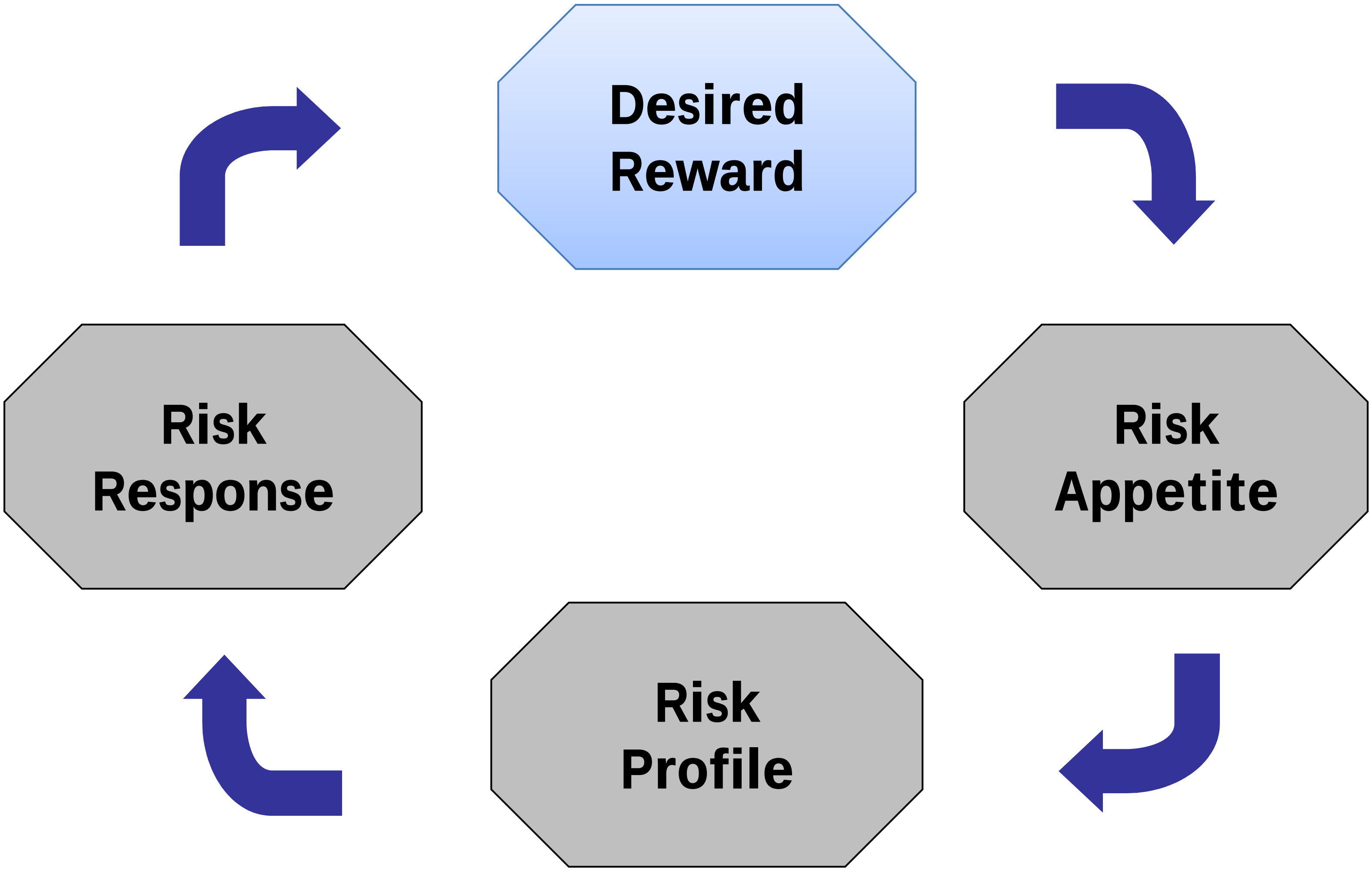
Key Risk Indicator (KRI) – A measure to indicate the potential presence, level, or trend of a risk.

