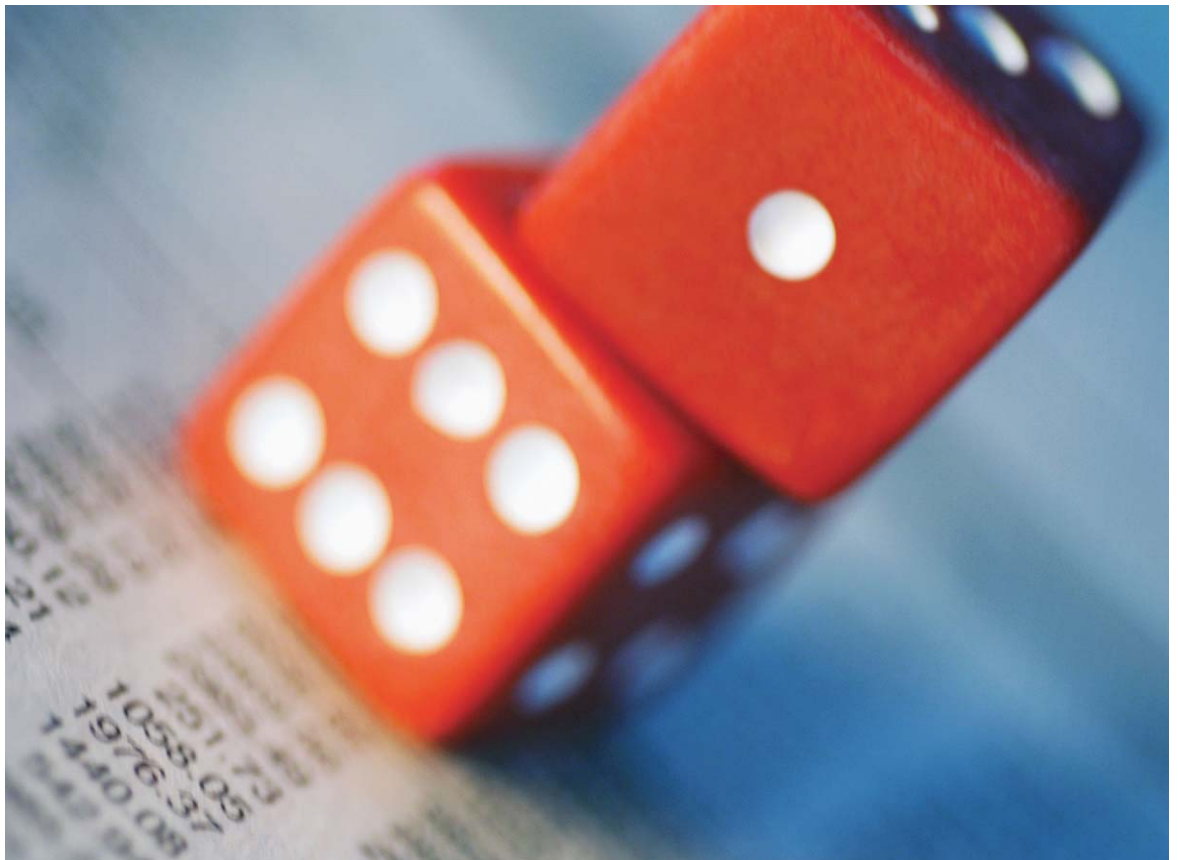


# The evolving role of the CRO



**A report from the Economist Intelligence Unit**

**Sponsored by: ACE, Cisco Systems, Deutsche Bank and IBM**



## Preface

*The Evolving Role of the CRO* is the first in a series of reports from the Economist Intelligence Unit's Global Risk Briefing, a research programme targeted at senior executives responsible for managing corporate risk. Alasdair Ross was the author of the report, and Gareth Lofthouse was the editor. The Global Risk Briefing is sponsored by ACE, Cisco Systems, Deutsche Bank and IBM.

The research for this paper is based on a survey of 137 senior risk managers, as well as interviews with chief risk officers. The Economist Intelligence Unit bears sole responsibility for the content of this report.

