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## IRM FOCUS – Papers on Risk

# RISK AND THE FINANCIAL CRISIS

As risk's management leading international education and training body, the Institute of Risk Management (IRM) asked its members for their views on the causes of the current financial crisis and lessons for the future. IRM is delighted to publish the following four essays. Each approaches the subject from a slightly different angle, but all of them shed light on how we got here and some ways forward.

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## The Root of the Problem

Pauline Bird

The City of London is the greatest employer of science and maths graduates in the country. How could it be that a disaster with such far reaching impacts was not spotted and dealt with before it brought the global economy to its knees?

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Let's examine the root of the problem. In order to expand their businesses the lending institutions needed to find new markets for mortgage lending. Two of those markets were buy-to-let owners (a new animal) and people whose credit history was suspect or who were unable to share the lender's risk in the mortgage lending by putting down a deposit. In a market where lenders became ever keener, it was possible to obtain what was (in effect) a loan of 125% of the purchase price, allowing borrowers to buy a run down property and renovate it. The second category was 'sub-prime' loans, a term which recognised the more risky nature of the lending.

The lenders recognised the risk in this lending, and removed the risk from their balance sheets by bundling up the sub-prime and other high risk loans and selling them to a company created for the purpose, the special investment vehicle or SIV. The shares in that company were sold to investors, who received the right to the income from the loans. This had the effect of removing the risk in the loans from the lender's balance sheet, and, even better, allowing the lender to take the full value of the loans over their lifetime of several years in one financial year, which improved the lender's financial results.

So far, so good. But what then possessed the lenders to buy other people's risk? The lender creating a SIV would discount the value of the loans for (in effect) early payment. So long as the loans continued to perform, the buyer would be getting a greater return on the loan than they had paid for it. These deals would also appear on the investor's balance sheet as an investment, and could appear in the accounts as a transaction 'marked to market' – that is the entire profit from the lifetime of the contract could be recognised in one financial year, which again would improve the apparent results for the investor in that year.

These techniques are based on a number of critical assumptions, the first being that borrowers with an impaired credit history would continue to repay their loans, and the second, that the property market would only increase in value. It is now clear that these assumptions were wholly or partially invalid.

The value of the deals depended partly on the strength of the underlying asset – either the repayment of the debt as expected or the rising value of properties that could be repossessed and sold to cover any default. Where the borrower was unable to service the debt, or where there was a shortfall between the forced sale value of the property and the lending, the investor in the SIV was left with a loss.

The organisations that have exposures to sub-prime debt have been very coy about revealing the extent to which they are exposed, although all of them understand the accounting techniques that have been used to generate results in the past. None of them can trust that the others' declared exposures are an accurate reflection of the true risk exposure, and therefore none of

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them can risk lending to the others, which has resulted in a sudden drought in available credit with catastrophic effects on business. Lenders whose business model depended on the availability of cheap short-term finance and the assumption that this would continue indefinitely were in a very precarious position almost overnight.

### Why did it happen?

Individuals are often driven more by their own interests in a given situation than by the collective good of the whole. The way that the City rewards its employees enforces this tendency, as a typical City reward system is based on a modest annual salary and an annual bonus that may be a multiple of the salary depending on the organisation's results.

It was in everybody's interest in these organisations that the annual results, as agreed by the auditors, were as impressive as possible, hence the attraction of taking profits from loans in one financial year rather than over the lifetime of the loan and making provision over time for defaults, which was possibly a more prudent treatment. In fact, shortly after Swiss bank UBS disclosed that it had some exposure to sub-prime lending in summer 2008, a commentator noted that where the employees of an investment bank knew that a type of transaction would result in fat bonuses for four years and a crash in the fifth, the employees would take the fat bonuses – the crash would not be their problem.

The City is extremely aware of some risks, but possibly insufficiently aware of others. For example, the investment banks have extremely sophisticated software for modelling market risk, but from the results that we now see, it appears that those who ultimately sanctioned the investment in the SIVs gave insufficient consideration to the risk in the underlying asset. There has been some press commentary suggesting that risk management departments were unhappy with the sub-prime deals, but that the traders applied pressure to be allowed to make markets in these products, and the traders won.