ERM RISKS

The risk to earnings or capital arising from:

Risks	***Definitions***
Credit Risk	An obligor's (e.g., borrower or counterparty) failure to meet the terms of any contract or otherwise fail to perform as agreed.
Market Risk	Movements in interest rates (repricing risk; basis risk; yield curve risk; options risk). Changes in the value of traded portfolios of financial instruments.
Liquidity Risk	The inability to meet obligations when they come due without incurring unacceptable losses. Changes in funding sources or market values.
Operational Risk	Inadequate or failed internal processes, people, systems, or external events.
Compliance & Legal Risk	Violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards.
Reputational Risk	Negative public opinion.
Strategic Risk	Adverse business decisions, improperly implemented business decisions, or lack of responsiveness to industry changes.

Balancing Risk & Reward



Risk as a Positive Force

Certainly any business decision is about capturing some reward. To capture it, you take certain risks. But the better question is how does the enterprise *USE RISK* to achieve its strategic, financial and value creation objectives.

	Actual			Projection			3 Year
	2012	2013	2014	2015	2016	2017	CAGR
Balance Sheet:							
Total assets	$ 2,763,865	$ 2,928,636	$ 3,089,521	$ 3,247,012	$ 4,147,788	$ 4,393,693	12.50%
Loans, Net	1,681,012	1,806,883	1,884,365	2,043,412	2,687,653	2,902,720	14.80%
Deposits	2,261,794	2,320,056	2,450,527	2,559,951	3,258,797	3,479,541	12.30%
Borrowings	179,806	337,042	334,804	356,035	421,975	417,645	8.90%
Capital	253,897	254,839	279,532	287,598	423,587	453,079	19.50%
Earnings:							
Net Income (Loss)	$ 23,449	$ 25,530	$ 29,355	$ 28,114	$ 29,401	$ 46,427	17.80%
ROAA	0.93%	0.91%	0.98%	0.92%	0.83%	1.12%	
ROACE	9.53%	10.23%	10.96%	9.98%	8.27%	10.59%	

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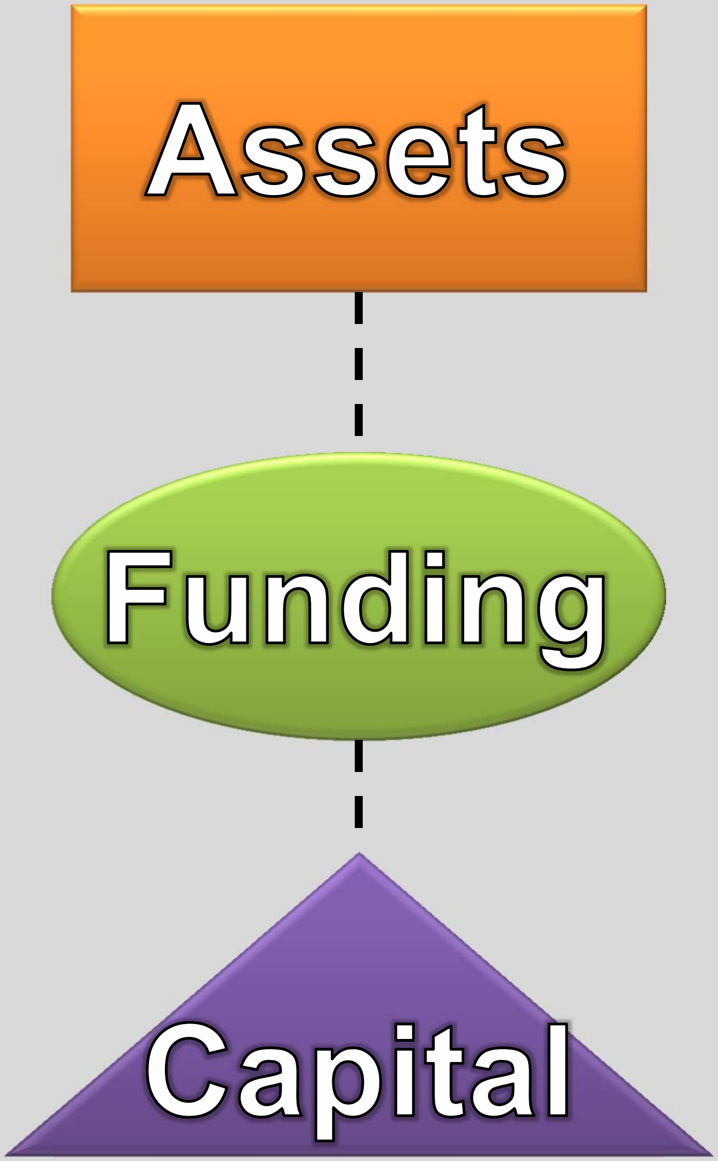
Strategic Balance Sheet Management



