


Enterprise Risk - Credit Risk - Market Risk - **Operational Risk** - Regulatory Compliance - Securities Lending

Understanding the Boundaries Between Credit and Operational Risk



Presented by:
Eric Holmquist
Managing Director, ERM Practice
Accume Partners

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ABOUT RMA

Founded in 1914, The Risk Management Association is a not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk principles in the financial services industry. RMA promotes an enterprise approach to risk management that focuses on credit risk, market risk, and operational risk.

Headquartered in Philadelphia, Pennsylvania, RMA has 2,500 institutional members that include banks of all sizes, as well as non-bank financial institutions. They are represented in the Association by more than 16,000 risk management professionals who are chapter members in financial centers throughout North America, Europe, and Asia/Pacific.

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ABOUT THE AUTHOR

Eric Holmquist is a Managing Director of Accume Partners. He has over 30 years of experience in the financial services industry, with experience covering all areas of bank operations. He has developed risk management, executive reporting and information security programs, and is skilled in creating operational efficiency and risk alignment. Prior to joining Accume, Holmquist was President of Holmquist Advisory, LLC, a consulting practice focused on enterprise risk management within the financial services industry. The practice focused on risk governance, risk assessment and reporting, as well as risk management practices for compliance, information security, information technology, business continuity planning and third parties. Previously, he also served as VP, Director of Operational Risk Management for Advanta Bank Corp. where he was responsible for the development and oversight of all aspects of the bank's operational risk management program.

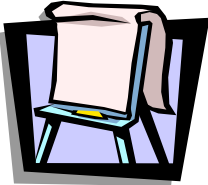
Eric has long been recognized as a thought leader in the areas of risk management, technology and information systems, change management and information security, and is a frequent speaker and author on these topics. He has also written over 50 published articles. He graduated summa cum laude from Villanova University with a degree in leadership studies.

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AGENDA

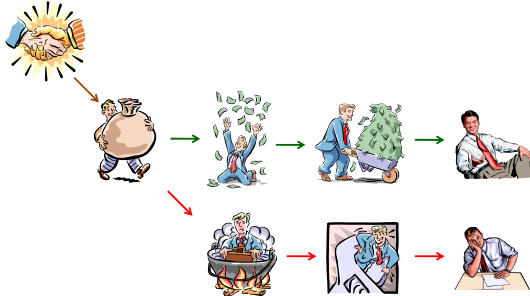
- The Lending Lifecycle
- What Boundaries?
- Awareness
- Accountability
- Actionability
- Q&A



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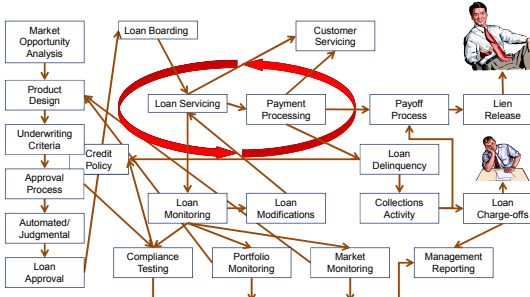
THE LENDING LIFECYCLE