It is not an uncommon experience for risk managers to be over-ruled where it appears that there is a large profit to be made. If everything appears to be going very well and large profits are being made, what could possibly go wrong? In these circumstances, risk managers are regarded as party poopers, who would hamstring the organisation in its efforts to make money. The City is often seen as a young man's environment – risk accepting and intolerant of nannying. Observers have also noted a herd mentality – 'everyone else is making money from this, why not us?' The culture prevalent in the City does not tend to encourage excessive prudence.

The Financial Services Authority (FSA) is reported to be unhappy about the way that mark to market accounting has been applied, and it is easy to see why. Where the

full value of a transaction that will produce results over several years is fully accounted for in the first year and there is considerable uncertainty about the actual (as opposed to the projected) outcome, reported results can be unduly flattering.

### What we can learn

Before the current troubles, it was unthinkable that old and respected City giants could fail, despite the collapse of Barings Bank in 1995. There has been some suggestion that an answer to the current crisis is to form a bank that is 'too big to fail'. The collapse of such giants as energy trader Enron and Barings should have weaned us off the idea that size is any predictor of safety. If any organisation makes a sufficient number of wrong calls it will collapse. The concept of 'unthinkable' is a very dangerous one.

The way that an organisation rewards its employees may have unintended consequences. If it is in the interest of individuals to find ways of portraying the organisation's results in a flattering light, they may do so if the personal rewards are great enough. Similarly, it is important to understand what policies have been applied in producing accounts, the implications of the policies and the potential distortions they introduce. A set of audited accounts is the product of some raw data filtered through the organisation's accounting policies and subject to a number of opinions. It may appear that everything in the garden is lovely, but some of the plants may hide a snake.

Risk culture is a very important safeguard against collapse. This will be an interesting and on-going challenge for the City. Is it acceptable to have an approach to risk that gives great results for some years, but puts the world economy to the sword as a result? Or will it grasp the nettle and take a more holistic approach to risk management? Probably, once the dust settles, there will be calls for far stronger regulation. It is by no means easy to see how regulation can be strengthened effectively while still encouraging an appropriate level of risk taking. The seeds of the next collapse are probably being sown in the technical department of a financial institution somewhere in the world at this very moment. The problem is how to identify it?

None of this is rocket science. Companies collapse for very prosaic reasons, and the reasons are often very similar, irrespective of size. Some of the causes of failure of financial institutions are, in general terms, eerily similar to that of Enron before them. It remains to be seen whether we will learn the lessons, or will we allow history to repeat itself?

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# CAMPARI on the Rocks

Andrew Chapman

It is difficult to comment on the current credit crisis and the risk issues that surround it without appearing to be political, but I will try.

The first 26 years of my working life were spent in banking. I worked in many different roles, but for many of those years I was a lending manager. I will admit there were occasions when I got it wrong, but on the whole I would like to think I got it right and helped many businesses and individuals succeed.

During most of that time, lending decisions were based on a simple mnemonic, CAMPARI – character, ability, margin, purpose, amount, repayment and insurance, the latter referring to insurance in the broadest sense, as will be clearer later. These were described as the canons of good lending. They provided the banker with a tried and tested model for credit risk analysis, and helped ensure the correct risk/reward ratio.

Over time analysts realised that many of the factors that underpinned CAMPARI could in effect be scored, and so this model was gradually translated into what we now call credit scoring. So how is it that what appears to be a fairly robust model leads to irresponsible lending? Good question, and one I have often asked myself.

In 2007, my daughter wanted a mortgage. Her fiancé had had a job for a year or so, but she was still at university. To get the property they wanted, they needed to borrow almost five times their joint income, which included her fiancé's bonuses, her part-time income and a government grant she received. My expectation was that they would need dad's guarantee to provide the 'insurance', as from my experience their request would otherwise fail the CAMPARI test:

**Character** – They had no real track record, neither of them had a credit card nor, indeed, any real credit history. Also, the lender they had approached was neither my daughter's nor her fiancé's account holder.

**Ability** – Quite correctly the mortgage adviser requested a detailed budget planner so that they could demonstrate that they could afford the repayments, but given the reliance on grants, part time work and bonuses, affordability was at best questionable, even in the short term.

