

Risk Management

MGM 510

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Lecture 7



The background features a series of vertical panels with rounded ends. The first panel on the left shows a person's hands typing on a laptop. The second panel shows a graduation cap icon. The third panel shows a play button icon. The fourth panel shows a target icon. The fifth panel shows an open book icon. The sixth panel shows a magnifying glass icon. The seventh panel shows a person icon. The eighth panel shows a bar chart icon. The ninth panel shows a line graph icon. The tenth panel shows a pie chart icon. The eleventh panel shows a scatter plot icon. The twelfth panel shows a bar chart icon. The thirteenth panel shows a line graph icon. The fourteenth panel shows a pie chart icon. The fifteenth panel shows a scatter plot icon. The sixteenth panel shows a bar chart icon. The seventeenth panel shows a line graph icon. The eighteenth panel shows a pie chart icon. The nineteenth panel shows a scatter plot icon. The twentieth panel shows a bar chart icon. The twenty-first panel shows a line graph icon. The twenty-second panel shows a pie chart icon. The twenty-third panel shows a scatter plot icon. The twenty-four panel shows a bar chart icon. The twenty-fifth panel shows a line graph icon. The twenty-sixth panel shows a pie chart icon. The twenty-seventh panel shows a scatter plot icon. The twenty-eighth panel shows a bar chart icon. The twenty-ninth panel shows a line graph icon. The thirtieth panel shows a pie chart icon. The thirty-first panel shows a scatter plot icon. The thirty-second panel shows a bar chart icon. The thirty-third panel shows a line graph icon. The thirty-fourth panel shows a pie chart icon. The thirty-fifth panel shows a scatter plot icon. The thirty-sixth panel shows a bar chart icon. The thirty-seventh panel shows a line graph icon. The thirty-eighth panel shows a pie chart icon. The thirty-ninth panel shows a scatter plot icon. The fortieth panel shows a bar chart icon. The forty-first panel shows a line graph icon. The forty-second panel shows a pie chart icon. The forty-third panel shows a scatter plot icon. The forty-fourth panel shows a bar chart icon. The forty-fifth panel shows a line graph icon. The forty-sixth panel shows a pie chart icon. The forty-seventh panel shows a scatter plot icon. The forty-eighth panel shows a bar chart icon. The forty-ninth panel shows a line graph icon. The fiftieth panel shows a pie chart icon. The fifty-first panel shows a scatter plot icon. The fifty-second panel shows a bar chart icon. The fifty-third panel shows a line graph icon. The fifty-fourth panel shows a pie chart icon. The fifty-fifth panel shows a scatter plot icon. The fifty-sixth panel shows a bar chart icon. The fifty-seventh panel shows a line graph icon. The fifty-eighth panel shows a pie chart icon. The fifty-ninth panel shows a scatter plot icon. The sixtieth panel shows a bar chart icon. The sixty-first panel shows a line graph icon. The sixty-second panel shows a pie chart icon. The sixty-third panel shows a scatter plot icon. The sixty-fourth panel shows a bar chart icon. The sixty-fifth panel shows a line graph icon. The sixty-sixth panel shows a pie chart icon. The sixty-seventh panel shows a scatter plot icon. The sixty-eighth panel shows a bar chart icon. The sixty-ninth panel shows a line graph icon. The seventieth panel shows a pie chart icon. The seventy-first panel shows a scatter plot icon. The seventy-second panel shows a bar chart icon. The seventy-third panel shows a line graph icon. The seventy-fourth panel shows a pie chart icon. The seventy-fifth panel shows a scatter plot icon. The seventy-sixth panel shows a bar chart icon. The seventy-seventh panel shows a line graph icon. The seventy-eighth panel shows a pie chart icon. The seventy-ninth panel shows a scatter plot icon. The eightieth panel shows a bar chart icon. The eighty-first panel shows a line graph icon. The eighty-second panel shows a pie chart icon. The eighty-third panel shows a scatter plot icon. The eighty-fourth panel shows a bar chart icon. The eighty-fifth panel shows a line graph icon. The eighty-sixth panel shows a pie chart icon. The eighty-seventh panel shows a scatter plot icon. The eighty-eighth panel shows a bar chart icon. The eighty-ninth panel shows a line graph icon. The ninetieth panel shows a pie chart icon. The ninety-first panel shows a scatter plot icon. The ninety-second panel shows a bar chart icon. The ninety-third panel shows a line graph icon. The ninety-fourth panel shows a pie chart icon. The ninety-fifth panel shows a scatter plot icon. The ninety-sixth panel shows a bar chart icon. The ninety-seventh panel shows a line graph icon. The ninety-eighth panel shows a pie chart icon. The ninety-ninth panel shows a scatter plot icon. The hundredth panel shows a bar chart icon.