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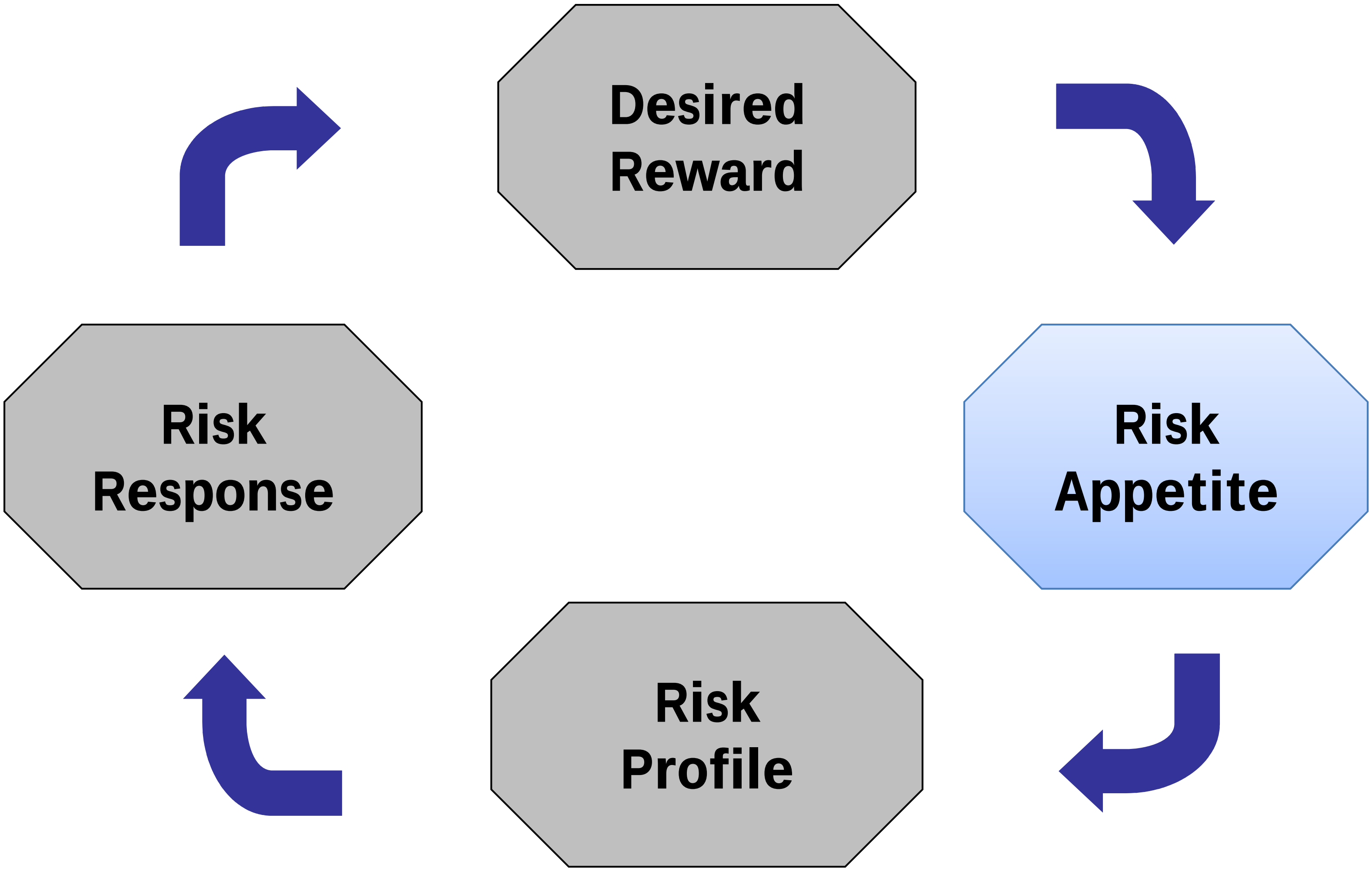
Balancing Risk & Reward