**Margin** – This is very much about the risk/reward ratio. The actual reward was very modest since the mortgage products on offer were very competitive and therefore had very fine interest margins, but on paper the risks were massive. However, at this point the housing market factor seems to have started to cloud any rational thinking.

**Purpose** – Mortgage lending for a house purchase would seem appropriate, a long term loan, for a long term purchase, and my daughter had no desire to borrow for any other purpose, or any more than was

needed, although I knew some lenders were prepared to lend up to 125% of the property value for a whole variety of purposes.

**Amount** – Many might recall that mortgage lenders used to work on simple multipliers as a guide to the maximum they would lend. These used to be set at around three times sole income, or 2.5 times joint, but over recent years these multipliers have become somewhat less restrictive. To borrow almost five times their income (much of which was indeterminable and unreliable) and almost the total value of the inflated price of the house would seem to be bordering on reckless. I again wondered to what extent this was influenced by the housing market boom.

**Repayment** – This relied in the short term on a government grant, earnings from part time employment and bonuses. In the longer term, it depended on my daughter securing full time employment on leaving university. Fortunately, the gamble paid off, but if it had not, I can only assume that the lender would have taken comfort from the steadily increasing value of the property, once again relying heavily on the housing boom.

**Insurance** – This really means security, and in this case meant the house. If the borrower fails to pay, then the lender seeks recourse to the security. Again, enormous emphasis was placed on the rising value of the asset, so much so that, as you have probably guessed, the mortgage was agreed on the spot, without a guarantee.

## Poor pawn brokers

How on earth did we get to this irresponsible credit culture? I feel certain that others would have been equally keen to lend to my daughter. Clearly complacency set in, driven by greed, because of the buoyant housing market. House prices were based on demand fuelled by access to almost limitless credit. The high proportion of lending to value was not seen as a problem; indeed we know that 125% mortgages were not at all unusual.

If you multiply my daughter's experience many million times, you end up with a totally distorted market, where profligate lending is the norm, which potentially has the makings of a global crisis.

What does this say about how lending decisions in banking have changed and why they have been allowed to develop in this way? The fact is that the regulator, the Financial Services Authority (FSA), knew about the problem even before taking responsibility for regulating mortgage lending!

Addressing mortgage lenders in 2003, Philip Robinson, a Director at the FSA<sup>1</sup>, used the CAMPARI model to emphasise his misgivings about the state of the mortgage market. He expressed real concerns about sub-prime mortgages, the rate of growth in mortgage credit and too much emphasis on the current and future

value of property. He likened their activities to pawn broking, and clearly in that regard he was correct, albeit hindsight has shown that they were very poor pawn brokers and should have stuck to banking.

His speech is quite prophetic and it is well worth reading the full text. But despite these dire warnings, the mortgage lenders failed to heed his advice and continued as before. More worryingly is the apparent inaction of the FSA given the evidence it had in its possession.

Why didn't the Government intervene? The answers may be quite simple. Robinson also pointed out that consumers cashing in on the value of their properties were supporting GDP growth. Another aspect to consider is the contribution that banks were making to the Treasury. In 2005, according to John Varley the CEO of Barclays<sup>2</sup>, the banking sector as well as contributing 7% to GDP, accounted for 25% of UK corporation tax. Barclays alone paid £3bn in tax.

Clearly, the banks and building societies ignored the canons of good lending, and as a consequence some very simple risk management principles. The regulator also seems to have abandoned basic risk principles. The Government on the other hand may have had different motives for its inaction. What is evident is that you abandon CAMPARI at your peril, be you a lender or a regulator!

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- 1 Robinson, Philip (2003). "The Mortgage Market and Credit Risk Management", CML/GEMI Credit Risk Management Workshop. FSA [online] Available from: <http://www.fsa.gov.uk/Pages/Library/Communication/Speeches/2003/SP149.shtml>
- 2 Varley, John (2006) "Financial sector profits keep the balance of payment afloat". Daily Telegraph online at : <http://www.telegraph.co.uk/finance/2947053/Financial-sector-profits-keep-the-balance-of-payment-afloat.html>

## The Naughty Years

Gerard Joyce

The first decade of the 21<sup>st</sup> century is not over yet, but already the naughty years have become 'the naughty years', which sums up what can only be described (in risk management terms) as the **tolerate** years.

