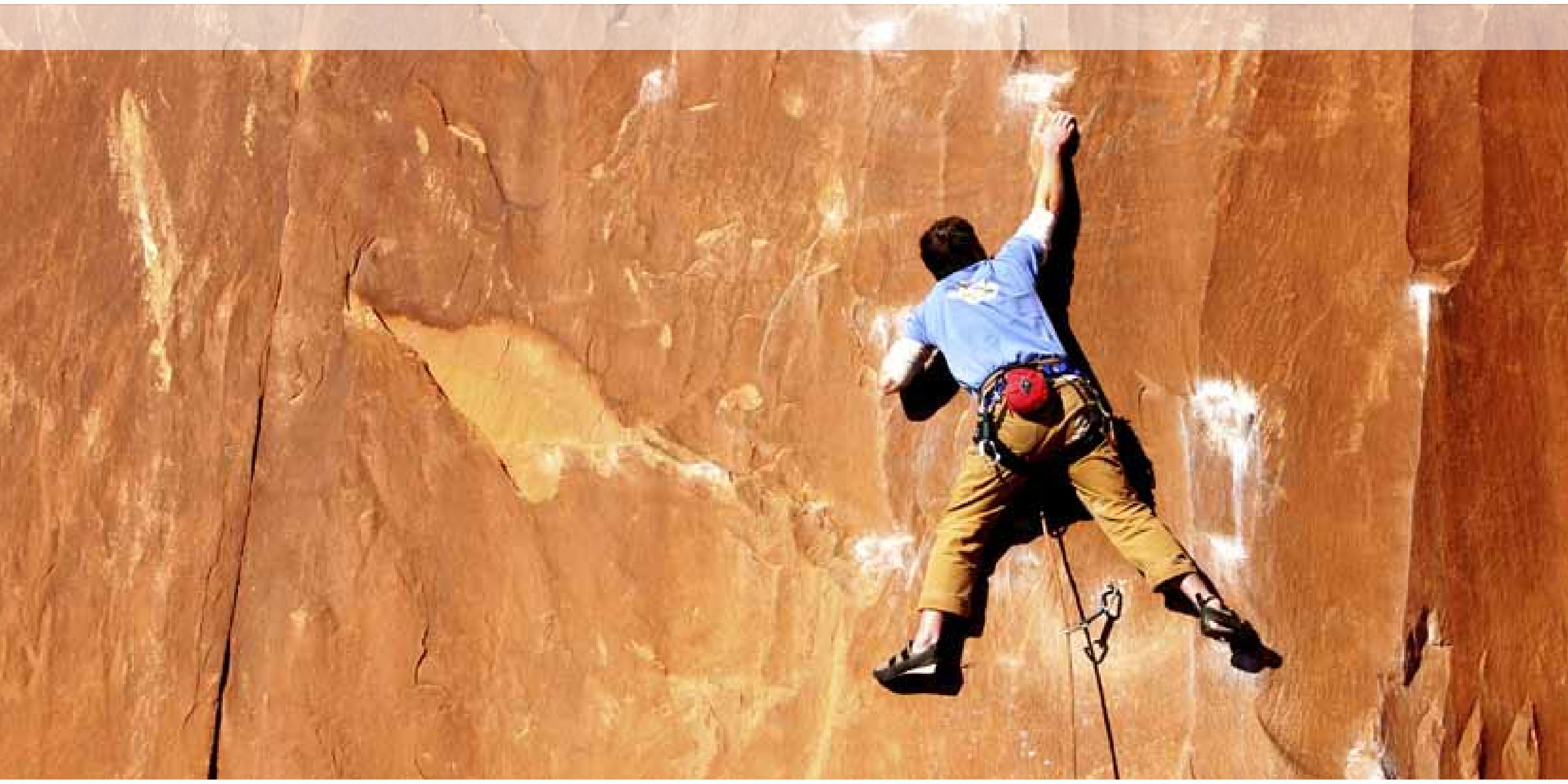
A research report by Whitehead Mann

Risky Business

How to manage risk in the wake of the financial crisis



Whitehead Mann Partnership

Risky Business – introduction

Our clients are naturally asking whether their own risk management function is fit for purpose in the current downturn.

The financial crisis and the subsequent sharp economic slowdown has raised profound questions about the way that companies assess and manage risk.

The financial services industry in particular has been shown to have had huge exposure to high-risk instruments and markets, without either a clear understanding of the risks being undertaken or a strategy to mitigate the potential consequences.

As the crisis in the banking and financial services sector spills out into the wider economy, our clients are naturally asking whether their own risk management function is fit for purpose in the current downturn. Does the company have the right people? Are they properly resourced? Are they able to influence the company's executive managers and directors?