Risk Appetite Statement

The aggregate <u>level and types</u> of risk the Board and management are **willing to assume** to achieve the Bank's **strategic objectives and business plan**, consistent with applicable capital, liquidity and other regulatory requirements. The statement describes both <u>qualitative and quantitative</u> measures and considerations.

OCC Bulletin

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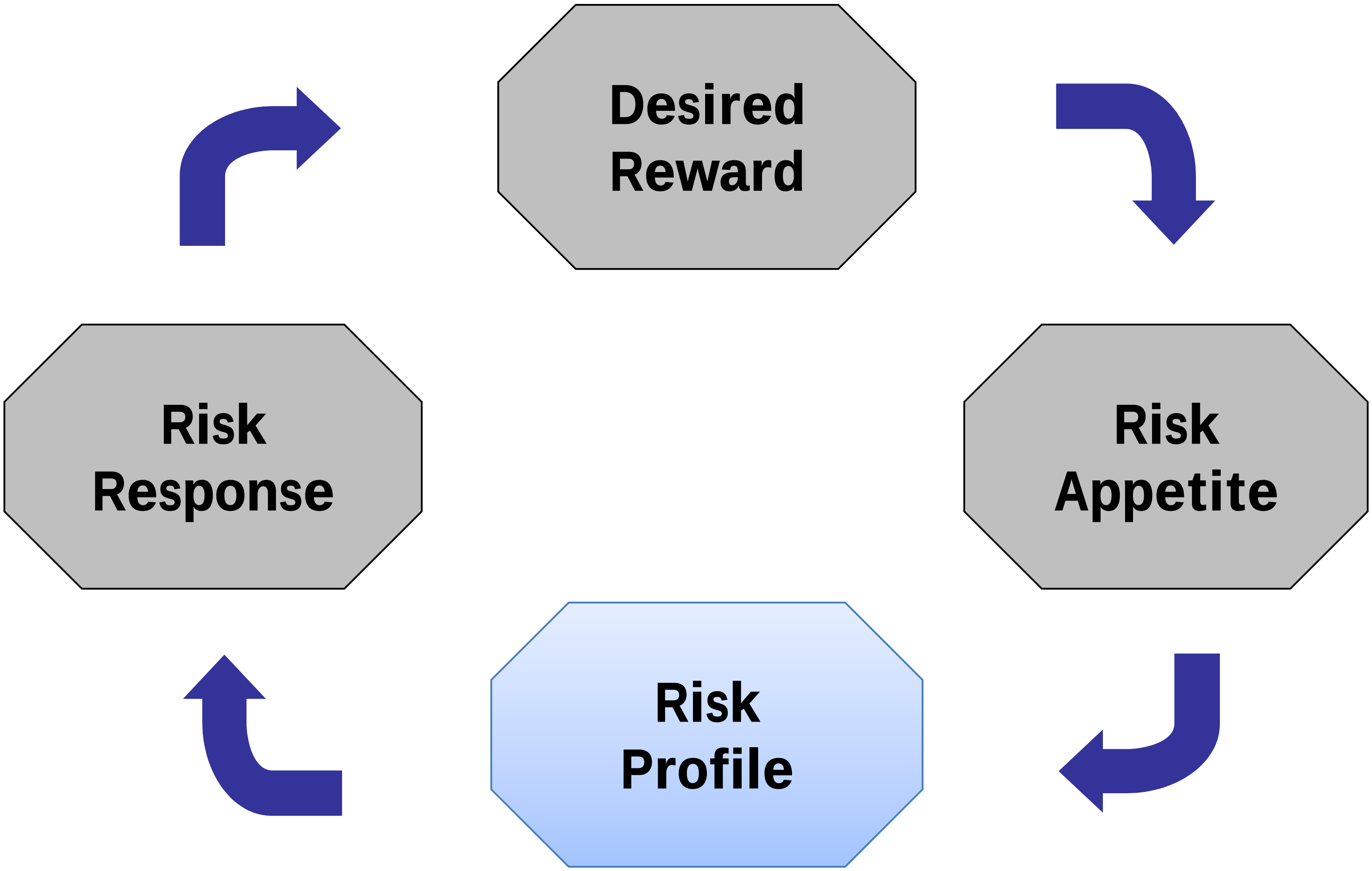