Despite the warning signs of the Enron, Arthur Andersen and Tyco scandals and the dot.com bust, the nonsense continued. Even the mighty US *Sarbanes-Oxley* served only to fuel the compliance industry while being regarded as a spoil sport by some in the financial services sector.

With all the attention given to risk management since September 2001, one would think that this would have been a decade of risk management prowess. As a result of the introduction of risk management standards and frameworks, such as A/NZ 4360, COSO, Basel II, etc, we had better tools to manage the risks. Financial regulators in the developed world were to be the watchdogs and ensure that the financial community stayed within the boundaries.

So where did it all go so horribly wrong? Was it really the sub-prime market in the United States? That was certainly part of it, but not all of it. Allowing the investment banks to leverage up to ratios of 30 or 40:1 is closer to the truth. And individuals are not totally blameless; many borrowed sums that were beyond their

capacity to repay in anything but a growing market. We chose to forget the truism – *Values can go down as well as up*. Has the constant repetition of this message at the end of advertisements for financial products made us oblivious to its significance?

In my father's time, you could only get a mortgage or a loan if you could produce 20% of the money required to purchase the asset. This was a good control. It meant that the borrower had a history of saving and if the borrower defaulted, the lender had a claim on an asset that was highly likely to cover the debt. These were comfortable safety margins engineered in the same way you would design safety into a machine that could physically hurt someone. And in a similar way, people forgot the reasons for the controls or believed them to be too restrictive and relaxed them... until something broke. The financial system that world economies are built on just broke!

### Risk management's role in all of this

Did risk managers tell their boards that they were sailing into stormy waters? Are there many like Paul Moore, former Head of Group Regulatory Risk at HBOS, who feel that they were in a rowing boat trying to stop the tanker, when they really should have been the pilot employed to steer the boat through a challenging course?

Could the errors made be somewhat explained by moral hazard. Were those who took the risks immune from the consequences? Jérôme Kerviel's reckless trading at Société Générale was only one indicator of a systemic problem in the financial markets. How could he have gone undetected? He didn't. The warning signs were ignored.

Risk management controls are often perceived as limiting; they are supposed to be. Over-riding the safety controls on a cutting machine could cost you an arm or a leg. Doing this in financial markets has had a similar outcome for many. When you leverage at a ratio of 40, the growth is huge on the way up and the fall is steep on the way down.

The truth is that risk management is only now coming of age. For years risk managers have been pushing the elephant up the C-suite stairs. The professional risk manager wants or wanted to do the right thing for all the right reasons, but often was seen, and used, to ensure that the enterprise was 'compliant' with all relevant laws and regulations – a box ticking exercise and an ineffective use of a valuable resource.

Laws and regulations are by their nature generic and only define the minimum standard required. What risk management seeks is a maximisation of opportunity while minimising the downside. This is a giant leap beyond the line of compliance and where risk management belongs.

Risk management did not fail. Organisations failed in their implementation of risk management. Mostly the failure was in the way responsibility was delegated to a few individuals, but the authority to cry "stop" lay elsewhere. Risk manager is an unfortunate title as it conveys the impression that this person can manage all the risks an organisation faces. Everyone is a risk manager – or should be – and organisations need risk officers to direct and embed a culture of risk management. Realising that the leveraged growth model was unsustainable, some risk managers treated the risk and exited the highly leveraged products. When the dust settles, they will emerge as survivors, the first rocks to appear when the swamp starts to drain.

### The way forward

The significance of risk management has prompted rating agencies, like Standard and Poor's, to enhance their ratings process through a risk management review. They view enterprise-wide risk management as an approach to assuring the firm is attending to *all* risks, while setting clear expectations about which risks the firm will and will not take.

The planned release of the ISO 31000 risk management standard this year comes at a time when a new approach is required and renewed energy to appropriately and effectively manage risks must be found. To be effective, risk management must be

aligned with the organisation's objectives. Without this alignment, there is a risk that too much energy will be spent chasing risks of little consequence.