To answer these questions, Whitehead Mann's Legal, Governance and Risk Practice surveyed more than 50 senior risk management professionals at FTSE 100 companies, covering such functions as internal audit, legal, compliance and company secretarial. We also interviewed seven FTSE 100 Audit Committee Chairs to gain their perspective.

Their opinions provide a fascinating and timely insight into how companies manage risk – and most importantly, how they should. Their opinions echo our own views based on our experience of working with clients in this field.

Our definition of a risk manager

For the purposes of our survey, we have defined 'risk manager' broadly as anyone whose role touches on managing and mitigating risk, whether that be financial, operational or market risk, or the company's reputation as a whole.

Our survey therefore includes risk managers from a wide variety of functions including legal, audit, compliance and health and safety.

Survey findings

Whitehead Mann surveyed more than 50 risk professionals at FTSE 100 companies and found:

Influence

- Only half of risk managers described the risk management functions within their organisations as influential, with one third (35%) saying they were 'quite influential'. Nearly one in eight risk managers (13.5%) said they were not influential in their organisations.

A changed attitude to risk

- Nearly 80% agreed that they have noticed a changed attitude in the past year in terms of how their organisation approaches the management of risk.
- All respondents said they had recently seen a closer alignment of risk management functions (i.e. legal, audit, compliance, health and safety, etc) with virtually all (97%) saying that even closer alignment would be beneficial.

Roles and responsibilites

- More than three-quarters (77%) said that providing wise counsel to the CEO and senior management was a 'very important' aspect of their job.
- Two thirds (67%) also saw raising awareness of risks and changing the organisation's culture as 'very important'.
- Nearly all respondents (97%) cited the need for a risk-aware corporate culture as a very important factor in establishing effective risk management within an organisation.
- Only one third of respondents saw preventing the business from taking excessive risk as a 'very important' part of their job.

Organisational structrure

- More than three quarters of companies (77%) have a designated person with specific responsibility for leading risk management.
- Two thirds of respondents (65%) said the appointment of a head of risk management with regular access to executive management and the board was a 'quite important' or 'very important' step in terms of establishing effective risk management.
- Nearly two thirds (63%) of respondents said that their company had a risk committee, though a quarter said that this had not enabled them to be more effective in their job.
- Nearly two-thirds (63%) said that an organisational structure that integrates all aspects of risk management was very important. The appointment of a board-level risk officer was seen as very important by only 10% of respondents.

These findings support our own views on how companies should alter their management of risk in response to the current crisis.

Three main themes present themselves from the individual survey findings above, namely:

- **Not all risk managers are sufficiently influential**
- **All organisations should consider having a Chief Risk Officer – but good ones are in short supply**
- **Risk managers need to develop the skills to be change managers**

Implications

Are your risk managers sufficiently influential?
Only half of the risk professionals surveyed described the risk management functions in their organisation as influential, and a quarter of those with a dedicated risk committee said it had not enabled them to be more effective.

These findings suggest that too many risk managers are insufficiently influential when it comes to making their views known at the top of their organisation. In the current market, where the painful cost of inadequate risk management is being demonstrated every day, it is surprising that risk managers do not believe themselves to have more clout.

The risk management function will only be truly influential when an organisation has both a corporate culture that takes risk management seriously and a risk function led and staffed by high quality individuals. One without the other will not work. We have found in our work for clients that the attributes of those high-quality individuals who lead risk management functions are not limited to excellence in their technical discipline – such people also need first-rate judgement, strong communication skills, the ability to build relationships and a talent for surrounding themselves with the best people.

People with these broader skills become influential as they win the ear of the CEO, gain respect across the organisation and are sought out for their opinion on issues beyond their specific area of technical competence.

In some organisations, we have seen the Chief Risk Officer or General Counsel become widely viewed as the third most important or influential executive behind the CEO and CFO. One Audit Chair went further, saying: "I would expect to see an influential risk person, whether that be a General Counsel or Head of Internal Audit, acting as a regular sounding board for the CEO. If I didn't, then that might alert me to a poor risk management culture".

Gaining the ear of top management may occur naturally, as high quality risk officers gain the trust of the executive suite. But, in many cases, a more formal structure may be required, with a senior risk manager being granted regular access to the board to present their views. Our survey found that every risk manager believed that access to the board would enable them to be more influential. We have seen this in practice at some companies where it is not only the Head of Internal Audit who has regular access to the Audit Committee but also the General Counsel.

A better integrated risk function is another route to greater influence. Individual functions, such as internal audit, compliance, legal, and so on, can become 'siloed'; indeed, our survey found that nearly two-thirds said that an organisational structure that integrated all aspects of risk management was a very important factor in ensuring that risks were dealt with effectively.