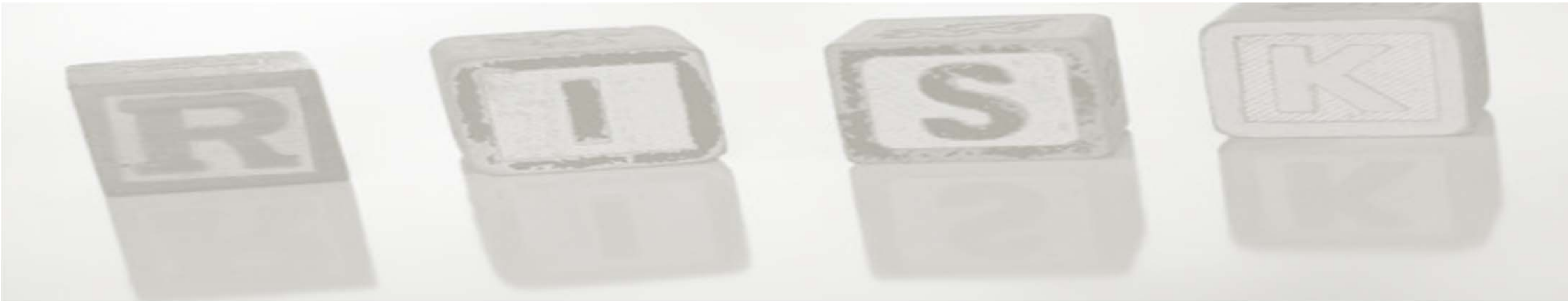

INHERENT RISK

- ➢STRATEGIC FACTORS
- ➢SIGNIFICANCE (impact)
- ➢LIKELIHOOD (chance)

RISK MITIGATION

- ➢PEOPLE
- ➢POLICIES
- ➢PROCESSES
- ➢CONTROL SYSTEMS

RESIDUAL RISK

- ➢ACCEPT
- ➢REDUCE
- ➢SHARE
- ➢AVOID
- ➢INCREASE

ERM – Looks to both strategic choices “inherent” and risk management “mitigation” to dial in desired risk level

Risk Profile - Assessment

Credit Risk

- Portfolio Composition
- Underwriting Characteristics
- Asset Quality Trends
- External Environment, & Market Conditions

Inherent Risk – Significance & Likelihood

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Mitigation – Policies, People, Processes and Systems, Control & Monitoring

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Composite Risk – Reflecting the Effects of Mitigation