The new definition of risk (ISO 31000 and its Guide 73) is "the effect of uncertainty on objectives". This revised definition emphasises the **effect** of events on the achievement of enterprise objectives and correctly removes the focus from the events themselves. So you must define your objectives before you can begin to identify and manage the risks to them.

For example, if one of your objectives is to provide the best and most innovative financial services to customers, then you must measure what might be lost if you fail to achieve this objective – your customer retention rate. This is an accurate measure of your performance in the achievement of this objective.

For each objective you need to identify what matters and measure it. If you can measure it, you can put a number on what your tolerance is: what level of loss the organisation can sustain before it begins to hurt. All employees at all levels need to understand what level of risk the organisation is willing and able to bear and when limits are approached, appropriate corrective action should be a natural response.

### Principles

The new standard suggests several principles that should be adhered to if an organisation's risk management is to be most effective. Risk management should;

- create value
- be an integral part of organisational processes
- be part of decision making
- be systematic, structured and timely
- be tailored (to the context)
- be dynamic, iterative and responsive to change

Many leaders of financial institutions claimed not to have known the extent of the exposure their organisations faced. Incredible! Would you drive a car at 100mph without knowing that the brakes work? Informed decision making is core to effective risk management. Complex financial products and arrangements must be matched with appropriate management information systems. In this 200<sup>th</sup> anniversary year of the birth of Charles Darwin, it seems appropriate to quote him: "Ignorance more frequently begets confidence than does knowledge".

If we are to recover from this current crisis, then trust must be restored. Big time. Greater transparency must be achieved. Good risk taking must be rewarded and reckless behaviour must be punished. Focus on long term shareholder value must return. Stop looking at the share price every five minutes! Top executives should be rewarded by what they achieve over three or five years, not three months. Stakeholder theory and no longer principle-agent theory should drive corporate governance.

Employees, customers, suppliers and the community have also invested in organisations, and it is time that the organisations recognise that their needs and expectations must also be considered when key decisions are made. Enterprise risk management recognises all stakeholders and places appropriately high emphasis on communication. Perhaps 2009 will be the year when risk management comes of age and

perhaps the next decade will be known as the Terrific Teens, led by informed risk taking, where stakeholders who engage in the risk are bound to the consequences.

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## Three Opportunities for Risk Management

Clive Thompson

How on earth did it happen: a house is repossessed in West Virginia and the global financial system falls down!

- Was it a weakness in risk management?
- Can we make sure it never happens again?
- Are there any opportunities for risk management to grasp?

In this paper I intend to argue the answers to those questions are No, No and Yes, this crisis will reveal opportunities for risk management. They will flow from the need to increase transparency for external investors, to support governance structures better and to provide proof of professional risk management application through academic qualification – the IRM International Diploma.

But first, it is important to knock down any arguments that risk management got us into this mess, why it couldn't be avoided and why it will inevitably happen again.

### Was risk management to blame?

Well, it was forecast. Regulators warned against over-extending credit lines in 2005, 2006 and 2007. They knew the US tax system encouraged taking out loans and even rewarded top up mortgages which, as 'silent second liens', the original lender knew nothing about. There was data in 2006 to suggest defaults were on the increase<sup>1</sup>. Houses were being bought by people who were virtually guaranteed to be in negative equity 12 months after moving in. And the US legal system incentivises borrowers to just 'hand back the keys', increasing the risk of default.

There is evidence that participants did apply risk management and that they identified the threat. This comes from studies of how 11 major banks reacted to the initial shock and turmoil in financial markets in 2007, released in March 2008<sup>2</sup>.

Some banks correctly assessed the risks to their own portfolios, but they had insufficient information to identify the tsunami effect on the system which would strike from September 2008.

Some banks tried to take action to mitigate their exposure, but they could not transfer the impact of the system crashing. In effect, banks which took action were playing pass the parcel without leaving the room when the final unwrapping revealed an exploding bomb!

