



# Risk governance: A benchmarking analysis of systemically important banks

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# Foreword

Since the global financial crisis, the Financial Stability Board have been very focused on the measures relating to capital, liquidity, leverage and recovery and resolution provisions. To a greater extent these financial stability policies are now determined, although full implementation will take some time. Policy alone will not, however, achieve the overall objective of making sure that taxpayers do not have to intervene again. Strong decision-making with good quality data and high quality people are also required. Policy makers have now focused on the importance of having a proper environment in place, such that boards and senior management teams will actually land the new financial stability requirements. This is best summed up in their November 2011 paper (*Policy Measures to Address Systemically Important Financial Institutions*) which sets out their anticipation of “higher supervisory expectations for risk management, data aggregation, risk governance and internal controls.”

Measuring progress on such expectations is more difficult than the more-quantitative measures associated with the financial stability policies. Each bank is different, with different business models and strategy, a wide variety of legacy systems and different approaches to managing global businesses. KPMG has relationships with the majority of the Global Systemically Important Banks (G-SIBs) and many of the Domestic Systemically Important Banks (D-SIBs). This report sets out the results of our informal benchmark of 20 of our key clients around the world. Based on KPMG Partners’ knowledge of the SIBs, we have asked a series of detailed risk governance and risk process questions at these banks to give a strong indicator of progress against the authorities’ expectations. Where needed, the responses were supplemented by the SIBs.

The results make for interesting reading and highlight the challenge of landing a series of interlinked requirements at the same time. Management teams are finding that the supervisors’ expectations are constantly moving — generally in only one direction. It is also clear that supervisors want an integrated approach to risk, governance and data and this is creating considerable management stretch. For example, many banks have made progress with the mechanics of BCBS 239 — their data is much improved. The new challenge is coming from a risk governance perspective, where it is proving more difficult to demonstrate how this refreshed data is actually being used in decision-making and revitalizing the business model. Indeed the European Central Bank (ECB) recently published priorities for 2016 — which are a proxy for most of the major supervisory bodies — and are focused on business model, data and risk governance, in addition to the more traditional financial stability risk categories — credit, capital and liquidity. It is clear they want a holistic picture.

I see a real determination by boards and senior management to tackle these challenges. There is an expectation from investors and the market more generally, as well as the supervisors and policy makers, to make this work. We hope this report will help management teams to validate their plans and assess their own progress against the standards expected of the industry.



**Jeremy Anderson**  
Chairman, Global Financial Services

# Strengthening risk governance

Recent assessment of risk governance at 20 SIBs found both challenges and opportunities for the Board Risk Committees (BRCs) of these institutions, specifically around automation of stress-testing and aligning risk appetite with business goals. Below are highlights of what we found.

## Top two challenges for the Board Risk Committee to effective risk governance

**81%** say quality of information



**56%** say timeliness of information

## Automation can address the challenges but prove vexing in stress-testing scenarios

**83%** say automation top challenge to stress-testing



**53%** automate less than half their stress-testing

## Equally important is aligning risk appetite with business goals, however...

**69%** do not fully embed Risk Appetite Statement with decision-making at a business unit level



just **50%** formally measure risk culture and of those that do, just half report on it to the BRC

## The good news is that progress is being made as these institutions continue to strengthen their risk management functions and risk governance

**85%** of BRCs now have risk management experience



**89%** say the skill set of the BRC somewhat improved in last three years

Chief risk officers spend more than **50%** of their time on decision-making

Throughout this report we dig deeper into the issues, oversight requirements and features of the banks with a more mature approach to risk.