Our thanks are due to everyone who shared their time and insights during our research. We are also grateful to the Professional Risk Managers International Association (PRMIA) for helping us to reach a wide range of senior risk managers.

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### Executive summary

**F**or a corporate post with only a decade of history, the chief risk officer (CRO) attracts a lot of attention. CROs have consolidated their position in the financial sector, where they began, and are increasingly to be found in other industries. As companies seek to respond to increased regulatory pressures and a growing array of business risks, the CRO is emerging as one of the most important positions in the management team.

A new survey of 137 senior executives from the Economist Intelligence Unit reveals how the CRO's role is evolving in the light of new trends and a broad range of emerging risks. Based on the findings of this research, plus interviews with several practising CROs, this report provides insights into the main challenges and issues facing top risk managers today.

Key findings of the research include the following:

- **CROs are growing in number and influence.** The role of CRO is well entrenched in financial services, and will become more commonplace in other industries over the next two years. Forty-five percent of all companies in the survey have already appointed a

CRO, while a further 24% will do so within two years' time. Only 31% of companies have no plans to appoint a CRO, and even here, the concept of integrated risk management at a high level of seniority is broadly embraced. The survey also indicates that the new risk overseers wield significant power. They play a critical role in enabling the business to make sound investment decisions and in enforcing better standards of governance, and most of them report directly to the board or the CEO.

- **Regulatory compliance is the top priority for risk management.** Regulatory risk ranks as one of the top two threats to global business, say risk managers in our survey, and regulatory compliance is the CRO's primary responsibility according to the majority of executives. The importance of assuring business continuity also figures prominently, but is seen as declining sharply over time—particularly in the financial sector where alternative sites and redundant systems will increasingly offer a realistic solution. Monitoring emerging risks and extending risk principles into wider business strategy are seen as more important tasks for the future.

#### About the survey

The findings in this report are based on a survey of 137 senior executives responsible for risk strategy. A total of 30% of respondents were senior risk managers, and 11% were CROs. A further 17% were chief executives and 12% were chief financial officers.

Among the companies responding to the survey, 57% were from the financial services sector. Respondents from 16 other industries participated, including professional services, energy sector companies, IT and technology firms, and manufacturers. The survey was conducted in April 2005.

- **The best CROs bring a "big picture" perspective.** The key benefit of having a CRO, according to 52% of executives in the survey, is their ability to expand risk management to encompass a broader range of risk issues. However it is unlikely, and possibly not even desirable, to find a CRO that has expertise in everything from financial risk management to IT network issues or the specific risks pertaining to different markets. The best CROs tend to have a broad business background, combined with the communication skills required to influence both the board and the managers and employees responsible for making day-to-day decisions.



● **Integrating risk systems and processes is the CRO's single greatest challenge.** Risk managers in the survey rank the IT challenges of integrating risk systems and processes as their top obstacle to success. This reflects the difficulty firms face in capturing data on risk events, and on integrating those data from a multitude of systems to build a clear and accurate view of risks across the business. Financial services companies in particular struggle to integrate risk systems, to capture data on risk events, and to measure operational risk.

As a high-profile role with reporting lines directly to the board or the CEO, the post of CRO is attractive for ambitious executives. But the task of expanding risk management from its origins in the corporate finance function to encompass a much broader array of risk issues remains hugely challenging. This paper