Those banks which were observed in March 2008 demonstrated the following:

Best Practices	Poor Practices
Sharing information freely and proactively across businesses with procedures for senior level challenge/action	Business areas making decisions in isolation, failing to see the full picture (incomplete information)
Consistent, independent validation and measurement of risk – or how risk profiles would change under challenging scenarios	Over-reliance on credit agency risk scoring, failing to challenge established practice
Managing risk by incentivising business lines to reflect the actual risk in their activity through internal pricing	Failing to access information across the organisation thereby unable to align their risk to their capital or liquidity positions
Using qualitative assessment to gain insight by means of flexible and dynamic risk scoring processes	Using outdated, static or inflexible assumptions which lacked perspective into the true nature of the risk

This last point needs to be highlighted. Risk professionals brought their own ideas and challenge to the data. Poor practice followed and established, almost tick box procedures.

We can all learn from the ‘genuine surprises’ that regulators observed<sup>3</sup>:

- The speed with which the banks were affected and the way the crisis spread so severely to all parts of the globe were unexpected. The inter-linkage and global nature of business introduce a level of fragility which should be catered for.
- The role of securitisation was seriously underestimated along with its impact on cash. It is very unlikely that financially engineered products will be embraced in the foreseeable future.
- The weakness of capital cushions was a shock; the models used only limited data when a longer perspective may have revealed concerns. Use as much data as possible.

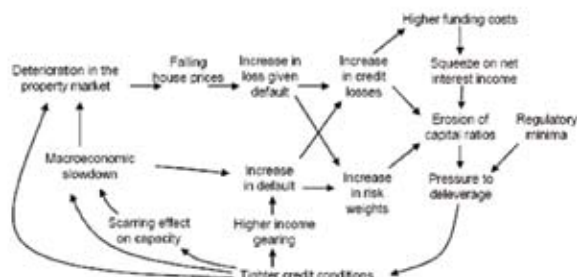
I question if individual institutions could or should have been aware of these issues and if they were whether there was any action they could have taken, other than closing down and returning shareholders’ funds. Banks operated within the rules laid down for the “system” which encouraged thin capitalisation (hence securitisation) and rating agency scoring among other problems.

I discuss later how I think regulation of financial markets will change and how I believe this will not only affect our banks but could have a creeping effect on the way we all do business, and hence manage risk.

### Can we make sure it never happens again?

The financial system is unique. It needs ‘faith’ to thrive, and perception causes cycles of behaviour for markets to act in a positive or negative manner. Currently the Bank of England is desperately trying to avoid negative cycle <sup>4</sup>:

### Risk and the Financial Crisis



(Source: Speech by Sir John Gieve, Deputy Governor of the Bank of England, to the Family Office Leadership Summit, London, 22 September, 2008)

The reverse took place in the lead-up to 2007: over-extended credit, over-inflated asset prices and under-

priced risk. Theoretically, long waves of economic activity occur every 40 to 80 years: severe downturns occurred in 1790, 1840, 1890, 1929, 1973, and now<sup>5</sup>.

A downturn every so often is necessary if we are to experience growth. The economy will eventually recover but future reverses will happen. The key is for regulators to identify and apply corrective measures in a timely fashion to minimise the impact.

### Regulation

The nature of regulation will change due to this crisis. I think regulators could force through ‘regime change’:

- Basle II could be re-drawn. The techniques where banks assess risks themselves and use credit rating agencies to support their assessment have both been found wanting<sup>6</sup>. Securitisations will be monitored more closely and risk managers will need to show regulators they are used to address risk profiles responsibly in future.
- Banks could be forced to build up capital and liquidity buffers in good times so as to have better cushions in bad times to avoid excessive procyclicality (the cycles described above). This will affect both state owned and independent banks and has significant implications for the cost of capital for all.
- Risk management in financial institutions will become more transparent. Regulation will demand banking products undertake rigorous risk analysis. The risk analysis techniques they develop may themselves seep out to the wider community, and indeed risk managers have tremendous opportunities as a result of this crisis.

We live in an increasingly regulated world and *if* certain organisations cannot be allowed to fail and *if* the taxpayer provides the safety net, *then* regulators have a *duty* to impose themselves much more in the intricacies of the system – and the state could legitimately take a wider role in economic activity. Increasing regulation will bring new risks, and costs.

In a global system, organisations can choose where to operate and how they are regulated. Global development is happening in China and the Far and Middle East where the state already plays a much greater role in economic activity and remained relatively unscathed. These countries do not participate in the way we currently regulate our systems, but they are being asked to help in the bail out. This dilemma will probably be addressed in the next five years.