# Demands on banks rise faster than capabilities

“ An assessment of risk governance at these banks highlights there may be significant gaps in their ability to meet the rising expectations of regulators. It is one thing to meet standards now, but the bar continues to move up. They need a plan for continuous improvement to support the financial institution’s ability to identify and manage future shocks. ”

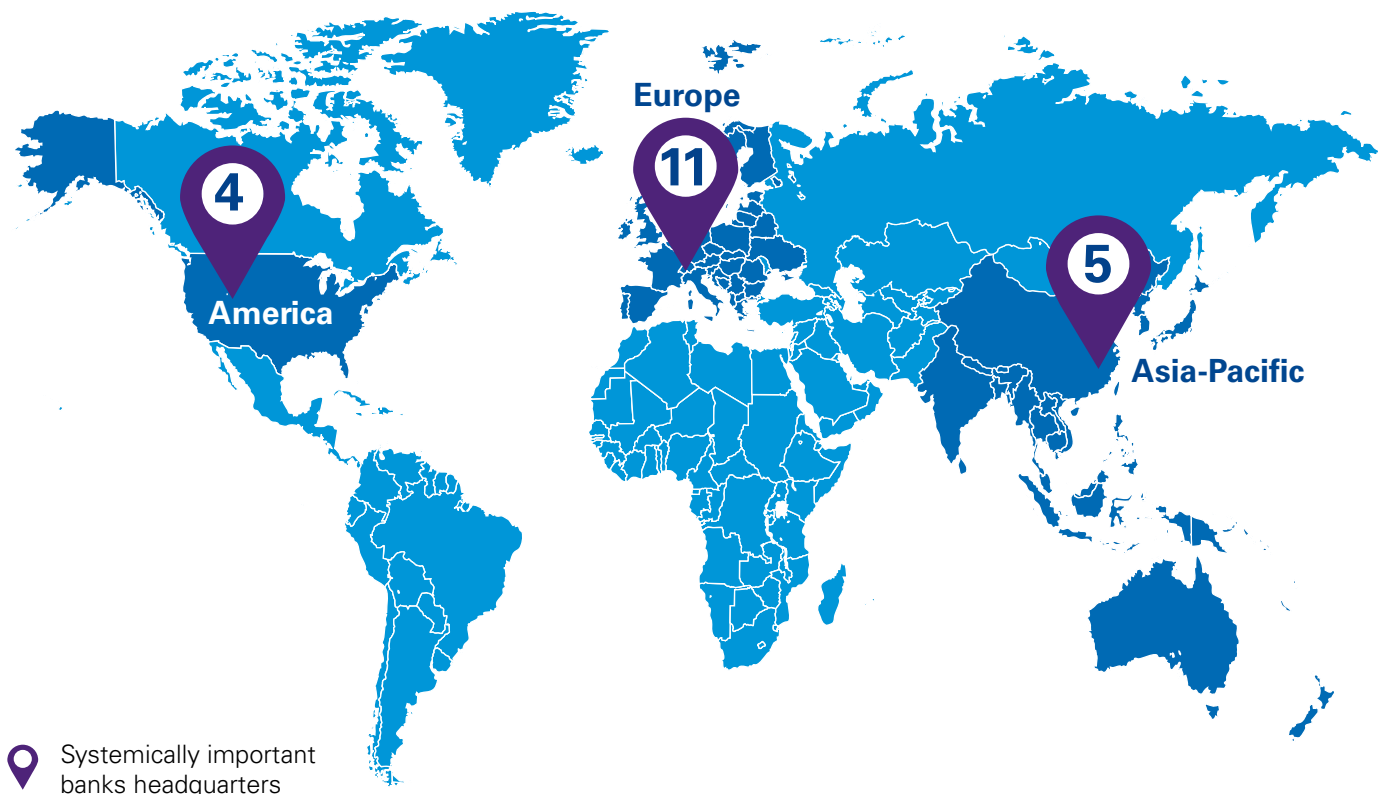
**Giles Williams**

Partner, KPMG in the UK

A new KPMG assessment of risk governance at systemically important banks (SIBs) finds that board risk committees (BRCs) face significant challenges in analyzing the entire array of risks that face the entity. A survey based on KPMG partners’ knowledge of 20 SIB clients from around the world shows the need for greater automation of data collection to allow more time for analysis by practitioners. The study shows that although skills and processes have improved in recent years, there is still a long way to go to raise the quality and granularity of risk governance to the standard that regulators expect.