Ch#7
Enterprise Risk
Management

Chapter
07

Topics to Cover in Week 7

- Enterprise Risk Management
- Features of Enterprise Risk Management
- Definition of enterprise risk management
- Benefits of enterprise risk management
- ERM and business continuity
- Importance of Resilience

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Enterprise Risk Management

- The term enterprise or enterprise-wide risk management (ERM) that is now the most widely used and generally accepted terminology for this broader approach.
- The fundamental idea behind the ERM approach is to move away from the practice of risk management as the separate management of individual risks.

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Enterprise Risk Management

- ERM takes a unifying, broader and more integrated approach.
- The ERM approach means that an organization looks at all the risks that it faces across all of the operations that it undertakes.

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Enterprise Risk Management

- ERM is concerned with the management of the risks that can impact the objectives, key dependencies or core processes of the organization.
- ERM is concerned with the management of opportunities, as well as the management of control and hazard risks.

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Enterprise Risk Management

- With the ERM approach, the relationship between risks is identified by the fact that two or more risks can have an impact on the same activity or objective.

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Enterprise Risk Management

- The ERM approach is based on looking at the objective, key dependency or core process and evaluating all of the risks that could impact the item being evaluated.

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Enterprise Risk Management

- Organizations practice risk management in a number of different ways.
- However, there are many common features to most of these approaches.

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Enterprise Risk Management

- Following section gives an overview of the features of enterprise risk management as a comparison to the silo-based approach whereby risk management tools and techniques are applied to different types of risks independently.

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Features of ERM

- 1** Encompasses all areas of organizational exposure to risk (financial, operational, reporting, compliance, governance, strategic, reputational, etc).
- 2** Prioritizes and manages those exposures as an interrelated risk portfolio rather than as individual 'silos' of risk.
- 3** Evaluates the risk portfolio in the context of all significant internal and external contexts, systems, circumstances and stakeholders.
- 4** Recognizes that individual risks across the organization are interrelated and can create a combined exposure that differs from the sum of the individual risks.

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Features of ERM

- 5** Provides a structured process for the management of all risks, whether those risks are primarily quantitative or qualitative in nature.
- 6** Seeks to embed risk management as a component in all critical decisions throughout the organization.
- 7** Provides a means for the organization to identify the risks that it is willing to take in order to achieve strategic objectives.
- 8** Constructs a means of communicating on risk issues, so that there is a common understanding of the risks faced by the organization, and their importance.

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Features of ERM

- 9** Supports the activities of internal audit by providing a structure for the provision of assurance to the board and audit committee.
- 10** Views the effective management of risk as a competitive advantage that contributes to the achievement of business and strategic objectives.

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Definition of ERM

RIMS

Enterprise risk management is a strategic business discipline that supports the achievement of an organization's objectives by addressing the full spectrum of its risks and managing the combined impact of those risks as an interrelated risk portfolio.

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Definition of ERM

COSO

Enterprise risk management is 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, manage risk to be within its risk appetite and to provide reasonable assurance regarding the achievement of entity objectives.

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Definition of ERM

IIA (Institute of
Internal Auditors)

A rigorous and co-ordinated approach to assessing and responding to all risks that affect the achievement of an organization's strategic and financial objectives.

HM Treasury

All the processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them and monitoring and reviewing progress.