### Three opportunities for risk management

#### External validation

Companies will increasingly have to demonstrate robustness in risk processes and procedures so that they can persuade investors of their worth. Risk officers can provide investors with a real sense of the

uncertainty surrounding the activities the organisation undertakes; the rating agency Standard and Poor's now includes enterprise risk management measures as a feature of its scoring methodology.

Statutory reporting is likely to become more frequent, albeit with shorter reports concentrating on risk metrics. Those metrics will be forward looking measures of the uncertainty surrounding future events and will be transparent. Risk management has the opportunity to develop these tools and techniques to bring clarity to the information available about risk profiles of companies.

#### Internal support

Board members will cry out for internal resource to stand apart from business lines and alert them to their risks, for instance, that suddenly successful business lines are precisely those which bring the greatest uncertainty. Risk management will need to verify such uncertainties independently. New ventures need to be subjected to appropriate opportunity risk management techniques developed by risk officers<sup>7</sup>.

Organisations will need to show their pay structures deliver risk-adjusted rewards in future, particularly in financial organisations<sup>8</sup>. Risk officers are best placed to support remuneration committees in strengthening incentives to behave prudently.

#### Professional qualification

To perform these functions effectively, indeed to become what I have alluded to as a risk officer, will require someone who can gain respect and so exert influence with fellow workers. The best way to do this is to be practical but also to have a theoretical understanding of risk and demonstrate academic achievement so that there is a ready agreement to the individual's knowledge and understanding of the principles and practices surrounding risk.

The IRM has grasped this challenge early by launching a graduate level International Diploma in 2007. We need to keep developing the Diploma's syllabus to include learning from events, such as the financial crisis, and to embrace advances in risk management that will evolve over the coming years.

*Clive Thompson FIRM is Project Director for Willis UK and Ireland.*

#### (Endnotes)

- 1 Bank of International Settlements, working papers no 259, "The housing meltdown: why did it happen in the United States?" Ellis, September 2008. This refers to the 60% to 75% of securitised mortgages in 2007 which were self certified, to teaser rates which were 3% to 4% cheaper for the first period and to negative amortisation loans which were offered where initial payments didn't even need to meet the interest payment
- 2 Senior Supervisors' Group, "Observations on Risk Management Practices during the Recent Market Turbulence" March 6, 2008
- 3 Malcolm Knight, General Manager of the Bank of International Settlements, "Now you see it, now you don't: the nature of risk and the current financial turmoil", speech delivered at the Ninth Annual Risk Management Convention of the Global Association of Risk Professionals, 26-27 February 2008.
- 4 Speech by Sir John Gieve, Deputy Governor of the Bank of England, to the Family Office Leadership Summit, London, 22 September, 2008
- 5 Smith, Marx, Kondratieff and Keynes, R.L. Norman, found at <http://www.southerndomains.com/SouthernBanks/> (10 Dec 2008)
- 6 Wade, R (2008): "The first-world debt crisis of 2007-2010 in global perspective", Challenge, vol 51, no 4, July/August, pp 23-54
- 7 Refer to IRM's Special Interest Group for Innovation, Value Creation and Opportunity. The author has benefitted from the input of the core team and particularly Mark Boulton, whose comments have been very helpful.
- 8 See Letter from FSA to CEOs 13 October 2008 subject: Remuneration policies

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- Designatory letters according to your membership grade

There are various grades of membership starting with Affiliate, which has no entry requirements and is open to everyone with an interest in risk management, through Specialist,

for those with a risk-related qualification, up to full Member and ultimately Fellow. Simply complete and return the application form from our website ([www.theirm.org](http://www.theirm.org)) or phone us on +44 (0)20 7709 9808 to join.

The Institute provides a broad range of courses to help you build your knowledge and skills. The International Certificate in Risk Management is an introductory qualification, with no entry requirement, which is studied through distance learning.

The International Diploma in Risk Management is the postgraduate qualification for the risk management professional. It is designed to equip today's practitioners to become the risk managers of tomorrow, through the development of a solid, progressive and practical set of skills which in turn enhance career portability, personal status and reward.

*Disclaimer: the opinions expressed in this publication do not necessarily reflect those of the IRM*