## Methodology

The survey, conducted in the second half of 2015, asked KPMG partners to answer the questions based on their knowledge of the SIB, supplemented by discussions with the SIB, where required. The banks surveyed comprise a significant portion of the 30 financial institutions listed as global systemically important financial institutions by the Financial Stability Board.<sup>1</sup> Four of those surveyed are headquartered in the US, 11 in Europe and five in the Asia-Pacific region.



<sup>1</sup> [http://www.financialstabilityboard.org/wp-content/uploads/r\\_111104bb.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_111104bb.pdf)



# The main findings of this report include:

- 1** The main challenges faced by BRCs are the quality and timeliness of information that they receive.
- 2** Greater automation would help banks to analyze the information, but the cost of achieving the standards expected by global regulators is considerable. While the benefits of enhanced automation are undeniable, these need to be balanced with the cost of delivery, particularly given the fragmented nature of systems which operate at many SIBs.
- 3** Risk management skills and resources are perceived to be rising but regulatory expectations continue to increase. Independent assessments of different aspects of the risk governance process would help to benchmark banks' capabilities.
- 4** A sizeable proportion of banks in the survey do not prepare the Risk Appetite Statement in concert with the strategic plan and a considerably higher proportion could do more to formally link the Risk Appetite Statement with the decision-making processes of the bank at a business unit level.
- 5** Banks need to do more to tie incentives to risk management capabilities if they are to develop a risk-aware culture.

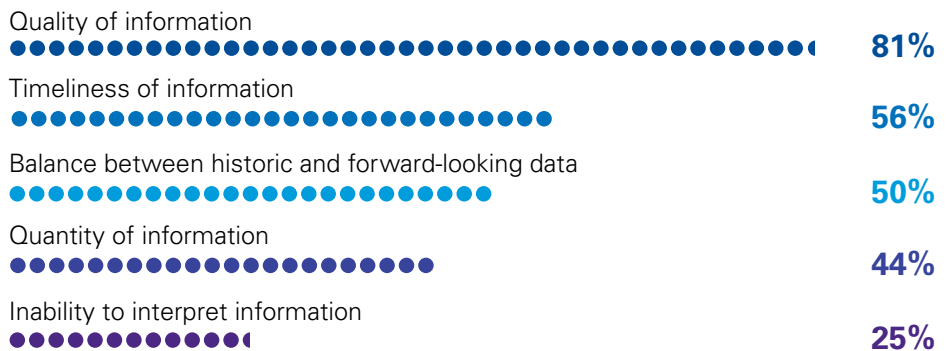


# Finding dots and connecting them

The best business decisions are based on relevant, comprehensive, actionable information, and the work of the BRC is no exception. The BRC sits at the top of the SIBs' framework of risk governance and in this regard has two functions: to set expectations and secondly to receive reports ensuring that those expectations are being met.

If it is not functioning well, the chances are that risk of one kind or another is not being managed effectively. But despite the importance of risk data, the quality of information is regarded by respondents as the biggest challenge for BRCs. The timeliness of information is the second-biggest challenge.

## Biggest challenges for board risk committees



The issue of data quality and timeliness should be seen in terms of the flow of work that passes through the Risk function and goes up to the BRC. Ninety percent of BRCs in the survey meet at least once a quarter while some meet more than 10 times during a year. A lot of information that goes to BRCs is produced through systems with some manual intervention, but the challenge is to obtain a more-granular and detailed analysis of risk data that is available automatically. Various scenarios need to be run against this data to see what the impact would be of changing market conditions.

Multiple systems and inconsistent data standards can cause this to be a time-consuming process, reducing the time-available to analyze the data. Instead, the production of reports for

the BRC needs to be embedded in the overall process of managing risks, rather than separate from it. That way, the focus of the Risk function won't shift periodically from its overall purpose to the compiling of reports.