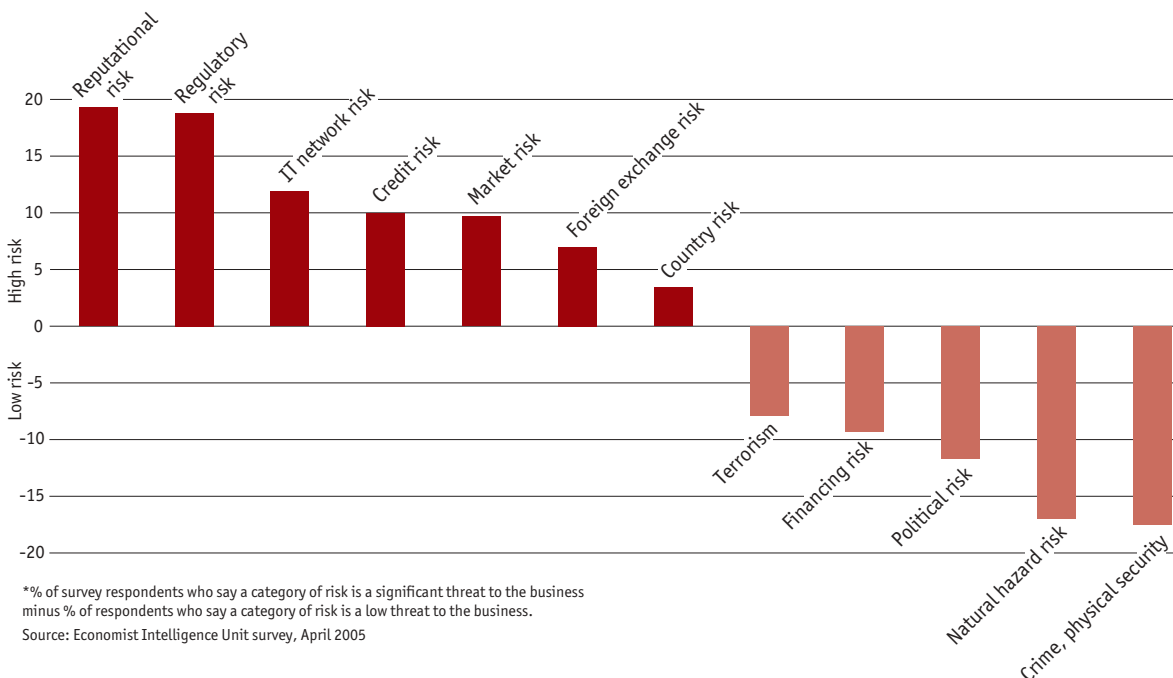
sheds light on the issues that CROs will need to contend with over the next three years, and identifies what kind of skills and strategies risk managers will need to be successful in a fast-evolving business environment.

## The emergence of the CRO

If the concept of risk as something to be measured and controlled goes back to renaissance figures such as Pascal and Bernoulli, the emergence of the chief risk officer is somewhat more recent. In fact, it can be dated exactly: to August 1993, when GE Capital gave James Lam a job that brought together management of credit risk, market risk and liquidity risk, and he coined the term chief risk officer for his business cards.

Mr Lam's appointment was not a response to the

**Category Risk Barometer**  
Average score for each risk category\*

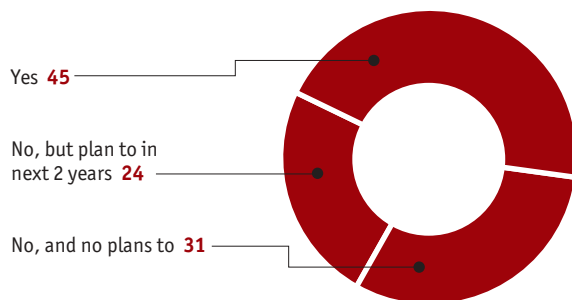


\*% of survey respondents who say a category of risk is a significant threat to the business minus % of respondents who say a category of risk is a low threat to the business.  
Source: Economist Intelligence Unit survey, April 2005



## The evolving role of the CRO

**Has your company appointed a chief risk officer (CRO) or equivalent?**  
(% respondents)



Source: Economist Intelligence Unit survey, April 2005

events people now immediately associate with the rise of risk management as a focus of board-level concern. This was before the succession of egregious governance failures exemplified by Enron, WorldCom and Tyco. It was before the dot-com bubble had inflated, let alone burst. It was before, even, rogue trader Nick Leeson had exploited the lack of integrated risk management at Barings Bank to such catastrophic effect.