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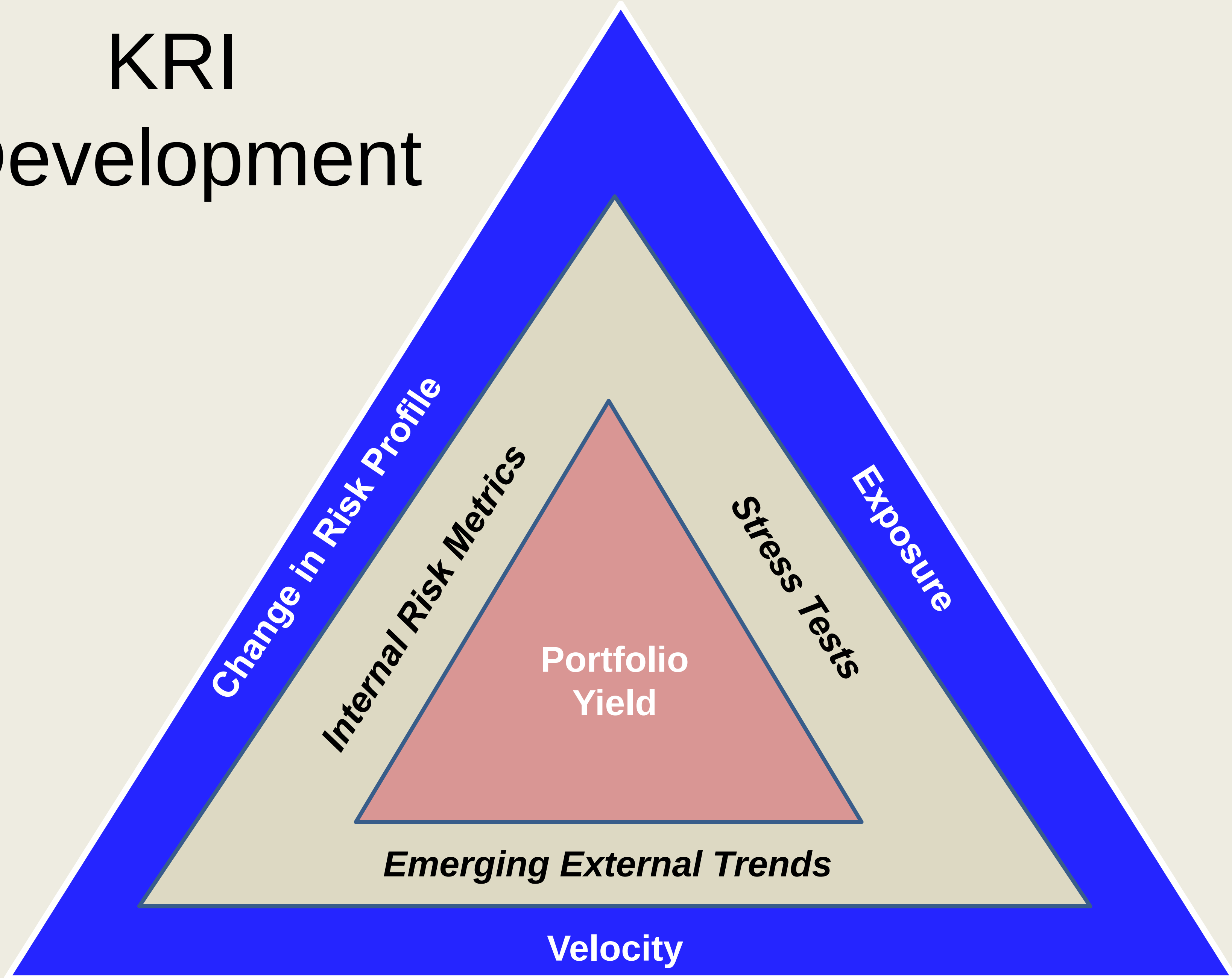