One answer to the problem of the quality and timeliness of information is to automate a greater proportion of the process of gathering it, enabling the Risk professionals and others time to analyze the risks and how to manage them. Automation is needed at every point in the risk governance process, but is seen as a particularly vexing problem for banks when performing stress tests, particularly when responding to regulatory requirements. Half the SIBs in the survey perform five or more stress-test scenarios a year, but continue to require a significant

amount of manual intervention. This is an onerous process, given the amount of data to be analyzed. So it is not surprising that the biggest challenges

in the area of stress-testing are automation and data quality, according to the survey.

### Top challenges for banks performing stress-testing



Most banks are struggling to keep up with the schedule of performing stress tests and responding to regulators' comments regarding the tests, as well as answering internal requests for more data. SIBs tend, therefore, to be reacting to the needs of the moment, rather than working to improve decision-making. Automation can help them, but it is only a part of the solution; the process of gathering data has to capture the right types of information.

This requires well-designed models that neither raise alarms too frequently nor instill a false sense of confidence that the banks are operating within risk parameters. Furthermore, automation cannot overcome the problem that banks often have several legacy computer systems that format data differently. They have difficulty, for example, aggregating their enterprise-wide exposure to a single counterparty across multiple systems.

**53%** automate less than half of their stress-testing

// The automation of risk-data analysis needs to be seen in the context of overall improvements in risk governance. It should enable people at key points in the risk architecture to have the time to think clearly of what the priorities are and how to deal with threats, both in the short- and long-term. Automation is an enabler. //

**Michelle Hinchliffe**  
Partner, KPMG in the UK

### A utilitarian approach to risk data

The complexity of quantifying and analyzing risk is daunting for an individual bank. This is why some financial institutions are considering the idea of forming a consortium of banks that would invest in a highly efficient and effective utility to collect and analyze all the relevant risk-related data of its members and produce actionable information. (KPMG is talking to a number of parties about the development of such a utility.) The reasoning is simple: it is better to have a single air-traffic-control system for all airlines, rather than many ATC systems operating at the same time. It will take several years to build the technological infrastructure of such a utility for a consortium of banks and to deal with potential anti-trust issues. In the meantime, banks on their own will have to manage their issues of collecting and analyzing huge amounts of risk data. Creating a sturdy risk-governance structure is a good place to start.

**41%** do not have their stress-testing process independently reviewed

# Needs and capabilities

**89%** say the skill set of the BRC somewhat improved over the last three years

It is clear, then, that automation is not a substitute for human skills; it complements and supports them. In terms of capabilities, 53 percent of the SIBs surveyed have seen a definite improvement in the skills of the BRC in the past three years and an additional 36 percent have experienced “somewhat” of an improvement. The quality and timeliness of information is, as we have seen, a major challenge for the BRC. But the inability to interpret the information is regarded as the top challenge by only six percent of SIBs. This suggests that if the information is of the right quality and received in a

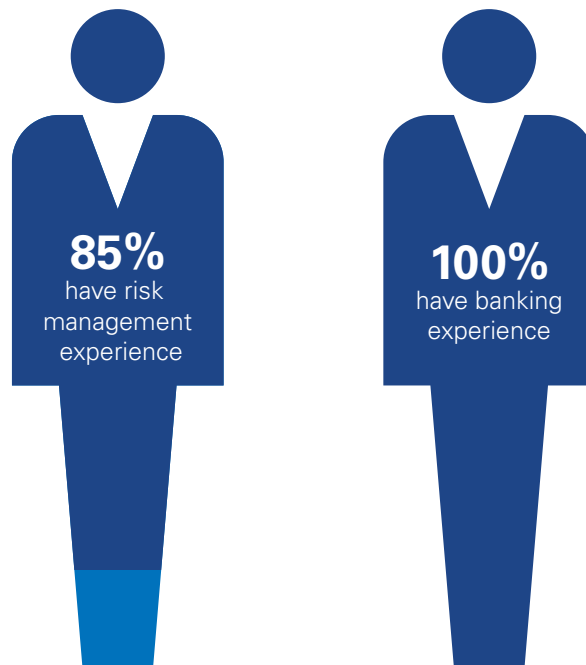
timely fashion, members of the BRC are considered to have the skills available to analyze it effectively.