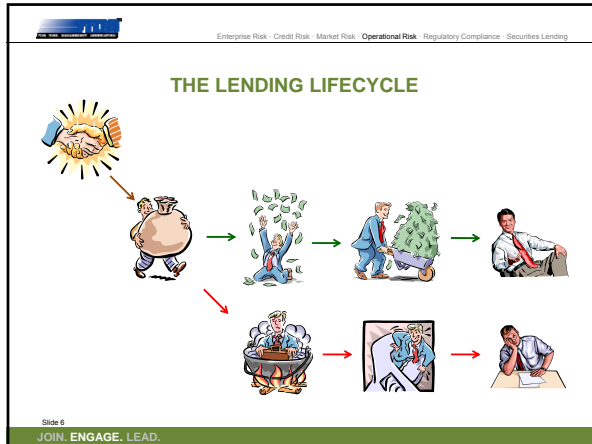
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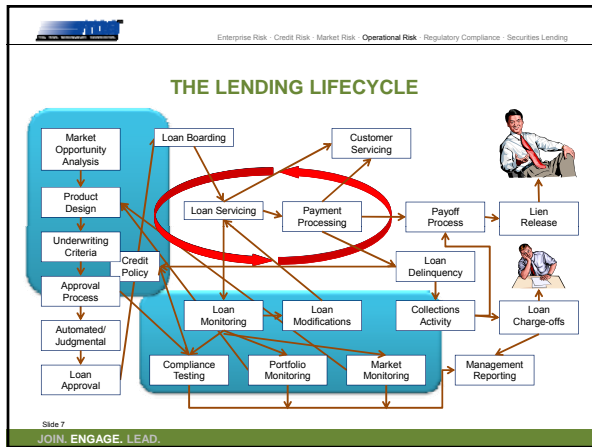
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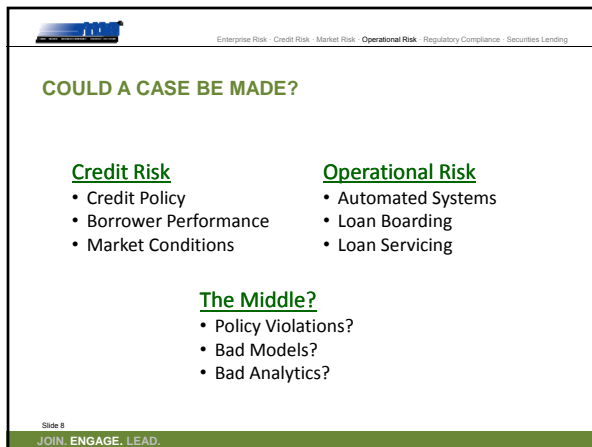
THE LENDING LIFECYCLE



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MANAGING THE BOUNDARIES

Risk Segments
What?
Where?
When?
Why?

Credit Market
Operational
How?

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Strategy Execute Monitor

- **Strategy** – Risks related to the strategy, objectives and organizational design.
- **Execution** – Risks related to the implementation of the strategic objectives.
- **Monitoring** – Risks related to the ongoing monitoring and analysis of the enterprise.

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Business is a lifecycle of perpetual design, execution and review.


Strategy Execute
Monitor

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Business is a lifecycle of perpetual design, execution and review.

That lifecycle is comprised of a large number of individual processes.




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Business is a lifecycle of perpetual design, execution and review.

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Each process has embedded within them a range of risks that need to be identified, assessed and managed.


- Credit Risk
- Interest Rate Risk
- Liquidity Risk
- Operational Risk
- Compliance Risk
- Strategic Risk
- Price / Market Risk
- Technology Risk
- Reputation Risk

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This requires a sound ERM approach.

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UNDERSTANDING EMBEDDED RISK

Commercial RE Lending			
Credit policy	Application process	Portfolio monitoring	Credit Risk
Product design	Automated and	Loan monitoring	Interest Rate Risk
Lending criteria	Judgmental approval	Market monitoring	Liquidity Risk
Approval authorities	Boarding process and	Fraud monitoring	Operational Risk
Geographic focus	systems	Compliance	Compliance Risk
Concentration levels	Servicing	Quality control	Strategic Risk
Sales teams	Customer service	Internal Audit	Price/Market
Staffing levels	Loan payoff/lien		Technology
Marketing	release		Reputation
Laws and regulations	Collections		

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The bank's ability to successfully manage the boundary between credit and operational risk is directly correlated to its ability to get past its operational silos.



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COMMON TROUBLE SPOTS

- Models
- Policy
- Roles and responsibilities
- Siloed operations
- Automated systems
- Change management
- Analytics and reporting



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Awareness

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DOCUMENTATION

- End-to-end process maps are a must.
- The roots of all risk run through assumptions.
- No automation without documentation.
 - Use, logic, assumptions, error states, etc.
- Roles and responsibilities clearly defined.
- Authority levels clearly defined.
- IF IS ISN'T WRITTEN DOWN YOU DON'T GET CREDIT.