Nevertheless, the breadth of responsibility Mr Lam suddenly found himself with did reflect change in the world of finance. Deregulation, consolidation, the development of new financial instruments and the growth and integration of capital markets were all sucking financial institutions into an ever broader, ever more complex operating environment. Systemic glitches such as the savings and loan bail-out in the US and the Latin American debt crisis had demonstrated the way problems could ripple out well beyond their origin. The hour of the CRO had arrived; Mr Lam just happened to be the first to give it a name.

Since then, numerous corporate governance scandals and a wave of new regulations have made firms (not to mention their shareholders) acutely aware of the need to raise the status and influence of risk management within the business. Moreover, the remit of the new risk managers is expanding. In the past, risk managers were usually focused on

overseeing financial risks. By contrast, our survey shows that today's firms see reputational and regulatory risk as the top threats facing global business, and the realm of risk management has had to expand accordingly.

This complex risk environment has set the stage for the risk manager's ascent into the top echelons of corporate management. Our survey shows that CROs are becoming increasingly commonplace, at least in the financial services industry where 61% of firms in the survey had already appointed a CRO. The role is also fairly well established in the energy sector, where regulatory pressures are also prevalent. For now, CROs remain more of a rarity in other industries, but this is likely to change, with 24% of all respondents indicating that their firms will appoint a CRO within the next two years.

## Man in the middle

What do companies hope to achieve by appointing a CRO? The main benefit of having one top-level executive with overall responsibility for risk, according to the survey, is to expand risk management to encompass a wider range of enterprise risks. Hence CROs are typically tasked with bringing an integrated approach to risk management, using tools such as a risk matrix to build a picture of risks across the entire business.

The CRO centralises risk management, but also brings several other benefits. One is to understand relationships between risks within separate business units that may never have emerged before. This is becoming more important given the increasing diversity and complexity of global businesses, where a risk that appears acceptable to the manager of an individual business unit may be inappropriate from the point of view of the enterprise as a whole. Using a comprehensive risk matrix, CROs can identify such linkages across the business and manage them more effectively.



**What in your view are the greatest benefits of having a single manager with overall responsibility for risk such as a CRO?**  
(% respondents)



Source: Economist Intelligence Unit survey, April 2005

The second most important way CROs benefit the business is by enabling firms to make decisions based on a better appreciation of the relationship between risk and reward. Enabling the business to make better investment decisions was cited as a key benefit of having a CRO by 43% of executives in the survey. A similar proportion of firms believe their top risk manager will help enforce better standards of governance at a time when firms must guard their brands against the slightest hint of impropriety.

Advocates for the CRO position argue that enterprise risk management (ERM) requires the focus of a dedicated senior executive. A CEO or CFO is unlikely to have time to get to grips with IT network risks, or to undertake the massive exercise involved in building a picture of operational risk. By contrast, CROs can concentrate on the various aspects of enterprise risk management, gaining appropriate insight across all functions where risks may threaten the enterprise.

## The makings of a top risk executive

This is not to say that a CRO must be a master of all trades in the enterprise. On the contrary, the likelihood of finding an individual with the background and time to get to grips with every subdiscipline of risk management, from credit and market to network and operational risk, is unrealistically ambitious.

“No CRO will have a command of all the range of issues that managers deal with,” says Malcolm Aish, until recently the group risk director at NM Rothschild & Sons and today a teacher and consultant on risk. “My style is to co-ordinate and be aware of risk, but not to take decisions.”

Even if available, a risk polymath might not be the most desirable candidate. A CRO who is presented as the ultimate expert on risk in every business unit and the final arbiter of how managers operate is likely to alienate other managers and persuade them to adopt defensive strategies. In effect, managers in such a situation are likely to see the CRO as a risk to their own autonomy.

This is the opposite of what integrated risk management demands. CROs are most effective when they provide the board with a clear vision of where enterprise risks lie, help define a policy for distributing and offsetting those risks, and work to communicate that vision so that individual managers understand and support it. A successful CRO does not command from above. Instead the CRO sets a framework for risk management, while day-to-day decisions on what is or isn't an acceptable risk fall to managers and employees in the frontline of the business. This issue of ownership is key: “Responsibility must be passed down to managers,” says Mr Aish. “Each unit manages its own risk—according to a group policy and within a framework, but it's their risk.”