The key question, however, is whether its skills have improved enough to meet the rising expectations of other stakeholders, and regulators in particular. This, of course, is hard to measure. Only a crisis reveals whether a financial institution is capable of withstanding the shock. Do BRCs have the relevant experience? All of the SIBs surveyed have banking experience within the BRC and 85 percent of BRCs have risk management experience.

“ SIBs need to develop a long-term strategy for dealing with current and future threats and opportunities. This should be tied to long-term goals for improvements in risk culture, talent and processes, all anchored in a rigorous governance structure that will stand the test of time. ”

**Mark Twerdok**  
Partner, KPMG in the US

## Skill sets of the board risk committee





### Benchmarking is a priority

Given the speed of change in the industry and the importance of capabilities, it would seem essential that the effectiveness of the BRC is formally assessed, however we found that...



**26%** do not formally assess the effectiveness of the BRC,

and of those who do,

just **14%** employ an external party to conduct the assessment, while

**41%** do not engage in an independent review for their stress-testing process.

The level of independent assessment is surprisingly low. You would expect, in this period of rapid change, that an independent assessment is needed to track whether the effectiveness of the BRC measures up to the rising standards that are expected of it.

### Lack of uniformity in some key metrics of risk governance

The way risk is managed is bound to vary from one financial institution to another, depending on the individual needs of each bank and the regulatory requirements of different jurisdictions. But the survey shows such a wide range in some key aspects of risk governance that the sheer variety raises questions, not least for regulators. Here are some of the key areas of difference:

**The number of members of a BRC.** This varies from three to 12, with six being the average. Most BRCs require a quorum, which averages about half the committee members, but it can be as low as 16 percent of committee members or as high as 100 percent.

**Frequency and length of BRC meetings.** The number of times a year that a BRC gets together varies and can be as many as 10 times or more. The duration of meetings ranges from less than an hour to four hours (2.1 hours on average).

**Stress-testing scenarios.** For the purpose of stress-testing, the number of scenarios ranges from as few as three to as many as 40. Scenarios range from testing what might happen if there was a repetition of the 2008 financial crisis to a hard landing for the Chinese economy or a collapse in property prices in designated markets.

# The changing role of the chief risk officer



As the range of risks widens and compliance requirements become more complex, the role of the chief risk officer is growing significantly. Eighty percent of CROs in the survey report to the chief executive officer, a big change since the financial crisis, when the majority reported to the chief financial officer. This reflects the growing importance of the CRO: approximately 60 percent of time is designated to decision-making while the remainder is spent approving or checking.

The CRO is also in charge of a larger department than before. According to the survey, almost all have seen an expansion in the number of full-time employees in Risk and more than a third have seen the employee base grow by 25 percent or more. Most of the increase of man-hours has been dedicated to compliance and operational risk; the time devoted to market risk and credit risk has also grown but by considerably less.

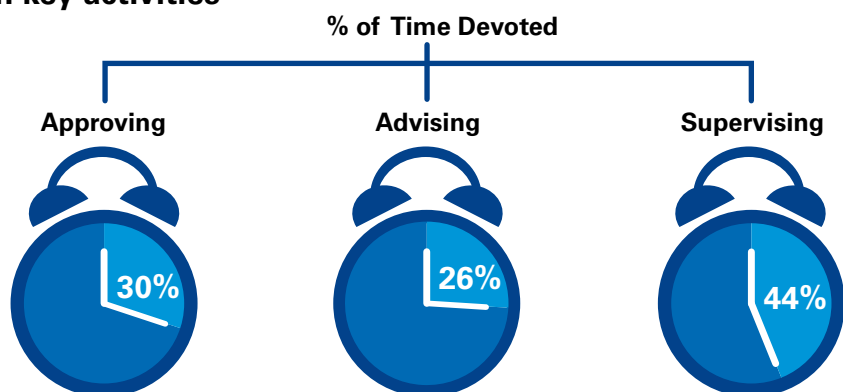
## Increase in percentage of time spent by the risk function in key areas, compared to three years ago