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OPERATIONAL TRANSPARENCY

- Cross-functional risk assessments.
- Cross-functional scenario analysis.
- Recognize the two risk discipline's difference in stakeholders (credit = few versus operational = many).
- Empowerment through leadership.
- Visibility on risk transfer.
- In short, leave your egos at the door.

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BUILD COLLABORATION

- Finders, minders and grinders.
- Deputize staff.
- Forbid absolutes (no such thing as a pure risk type).
- Effective change management.
- Awareness breeds appreciation.
- Appreciation breeds cooperation.
- Encourage, acknowledge and reward creativity!

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STARTS WITH SENIOR MANAGEMENT

- Tone means everything. EVERYTHING!!!
- The CCO also has operational accountability.
- The COO also has credit risk accountability.
- Committees aren't accountable, people are.
- We must stay focused on the fact that everyone is striving for the same goal – profits.

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QUALITY CONTROL

- QC must be viewed as a secondary control.
- Who is testing assurance w/credit policy?
 - Both a control and governance question
- Who will review policy exceptions?
- Policy compliance linked to compensation.

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“LOCKER INSPECTION!”

- Untested = too much risk (period).
- All key models should be reviewed at least annually:
 - Validate all logic
 - Validate all assumptions
 - Verify data (in and out)
 - Test models
- Who will be doing the testing?
- What will happen with the test results?

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CHANGE MANAGEMENT

- Cross-functional input is very important.
 - Impact analysis must be broad
- When it comes to change, transparency is critical.
- This includes policy changes.
- Remember, all risk assessments are built on a set of assumptions at a given point in time.

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Actionability

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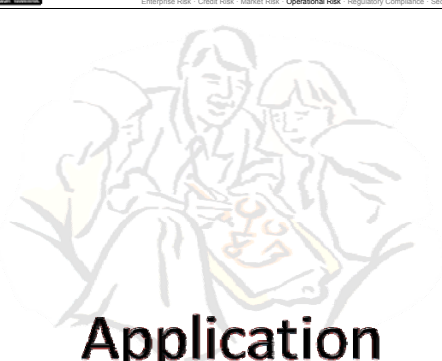
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CULTURE IS KEY

- Ability to openly discuss risk and failure.
- Focus must always be:
 1. What happened?
 2. What does it mean?
- What could go wrong? What did we miss?
- The word "blame" does not exist in the lexicon of risk management. Poor managers ask: "Who's at fault?" Good managers ask: "How do we fix it, both now and for the future?"
- Nor does the phrase "Because I said so."

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Application

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MANAGING MODELS


- Essentially about one thing, the assumptions.
- Documentation is essential.
 - Gets assumptions out in the open and allows for cross-functional review
- Think about the broad context of risk for each key model.
- No untestable black-boxes.

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POLICIES

- Policies must be socialized before being changed.
 - Who are the stakeholders?
- What is the true impact of the policy?
- What is the full impact of the changes?
- Who is accountable?
- Who will monitor?
- Consequences?



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ROLES AND RESPONSIBILITIES / SILOS


- Separation of duties is fine, cross-trained is even better.
- Supervisors and above should have risk management built into their performance evaluations.
- There really shouldn't be any scenario where someone can say, "Oh, that's his risk, not mine."
- This also requires definition of risk appetite.
- Everyone should be thinking like a risk manager.

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AUTOMATED SYSTEMS

- Document, document, document.
- Focus on assumptions.
- Automation doesn't eliminate risks, just changes them.
 - Often changing a credit risk to an operational one
- Contingencies?



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ANALYTICS AND REPORTING

- Be very careful with “risk-based” reporting.
- Remember, risk management is fundamentally focused on two things:
 - Our strategy
 - Our execution (people, processes, technology)
- Risk types are lenses through which we view the world.
- Never lose site of the fact that it takes a village.

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TO SUMMARIZE

- Everything starts with culture and tone.
- Awareness breeds accountability.
- Document, document, document.
- Test any model of consequence.
- Transparency is a very good thing.
- Always remember, categorization is only important for one very small and only marginally valuable part of the conversation.
- Mature risk management means cross functional.
- It's a risk, manage it.

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