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Benefits of ERM

Financial

- Reduced cost of funding and capital
- Better control of CapEx approvals
- Increased profitability for organization
- Accurate financial risk reporting
- Enhanced corporate governance

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Benefits of ERM

Infrastructure

Efficiency and competitive advantage

Achievement of the state of no disruption

Improved supplier and staff morale

Targeted risk and cost reduction

Reduced operating costs

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Benefits of ERM

Reputational

Regulators satisfied

Improved utilization of company brand

Enhanced shareholder value

Good reputation and publicity

Improved perception of organization

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Benefits of ERM

Marketplace

Commercial opportunities maximized

Better marketplace presence

Increased customer spend (and satisfaction)

Higher ratio of business successes

Lower ratio of business disasters

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ERM and Business Continuity

- There is an important relationship between enterprise risk management (ERM) and business continuity management (BCM).

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ERM and Business Continuity

- The risk assessment that is required as part of the risk management process and the business impact analysis that is the basis of business continuity planning (BCP) are closely related.

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ERM and Business Continuity

- The normal approach to risk management is to evaluate objectives and identify the individual risks that could impact these objectives.

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ERM and Business Continuity

- The output from a business impact analysis is the identification of the critical activities that must be maintained for the organization to continue to function.

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ERM and Business Continuity

- Based on the definition of ERM set out above and the fact that it should be applied to the evaluation of core processes, it can be seen that the ERM approach and the business impact analysis approach are very similar, because both approaches are based on the identification of the key dependencies and functions that must be in place for the continuity and success of the business.

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ERM in Energy and Finance

- Risk management in the energy and finance sectors has become a well-developed specialist branch of the discipline.
- In the finance sector, the objective of an ERM initiative is to enhance shareholder value by:

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ERM in Energy and Finance

1. Improving capital and efficiency by providing an objective basis for allocating resources and exploiting natural hedges and portfolio effects.

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ERM in Energy and Finance

2. Supporting financial decision making by considering areas of high adverse impact and by exploiting areas of risk-based advantage.

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ERM in Energy and Finance

3. Building investor confidence by stabilizing results and protecting them from disturbances and thus demonstrating proactive risk stewardship.

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ERM in Energy and Finance

What is Basel II?

- Basel II is the second set of international banking regulations defined by the Basel Committee on Bank Supervision (BCBS).
- It is an extension of the regulations for minimum capital requirements as defined under Basel I.

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ERM in Energy and Finance

The Basel II framework operates under **three pillars**:

1. Capital adequacy requirements
2. Supervisory review
3. Market discipline

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ERM in Energy and Finance

- Banks have been subjected to Basel II for some time and are preparing for implementation of the Basel III requirements by 2019.

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ERM in Energy and Finance

- The statement that risk management has failed in banks is more difficult to contradict.
- However, the reality is that it was not the failure of risk management principles that caused the banking crisis.
- It was the failure to correctly apply those principles.

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ERM in Energy and Finance

Many banks made two simultaneous mistakes:

- An accurate risk and reward analysis was not undertaken, so that banks made decisions on the basis of the rewards available, rather than taking a more balanced view of the risks involved in seeking those higher rewards.

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ERM in Energy and Finance

- Quantification of the level of risk involved was not accurate, because the banks were taking such a risk-aggressive approach that certain events were considered to be so unlikely that they could be ignored.

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Importance of Resilience

- One of the best-established resilience standards is the Organizational Resilience Standard (ASIS SPC.1-2009) published by the American National Standards Institute.

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Importance of Resilience

- This ASIS standard takes an enterprise-wide view of risk management, enabling an organization to develop a comprehensive strategy to prevent, when possible, prepare for, mitigate, respond to, and recover from a disruptive incident.

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Importance of Resilience

- The overall approach is that a resilient organization needs to ‘prevent, protect and prepare’ in relation to resources and assets and at the same time be able to ‘respond, recover and review’ when a crisis occurs.

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Importance of Resilience

- The emergence of resilience is an opportunity for risk management and business continuity specialists to work together to ensure a more coordinated approach to enterprise risk management, business continuity and crisis management.

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Importance of Resilience

- There are three behaviors that should be achieved by an organization if it is to achieve increased resilience:
 - ✓ awareness of changes in the external, internal and risk management environments, so that constant attention to resilience is ensured;

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Importance of Resilience

- ✓ ‘prevent, protect and prepare’ in relation to all types of resources, including assets, networks, relationships and intellectual property;

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Importance of Resilience

- ✓ ‘respond, recover and review’ in relation to disruptive events, including the ability to respond rapidly, review lessons learnt and adapt.



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Thank You