	Significant increase	Moderate increase	Minor increase	Total increase
Credit	11%	22%	22%	56%
Market	0%	39%	28%	67%
Operational	44%	28%	22%	94%
Compliance	65%	29%	6%	100%

The BRC has seen a similar shift in responsibilities. The average amount of time devoted to advising is now slightly more than a quarter of the total, compared with 30 percent approving

and 44 percent spent supervising. The proportion of time devoted to advising and approving is likely to increase further in the next few years, as global regulators demand more from BRC members.

## Percentage of time spent by board risk committee on key activities



Activities might include approving policies and methodologies, risk appetite, stress-test scenarios, capital plans

Activities might include providing advice to executive committees on risk strategy, risk appetite, due diligence processes and risks associated with proposed and current business activities

Activities might include providing oversight of risk management processes, compensation assessment, resourcing and qualifications of risk management function, effectiveness of controls to manage risks

### Banks with a more mature approach to risk

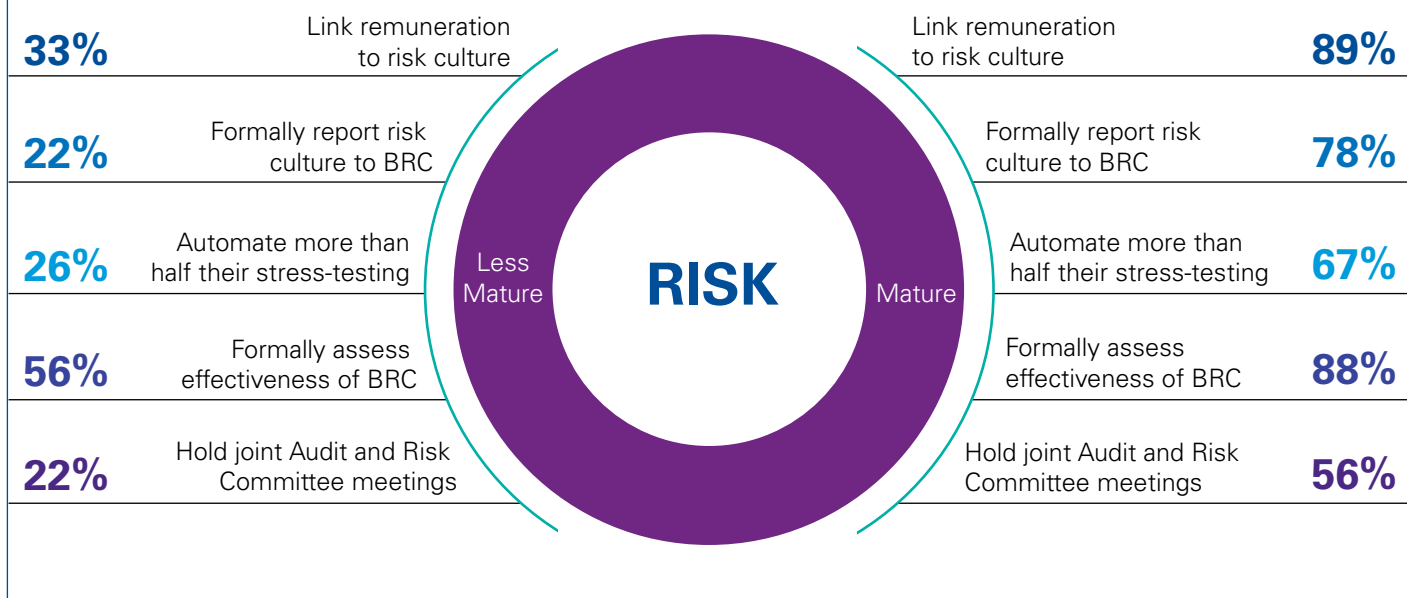
It is possible to tentatively draw some rather stark contrasts between nine banks that formally measure risk culture and nine that do not. This shows that 89 percent of the former directly link remuneration and risk culture, versus only 33 percent of the latter. In addition, 78 percent of the banks that formally measure risk culture report risk culture to the BRC, compared with only 22 percent of the latter.

