# NEW STUDY SHOWS DIVERSE ‘BEST PRACTICE’ STANDARDS WITHIN RISK MANAGEMENT INDUSTRY

By Helena Bachmann

**May 20, 2008 –** Geneva, Switzerland - Even the most conservative company executive will likely agree that taking risks is an inherent part of doing business – as long as sound risk management policies are implemented and adhered to.

A just-released study by two industry veterans benchmarks the approaches being taken and focuses on how effectively governance and risk management are being pursued by Boards and the risk control organizations of major companies. The study was presented late last month in Chicago at the Loyola University Center for Integrated Risk Management and Governance symposium entitled *Corporate Boards: Managers of Risk, Sources of Risk,"* and will be published in their monograph series later this spring.

The recent sub-prime crisis has not only exposed the possible deficiencies in the risk control and management structures, but also suggests a lack of a comprehensive and integrated approach to risk mitigation.

In January and February of this year, Michael A.M. Keehner of Columbia Business School and David R. Koenig, head of Ductilibity, LLC, a U.S.-based private research and governance advisory firm, carried out an in-depth study of cross-industry risk practices of 65 major international companies, represented by Board Directors, Chief Risk Officers, CFOs, and other C-Level executives.

Among the examined topics were questions of whether companies are diligently exercising risk management as an element of governance, how (and by whom) the measures are being implemented, how the risk management practices are being improved, and what the reporting structure for the risk management organization is.

The findings, says Mr. Koenig, “are all the more relevant, given the extent to which top-level practices differ. There are a wide variety of current approaches to the implementation of risk management, even within the same industry.”

Indeed, the study, entitled: *The Relationship Between Boards of Directors and their Risk Management Organization: Are Standards of Best Practice Emerging?* clearly shows that “a definition of applied best practices of risk management within a governance structure does not yet exist, and there are some gaps in the existing ones, ” Mr. Keehner notes. “However, there are patterns emerging in the position of risk management relative to the Board, which committees have responsibility for oversight of the risk management organization, and the extent to which risk management is used.”

As long-time financial sector executives, Mr. Keehner and Mr. Koenig have an insider’s grasp of the challenges facing Boards and risk professionals, who are pursuing risk management and governance to reduce the costs of financial distress, develop financial plans and funding for investment programs, and stabilize cash dividends. Besides teaching at CBS, Mr. Keehner serves on the Board of Oppenheimer Holdings and is a former executive and Board member of Kidder Peabody Group. Mr. Koenig is a past Chair of the Board of Directors of the Professional Risk Managers' International Association, and led the development of three risk management departments at various industry firms.

The practice of formal identification and management of risks has been accelerating since the mid-1990s, when a series of corporate mishaps focused attention on the need for efficient risk control practices. In the past decade, however, "the field has evolved from a technical discipline focused on specific exposures, to an expectation of shareholders, regulators and others affected by the performance of governance at publicly held companies," Mr. Koenig says. "And from our survey responses it is clear that the companies that participated in our study – many of them global leaders in their field – have rapidly advanced the effectiveness of the interaction between the Board of Directors and the risk management organization over the past few years."

The study further shows that, as companies better understand their specific needs and adapt to new demands, substantial changes are occurring in risk management and governance schemes.

"We found that risk management is placed very high within the executive hierarchy and most businesses have risk policies in place with either direct or indirect reporting of their RMOs to the Board," Mr. Keehner notes.

The survey found that the RMOs role is crucial in an organization's quest for an effective, narrowly-focused risk management, and, consequently, the preservation of its long-term capital. One respondent said that the primary purpose of his company's RMO is "to ensure there are no surprise losses and to make sure we are properly compensated for the risks we take."

However, despite concerted efforts toward elimination of the gaps in risk mitigation practices – as evidenced in the survey -- some shortcomings still remain. "Some firms may be over-confident that their risk policies are understood throughout the company, whereas in fact education programs for new and existing employees appear to be lacking," Mr. Koenig says.

The study was aimed at Board of Directors "but it's highly relevant for CROs as well," Mr. Koenig notes. "The Board needs to know whether they have the 'correct' or 'industry standard' model in place in terms of their risk management reporting structure. This is critical information at a critical time for governance, as the demand is growing for talent at the Board level capable of understanding the complex financial structures and risks that today's changing global markets present."