Risk committees are another formal structure that can help risk managers exercise their authority more widely. In the words of one Head of Internal Audit: "What gets measured gets done". Over 80% of our respondents who described themselves as influential said that they had a risk committee and had benefited from it. However, simply forming a committee will have no effect in improving risk management by itself, unless they find a receptive audience in the executive suite and board. This perhaps explains why a quarter found that a risk committee did not help make them more influential, and serves yet again to underscore the vital importance of corporate culture in determining whether an organisation takes risk seriously.

High calibre people working in an integrated team can ultimately only prove influential if the board and management team are prepared to listen.

Implications

All organisations should consider having a Chief Risk Officer – but good ones are in short supply
More than three quarters of organisations have a designated individual (other than the CEO) who has overall responsibility for managing risk. This individual is often the Chief Risk Officer but may be known by another title; in many organisations, the General Counsel, CFO or Head of Internal Audit operate as a Chief Risk Officer in all but name.

The risk managers we surveyed had witnessed the closer alignment between risk functions over the past couple of years, though it's equally clear that this process has further to run. Virtually all our respondents called for even closer alignment between various risk functions in future. But the question remains: how far should this alignment go, and is the logical end point the appointment of a Chief Risk Officer within all organisations?

At face-to-face interviews carried out in conjunction with our survey, two FTSE 100 companies discussed with us the benefits of creating such a role. Others were more sceptical. Chairs of audit committees, in particular, received the idea coolly. One Audit Chair accepted that "risk functions huddling together for warmth was a good thing" but like other audit chairs suggested that giving one person overall responsibility for all risks could lead to line managers in the organisation shrugging off responsibility for managing risk in the belief that the issue was being dealt with elsewhere.

Risk managers who were in favour of a Chief Risk Officer rejected this argument, insisting that the culture of the organisation should ensure that risk continues to be owned by the business as a whole. It then becomes the Chief Risk Officer's job to lead a holistic approach to risk management and ensure that the issues remain firmly at the top of the corporate agenda. So instead of having a number of different voices in the organisation vying for attention and, often, the duplication of resource, there is one voice responsible for ensuring that the appropriate level of senior management attention is directed to the issue. It is worth adding that a number of risk managers admitted that the biggest barrier to the creation of a Chief Risk Officer in their organisation was internal politics.

In our experience, the appointment of a Chief Risk Officer or equivalent can work well, assuming that an individual with the right skills can be found to take the role. In practical terms, there is a shortage of candidates who have a working knowledge of legal, internal audit, risk and compliance and so their credibility is challenged at the most senior levels on these topics. However, those that have made a success of the Chief Risk Officer role have built strong teams around them and successfully leveraged the expertise that exists in the team. They also enjoy a strong relationship not only with the CEO but also with other members of the senior management team. In addition, effective Chief Risk Officers have an ability to "stay above the fray" and project a calm image of authority.

Risk managers also need to be change managers
A General Counsel of a FTSE 100 company told us that organisations should be wary of focusing too heavily on the detail of risk management at the expense of the company's broad approach to risk. "Calling it 'risk' is the wrong starting point; it should be about culture and understanding," he said.

All risk managers agreed that the key to effective risk management is the culture of the business. The typically expressed view was that even with all the technical skills in the world, brilliance in commercial judgement and superior relationship building skills, a senior risk manager will not ultimately succeed if the organisation is culturally averse to sound risk management. But corporate cultures are not static. At a minimum, they need maintenance and repair, but often they need more fundamental change to reflect shifts in the marketplace or economic landscape. Given this, should risk managers at the most senior levels be able to influence and even drive cultural change?

During the course of our face-to-face meetings, a number of risk managers agreed that this was an increasingly critical aspect of the job, and over 60% of respondents to our survey described "Changing the culture of the organisation so that it takes risk management more seriously" as a very important part of their job.

But exerting such influence, and ensuring that risk management issues receive prominence, requires a risk manager who is both trusted and respected by the CEO. It is little surprise, therefore, that more than two-thirds (70%) of our respondents thought that "Providing wise counsel to the CEO and Senior Management" was a very important responsibility. Without playing such a role, influencing the culture is impossible.

Our survey respondents were divided on whether they should lead in preventing the business from taking excessive risk. The Audit Chairs we interviewed were clear that the board sets the organisation's appetite for risk, and that the executive team is then responsible for managing accordingly. We were surprised by this divergence of views, but suspect it reflects individual sector trends and the different risks being managed within them. Over the next few years, we would expect to see much greater agreement amongst those in risk management functions about their core responsibilities.

As search consultants, we find that most risk management candidates emphasise their technical credentials, their ability to mitigate risks and their successes in dealing with issues after a crisis. But the importance of culture means a risk manager's expertise as an influencer and 'change agent' will become one of the key determinants of their ability to operate at the most senior levels.

As the recession bites over the coming months, most companies will be undergoing fundamental change. Chief Risk Officers and other top risk management professionals, who have not hitherto seen themselves as playing a part in driving organisational change, should find themselves called upon to assist. As companies seek to introduce a more responsible attitude to risk into the company's culture, and make it part of the performance appraisal and reward structures, the best risk managers will add 'change manager' to their job description.