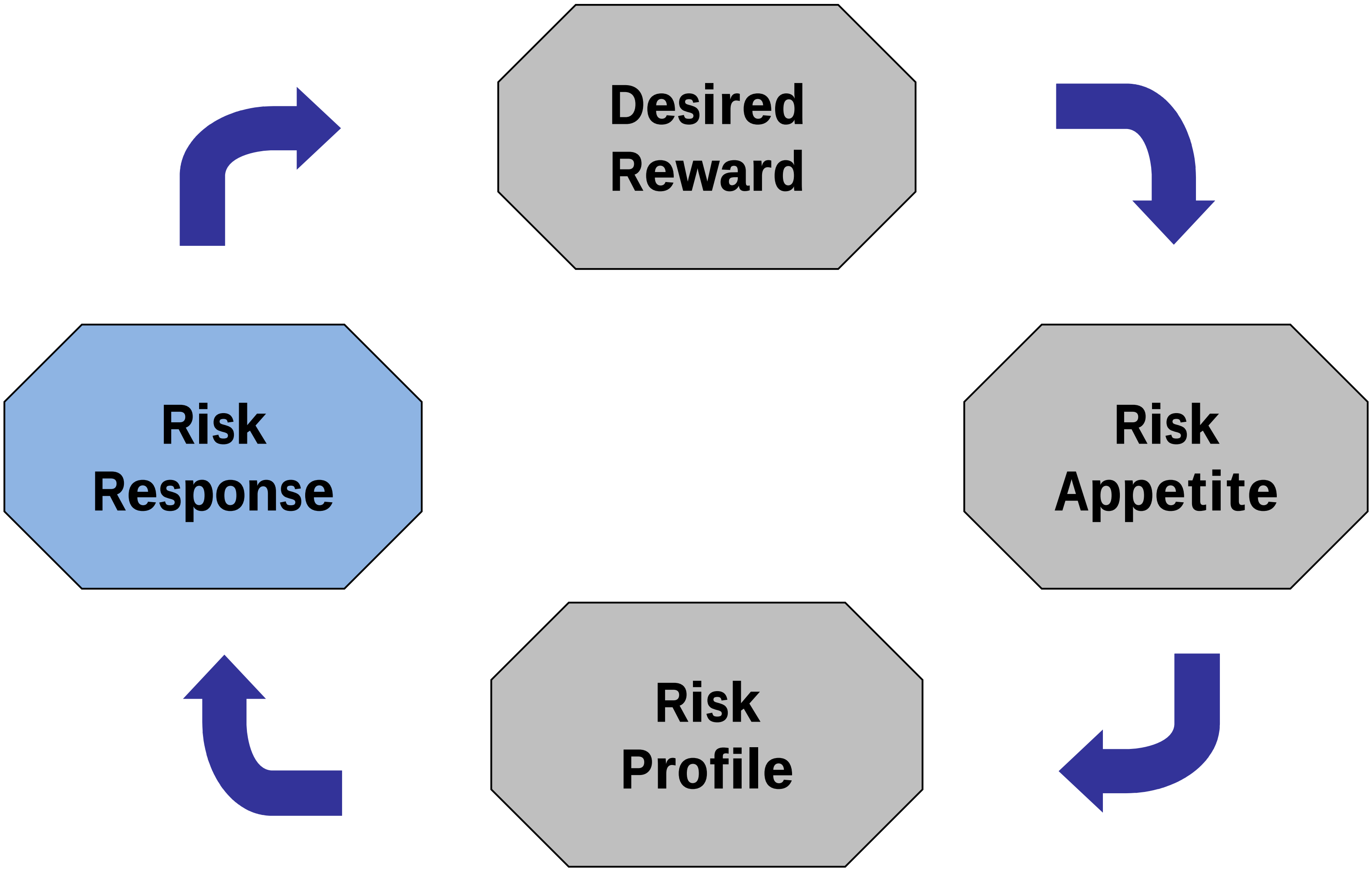
Trends – The Direction and Velocity