There are wide gaps between the two groups in other areas as well. Sixty-seven percent of the banks that formally measure risk culture automate more than half of their stress-testing, compared with 26 percent of the latter group. Also, 88 percent formally assess the effectiveness of their BRC, compared with 56 percent of the latter. And 56 percent

of the former group holds joint meetings of the Audit Committee and the Risk Committee versus only 22 percent of the group that doesn't measure risk culture.

This set of contrasts is useful when developing a picture of a more mature BRC and Risk function. At a financial institution with a more-developed approach to risk governance, there are more formal assessments of effectiveness, and risk culture is reported to the BRC. Remuneration and risk culture are linked. And there is some coordination between the Audit Committee and Risk Committee by means of joint meetings. In isolation, these items are beneficial; taken together, they improve the overall risk governance of the institution.

### Banks with less mature versus mature approach to risk



# Creating a more robust risk culture

**50%** percent measure risk culture, and of those that do, only half report on risk culture to the BRC

A bigger role for the CRO needs to be matched by an enhanced approach to risk throughout the financial institution, not just in a single department. Many equate a more risk-aware enterprise as being more risk-averse but this is a myth. A delineation of the risk parameters partly depends on preparing a Risk Appetite Statement in parallel with the bank's strategic plan — thereby aligning overall business goals with the risks they entail. By doing so, banks may find they can take on more risk in certain areas, not less. Yet a sizeable proportion of the survey sample (22 percent) does not prepare the Risk Appetite Statement along with the strategic plan, and 69 percent do not fully embed the Risk Appetite Statement within the detailed decision-making processes of the bank at a business-unit level.

One way to align business goals with the risk culture is to connect the latter with remuneration, but the survey shows that 39 percent of the financial institutions do not do this. Furthermore, 82 percent do not hold joint meetings of

the remuneration committee and the BRC. In the UK, banks are being called on by regulators to make a direct link between risk culture and pay, but this is not yet the case in the rest of Europe. Although there is no regulatory requirement to do so in the US, a number of American banks are discussing the idea of connecting the two. However, there is a methodological problem of measuring risk when threats are absent. Is it because they are being managed well or because no threats exist?

Partly for this reason, perhaps, only half the financial institutions surveyed worldwide actually measure the risk culture and only half report on the risk culture to the BRC. Some include risk questions in employee surveys and measure such things as the number of risk-tolerance breaches. There are certain types of risk, therefore, that can be measured, such as operational failures or compliance breaches. And, in any case, if remuneration is not linked to risk culture, how can employees be incentivized to manage risk effectively?



# Lessons for the future

The soundness of systemically important banks is a matter of interest not just to these organizations but to regulators and the public at large. Effective business management rests on a robust process of preparing for threats that could affect key parts of the bank's operations and this, in turn, depends on a strong risk governance structure. This survey of 20 systemically important banks shows that there is some confidence among these organizations that they have the capabilities and governance to meet the challenges of the future. But this is hard to evaluate independently, because a significant number do not formally assess the effectiveness of BRCs while an even higher number do not independently review the stress-testing process.

Skills and resources are being deployed to the Risk function to the point where financial institutions express confidence that their BRCs are capable of interpreting the risk data they receive. But they admit that the quality and timeliness of the data being analyzed is a significant challenge. One answer is to invest in greater automation of data collection.