The exceptional risk management candidates to some extent already emphasise their change management experience and influencing skills. However, these individuals are rare and organisations will need to give careful thought as to how to expose their risk managers who, in the formative years of their career develop highly specialised technical expertise, to the experiences which will enable them to be effective change managers.

All respondents agreed that their responsibilities fall into the following six categories:

- Technical assessment/raising awareness of risks.
- Mitigation of risks.
- Changing the culture of the organisation so that it takes risk management more seriously.
- Preventing the business from taking "excessive" risk.
- Providing wise counsel to the CEO and senior management.
- Crisis management and/or dealing with issues in the wake of a crisis.

Conclusion

It is undeniable that broad issues of risk management will dominate business debates over the next few years, and companies will come under pressure to demonstrate their risk management credentials to investors, regulators and the media alike.

In our view, companies that develop the most effective risk management functions - functions which assist both in minimising the bad decisions but also in making the good decisions even better - will be those that have not only developed the best integrated structures internally but have equipped their risk managers to lead and influence the company's cultural approach to risk.

Appendix: Comprehensive findings

Whitehead Mann surveyed 50 risk management professionals from FTSE 100 companies from November 2008 to January 2009.

The comprehensive results were as follows:

- Only half of risk managers described the risk management functions within their organisations as influential, with one third (35%) saying they were 'quite influential'. Nearly one in eight risk managers (13.5%) said they were not influential in their organisations.

- Nearly 80% of risk professionals either agree or strongly agree that they have noticed a changed attitude in the past year in terms of how their organisation approaches the management of risk.

- Regulation was cited by more than two-thirds of respondents (69%) as the main driver of this more serious attitude to risk management. A response to the tougher trading conditions was cited by nearly two-thirds (65%), while 44% cited the credit crunch. Shareholder demand (41%), fear of litigation (38%) and directors' fear of personal liability (31%) were also seen as primary drivers.

- More than three-quarters (77%) said that providing wise counsel to the CEO and senior management was a 'very important' aspect of their job. Two thirds (67%) also saw raising awareness of risks and changing the organisation's culture so that it takes risk management more seriously as 'very important'.

- Only one third of respondents saw preventing the business from taking excessive risk as a 'very important' part of their job. Forty percent saw this as a 'quite important' part of their responsibilities, while nearly a quarter (23%) described it as neither important nor unimportant.

- All respondents said they had seen a closer alignment of risk management functions (i.e. legal, audit, compliance, health and safety, etc) over the past few years, although nearly all (97%) said that even closer alignment would be beneficial.

- More than three quarters of companies (77%) have a designated person with specific responsibility for managing risk, although there was considerable diversity in terms of this person's job title with chief risk officer, group risk director, head of compliance, business unit managers and the finance director all being named as the designated person with responsibility for risk.

- In terms of establishing effective risk management, 97% of respondents cited the need for a corporate culture that takes risk management seriously as a 'very important' factor. Nearly two-thirds (63%) said that an organisational structure that integrates all aspects of risk management was 'very important'. The appointment of a board-level risk officer was seen as 'very important' by only 10% of respondents.

- Two thirds of respondents (65%) said that the appointment of a director representing risk management who does not sit on the board but has regular access to both the executive and non-executive directors was a 'quite important' or 'very important' step in terms of establishing effective risk management within an organisation.

- Nearly two thirds (63%) of respondents said that their company had a risk committee, though a quarter said that this had not enabled them to be more effective in their job.

- Nearly two thirds of respondents (64%) said that internal audit had the highest profile within their organisation in terms of managing risk, with the legal department being cited by half. Compliance (21%) and company secretarial (14%) were seen as having the lowest profile.

- In more than 60% of cases, the head of the relevant department sits on the executive management committee.

- Companies domiciled in the Eurozone were seen as having the weakest risk management culture or regulatory regime, compared to the UK and US. UK-domiciled companies were seen as having the strongest risk management culture and were cited by 86% of responses as working within the soundest regulatory regime.

- The role of risk manager was seen as more influential/high profile, and better remunerated, in the US than in the UK or Eurozone.

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Acknowledgements

We would like to thank the interviewees who gave up their time to take part in this project and those who completed the survey.

About Whitehead Mann

Whitehead Mann provides executive search and leadership development services and operates internationally in the world's most important economic centres. Our clients include global multinationals, FTSE 100, Fortune 500, and CAC 40-listed companies; and national and regional organisations.

We help our clients and candidates address business, leadership and career issues at Board and senior management level. Our services cover: search including both executive and non-executive directors, leadership evaluation and development, talent management and due diligence.

We work as a single team globally, ensuring that our clients benefit from our deep sector and functional expertise, irrespective of location.

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