RISK ASSESSMENT MATRIX Sample Bank				
Risk Area	**Inherent Risk**	**Risk Mitigation**	**Composite Risk**	**Trend**
Credit Risk	ELEVATED	ADEQUATE	MODERATE	STABLE
Market Risk	MODERATE	ADEQUATE	MODERATE	STABLE
Liquidity Risk	MODERATE	MARGINAL	MODERATE	INCREASING
Operational Risk	ELEVATED	ADEQUATE	MODERATE	STABLE
Operational - IT Risk	HIGH	ADEQUATE	ELEVATED	INCREASING
Compliance & Legal Risk	ELEVATED	MARGINAL	ELEVATED	INCREASING
Strategic Risk	ELEVATED	ADEQUATE	MODERATE	STABLE
Reputation Risk	MODERATE	ADEQUATE	MODERATE	INCREASING

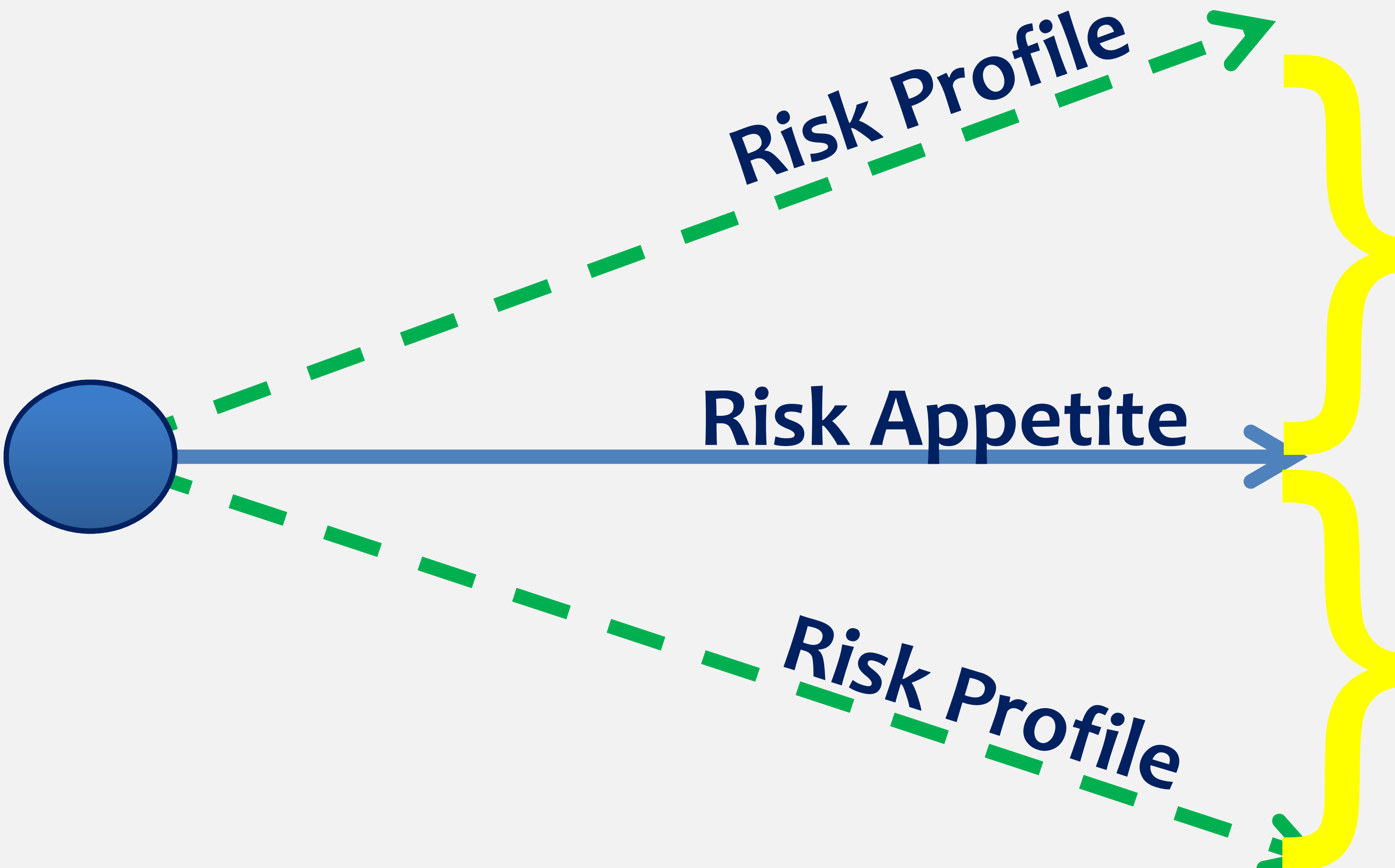
KRI Development



Balancing Risk & Reward



Risk Response



An effective ERM process answers four key questions:

1. Do we understand the risks we are taking across the company (enterprise)?
2. What is the reward?
3. Is the risk acceptable?
4. Is the reward great enough?

The Five Enduring Principles of Enterprise Risk Management: J. Salvetti and N. Schell

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Jack R. Salvetti is the President of S.R. Snodgrass, P.C., a regional accounting and consulting firm specializing in service to the banking industry. Jack assists banks throughout the United States by formulating successful strategies, improving financial performance, and implementing dynamic enterprise risk management frameworks. Jack is a frequent speaker, writer, and instructor at bank management schools and bank director programs.

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