Banks need to continue to address a number of issues arising from the data in this report:

- 1 Develop a more robust process of risk-data analysis to help the BRC work through problems and analyze future threats, both medium- and long-term.
- 2 Ensure that the risk appetite statement is not only aligned with, but also embedded in, the strategic-planning process.
- 3 Establish a methodology to measure the risk culture and a plan to tie incentives (remuneration or otherwise) to risk measurements.

Given the importance of systemically important banks to the global economy, it is a matter of considerable interest how these organizations manage their risk and plan for future threats. Only the very highest standards of risk governance will prevent a repetition of the financial crisis, or at least mitigate its worst effects. Forewarned is forearmed.



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Michelle is a senior partner within the Financial Services Audit practice at KPMG in the UK. She has worked for over 25 years with KPMG providing major international banks with audit and advisory services. Michelle works closely with executive management and non-executive directors to help them interpret the impact of both accounting and regulatory changes on their business and provides business insights gained through leading the external and internal audit process.



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Mark is a partner at KPMG in the US with more than 27 years of experience. He leads the Financial Services Enterprise Risk Management service activities and also leads the Credit Risk Financial Services practice for KPMG in the US. Mark serves on the KPMG Financial Services Risk and Compliance leadership team. His primary areas of focus include enterprise risk assessment, operational risk management, risk and control assessment, risk appetite and risk reporting.



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Giles leads KPMG's Financial Services Regulatory Centre of Excellence for the EMA region, providing specialist advice to our member firms' clients on how to interpret and respond to the breadth of regulatory developments post the financial crisis. He has worked on consulting projects and investigations in the financial sector for more than 15 years. Giles' practice is to assist clients dealing with the regulator directly, or in the context of a significant change program to ensure "regulatory safety" of the primary program objectives. He also focuses on advising clients on how to respond to new regulatory developments and initiatives now impacting the sector.

# Additional reading

Banking regulation has advanced noticeably since the 2008 financial crisis, with considerable progress achieved in 2013. However, many regulatory details remain unresolved and the banks' success in adapting to these regulatory changes varies greatly by institution and jurisdiction. In KPMG International's Evolving Banking Regulation series, we provide the latest updates and insights into regulatory developments and how banks can best respond.



## **From design to implementation**

Banks continue to grapple with the complexity of keeping track of, and adjusting to, the sheer volume of measures and the multiple interactions between them. This chapter focuses on five emerging areas where banks will need to respond to the uncertain evolution of regulatory and supervisory developments, including: Macro-prudential policy, risk-weighted assets, Comprehensive Assessment Supervision, MREL, and TLAC.



## **The search for a viable strategy**

This second part of the series looks at bank structure, and the search by many banks for a viable and sustainable future in a world where new regulatory, market and commercial pressures are driving business model change. Banks face a variety of economic and commercial pressures, which are changing rules of the game by requiring banks to rethink their strategic direction and the implications for their customers.



## **Data and technology: The regulatory and business challenges**

The third paper in the series examines data and reporting requirements as well as the cybersecurity risks. In addition, we cover the challenges that banks face in meeting these requirements and rising expectations of the clients, customers and investors, along with the demands of regulators. In particular, the report focuses on why high-quality data and effective technology should be at the heart of a profitable and sustainable bank strategy.



## **Governance: From expectations to delivery**

The fourth part of the Evolving Banking Regulation series examines the governance challenges facing banks. In this edition, we focus on how to meet the expectations of regulators and supervisors while addressing the commercial advantages of good governance. Elements such as culture, values, supervisory assessment and the suitability and accountability of board members and senior management are also reviewed.



## **Culture and conduct**

Culture is a complex but highly valuable asset for firms operating in competitive markets. It is therefore important for firms to observe, monitor and change their culture over time to support the successful realization of the firm's vision and strategic priorities. The focus of this edition of the Evolving Banking Regulation series is on the risk culture of banks and related behaviors.

The Evolving Banking Regulation series is published by our Global Regulatory Center of Excellence. Please visit [www.kpmg.com/regulatory\\_challenges](http://www.kpmg.com/regulatory_challenges) to learn more.

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