Risk Management in the Financial Services Sector Conference

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Risk Management and Compliance

Regulating Risk Management

European Institute of Management & Finance

MAP S.Platis

What is Risk?

- **Risk is Uncertainty**

  - If we know the impact of an event that shall occur we bear <u>no risk</u>
  - Risks arise (and must be managed) out of the uncertain impact of an uncertain event.

It is this the management of this uncertainty that authorities across the world seek to regulate.

Stages of Risk Management

- Risk identification
- Risk Assessment (measurement, and tolerance limits)
- Risk Mitigation
- Risk Monitoring

Measuring Risk
(its easy … in theory)

- To measure risk one needs to assess;
  a) the likelihood of a certain event occurring, and
  b) the impact sustained if a certain event occurs

the possible outcomes are charted onto a Risk Matrix

		Impact of event					
Probability of event occurring		V. Low	Low	Moderate	High	V. High	Critical
	Expected	A	B	C	D	E	F
	V. High	A	B	C	C	D	E
	High	A	A	B	C	C	D
	Moderate	A	A	A	B	C	C
	Low	A	A	A	A	B	B
	V low	A	A	A	A	A	A

Mitigating & Monitoring Risk

- The goal of **risk Mitigation** is to either:
  a) Reduce the probability of an adverse event occurring, or
  b) Moderate the impact in the event that an adverse event occurs

- **Risk Monitoring** is the process of keeping track of the identified risks. It entails selecting risk indicators (early warning indicators) and overseeing their performance within a framework of predetermined parameters. The process is ongoing and monitoring is done at regular intervals (ideally continuously).

What are Regulators trying to achieve by regulating Risk Management

- Introduce minimum Risk Management standards (and bring about a level of uniformity)
- Benchmark/rank market participants against each other in terms of risk
- Identify, assess, mitigate and monitor systemic risks (identify contagion risk)
- Encourage market participants to think critically about risk and introduce (in a structured way) risk management in a company's decision making process
- Achieve market discipline

… to name a few

What do Regulators … regulate? (1)

- **Risk identification**
  - In addition to the risks identified in primary legislation regulators issue secondary legislation to address specific risks (and impose requirements regarding the management thereof)
- **Risk Assessment (measurement)**
  - The regulatory framework often provides for the calculation of certain types of risk (e.g. Credit Risk Weights under the Standardized approach for calculating Credit risk). A number of complex methods and instruments are available. Regulators encourage risk measurement practices commensurate to the operations of each company

What do Regulators … regulate? (2)

- **Risk Mitigation**
  - By introducing regulation aimed at either:
    a) reducing the likelihood of an adverse even occurring (e.g. controlling /banning certain types of activities), or
    b) reducing the impact of an adverse event when it occurs (e.g. through limits for example to exposures against certain types of instruments or type of clients/industries)
- **Risk Monitoring**
  - Regulators typically require companies to systematical submit returns on a number or risk metrics. (e.g. Capitalization levels, large risk concentrations, cash deposits accepted etc.)
  - Companies have broad discretion in the way they monitor risks. Nevertheless, there are requirements for documenting monitoring

Compliance … another control function

- A key task of the Compliance Function is to manage the Compliance Risk.
- Compliance risk is the risk of:
  - legal or regulatory sanctions, financial loss, or loss to reputation an institution may suffer

  as a result of:

  - its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice
- As with any other risk the objective is to:
  - <u>identify</u>, <u>assess</u>, <u>mitigate</u>, and <u>monitor</u> compliance risks

Risk Culture

- **Risk Management is as much about culture as it is about processes and regulation**
- Risk Management, Compliance and Corporate Governance, in today's global financial sector share some common origins and have evolved in tandem.
- All three disciplines aim to transform financial institutions so that controls and risk management are not seen as externally imposed constrains but rather as best practices that protect and support them.

Thank you !