Such a role requires broad-based business skills



### CROs: important or impotent?

The number of CROs may be growing, but does this new breed of risk manager have the clout to deliver real change? Or is the appointment of CROs simply a type of corporate “window dressing” designed to reassure investors and regulators that the firm has a sound risk strategy?

Certainly the window-dressing theory appears to be contradicted by our survey: questions with a bearing on the issue show that the view of risk management as PR is generally discounted. For example, when asked to identify the key benefits of having a single manager with overall responsibility for risk, respondents place increasing trust between the company and its shareholders third-last on the list, and increasing trust with customers second-last.

In a similar vein, where respondents are asked to

prioritise the tasks facing risk managers, educating investors on the organisation’s risk management strategy is among the lowest scorers. While there is no doubt of the importance of reassuring stakeholders that a comprehensive and effective risk management is in place, CROs are responsible for implementing the system, not for getting the message out once they have done so.

CROs also appear to benefit from strong backing from the board, according to the survey. When questioned on the main obstacles facing senior risk managers, for instance, the difficulty in gaining board-level support for risk initiatives is the lowest-scoring option of all. In return, CROs believe one of their primary responsibilities is to keep the board informed of significant risk issues.

more than expertise in specialised areas of risk management—a fact which is confirmed by the survey. More than 60% of executives cited the ability to understand business issues as a critical skill for an effective risk manager, compared with only 37% who

believe that technical risk management skills were essential, and 31% who said that a strong record in finance was important. The ability to communicate risk issues to employees and other corporate stakeholders is also vital, according to over half of executives in the survey.

#### What skills and experience are most important in an effective risk manager? (% respondents)



Source: Economist Intelligence Unit survey, April 2005

### Obstacle course

Corporate leaders may support the idea of integrated risk management, but a range of challenges make this difficult to accomplish. Foremost among these is the IT challenge of consolidating multiple risk systems and processes, at least for financial services companies in the survey. This is a particular problem in the context of compliance projects for Sarbanes-Oxley or Basel II, where regulatory reporting rules require data to be regularly updated from a hodgepodge of applications and databases.

Financial services companies also struggle to measure operational risks, an issue which is made all



the more difficult by the challenge of obtaining sufficient data on events to support risk modelling. “Operational risk management is still more of an art than a science. The quantitative tools just aren’t there,” argues John Wilton, vice president for strategy, finance and risk management at the World Bank. The World Bank uses a software tool to evaluate operational risk based on responses to detailed questionnaires sent to all departments once a year. Risks are scored, aggregated and colour coded to highlight areas of concern. “After three years, we’re beginning to see changes over time,” Mr Wilton says, “but we still have a long way to go.”

There is a danger, too, of over-reliance on analytical tools at the expense of intuition. “Eyes and ears are the most important tools,” Mr Aish says. “You’re looking for threats to the company that others are not finding. Barings sent auditors out to Singapore, but they didn’t spot Nick Leeson.”

In the non-financial sector, the main obstacle facing risk managers is the difficulty of managing risk across globally dispersed operations, which figures only third in the list for the financial sector. Non-financial firms are also concerned about the difficulty of managing risks posed by business partners such as suppliers and outsourced service providers. Both come above the IT challenge in the list of obstacles facing risk managers outside finance.

Another challenge executives face in implementing integrated risk management is in the strains it places on organisational structure, particularly in organisations that have grown through acquisitions and accretions. As each new business unit is bolted on to the corporation, a potentially new structure, business culture, organisational system and technological backbone is inherited. Full integration into the parent is expensive, difficult, and, from some business points of view, may be inappropriate and

**Main obstacles for risk managers**

Average % score given by respondents for each obstacle\*



\* % of survey respondents who say this issue is a major obstacle minus those who believe it is not a major obstacle  
Source: Economist Intelligence Unit survey, April 2005

risky in itself. The result is a constellation of interests where each unit may be optimally tuned to its own aims and priorities, but where integrating them to get the best results is deemed too difficult.

This chimes with the experience of Mr Aish: “The main difficulty is a cultural one. Is the role accepted throughout the organisation? The risk is the small group of individuals who are not willing to co-operate. They are not hard to detect, but they’re senior people and managing them is difficult.”

At the World Bank, it seems this battle has been won. “The first challenge was to overcome scepticism,” says Mr Wilton. “We’ve achieved that.” But new challenges quickly arise. “The output from the risk assessment needs to be translated into an action plan,” he adds. “There needs to be a formalised process of follow-up, so it builds on successes and lets you take risk management to another level.”





## The road ahead

Integrated risk management is a relatively new discipline, and one where priorities and strategies are likely to evolve rapidly. The dynamic nature of the profession is demonstrated in the survey, with risk managers being asked to identify their top priorities currently, compared with how they expect these priorities to shift three years from now.

Regulatory compliance emerges as the overriding focus for risk managers today, and will remain the top priority in three years' time. This reflects the CRO's importance in guiding the company's response to regulatory requirements, and suggests that firms believe that compliance requirements will continue to place heavy demands on their businesses for many years to come. In other areas, however, the survey suggests there will be a shift in the focus of risk management over the next three years.

Informing the board on risk issues is the second most important priority for risk managers today, but its importance declines sharply over time relative to

other risk management tasks. Similarly, business continuity, defined as the ability to sustain operations in the event of a disaster, is seen as the third most important priority for risk managers today. However, for financial services firms it becomes considerably less important over time, possibly because many of these companies will have completed the construction of alternative business sites and duplicate networks in this timeframe. In other sectors, where operations are harder to duplicate, this priority continues to figure at second place on the list in three years' time, immediately below regulatory compliance and ahead of informing the board.

Other issues that are deemed a relatively low priority today will assume greater importance for risk managers in the future. Identifying and monitoring emergent risks rises sharply up the list of priorities among all respondents, from fourth now to second most important issue in three years' time. This probably reflects the increased pace of change in the risk environment, with new risks emerging from more regulation, electronic security threats, and the

### How much of a priority are the following risk management activities in your company?

| All sectors  | Now | Three years from now |
|--|-----|----------------------|
| Ensuring that the organisation is in full compliance with regulations  | 1   | 1                    |
| Informing the board of significant risk issues   | 2   | 5                    |
| Assuring business continuity   | 3   | 7                    |
| Delivering an integrated picture of risk across the enterprise   | 5   | 4                    |
| Monitoring and identifying emergent risks  | 4   | 2                    |
| Training and communicating with the workforce on risk management policies and structures                             | 8   | 11                   |
| Extending risk principles into the wider business strategy (eg, new product development, development of new markets) | 7   | 3                    |
| Developing the data strategy required to build an accurate picture of operational risk                               | 6   | 10                   |
| Educating the investment community on the organisation's risk management strategy                                    | 9   | 9                    |
| Developing alternative risk transfer strategies  | 11  | 8                    |
| Evaluating insurance coverage  | 10  | 6                    |

Source: Economist Intelligence Unit survey, April 2005



ongoing globalisation of businesses. Extending risk principles into the wider business strategy by, for example, developing new products and markets also rises, from seventh priority to third, suggesting that the CRO's role will become more strategic.

## Conclusion

The rise of the CRO has marked a watershed in the way companies perceive and deal with risk. Whereas risk managers were traditionally concerned with the relatively precise science of quantifying and offsetting financial risks, they must now get to grips with issues as diverse and nebulous as PR crises, IT failures and the impact of new regulation. Developing a coherent

response to these challenges calls for individuals with multi-disciplinary experience, along with the influence and charisma required to ingrain sound risk principles within every part of the business.

In terms of best practice, how to measure and manage operational risk is likely to be a key issue for CROs over the coming years. Given the difficulty of capturing many aspects of operational risk numerically, the approach will depend on the mix of quantitative and qualitative measures, and this is where the specialised skills of the experienced CRO will come into their own. According to the World Bank's Mr Wilton, "at the end of the day there's no substitute for the seasoned executive who can make a judgment call."

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