

Risk management to the fore

By Margaret Ferns

PRiM's principle aims;

To provide a Luxembourg-based forum for networking and exchange of information between professionals of the risk management world

To explore opportunities for cooperation with other Luxembourg professional associations through conferences, joint working groups and other activities

To contribute actively to the institutional and regulatory world in the Luxembourg financial sector through membership of commissions, working groups and other similar initiatives

While retaining our original principal focus on the financial sector, to share experience and lessons with risk professionals from other industries

To provide - in co-operation with the IFBL - risk management training in support of the industry-recognised GARP (Global Association of Risk Professionals) Financial Risk Management Program (FRM) and to seek to broaden this educational stream of activity in line with needs of risk professionals in Luxembourg

To provide opportunities to learn of a broad aspect of risk issues through the organisation of conferences

To publish a quarterly newsletter on risk management issues

Business Review is pleased to announce that it has formed a media partnership with the Luxembourg association for Professionals in Risk Management (PRiM). PRiM was first founded in July 1997 and its membership comes from, not only the risk management function in banking, insurance, audit and consulting, but also from a broad range of related functions such as compliance, internal audit or operational and general management.

As part of our media agreement we will be reporting on PRiM events and educating and updating readers on risk management issues via close contact with PRiM and its members. This is something BR feels is extremely important given that effective (and transparent) risk management underpins the very success of the world renowned financial centre the Grand Duchy has worked so hard to establish. To launch this new press partnership, BR talked to Michael May, President, PRiM about the organisation's objectives and the issues he feels are key to successful risk management.

What is risk management?

In order to carry out effective risk management, it is necessary to understand what risk is, and so May began by providing a broad definition. He quoted The Simple Rules of Risk (Eric Banks/



Michael May,
President, PRiM.

Wiley 2000), which says that risk is, "The uncertainty surrounding the outcome of a future event." From this straight forward definition risk management can then be broken down into five broad categories. "Financial risk (liquidity, interest rates, processes, systems, credit/counterparty); operational risk (Basel II, people, processes, systems and external events); business & strategic risk (competition, reputation, industry change, client demand, R&D, legal, regulatory, political and accounting); framework for risk analysis (time, scenarios, measures, benchmarks, internal/external drivers) and process flows for risk management (measurement, reporting, analysis/assessment, decision and action)." It is clear from the above that risk management is a function which is vast and complex, and one which touches almost every aspect of business. However, there is one feature of risk that May feels has

hitherto been, not ignored, but perhaps not given the profile it deserves - people risk. "After all, you can have the best systems and plans in the world, but in the end it all comes down to the people who carry it out." He illustrated his point by quoting three high profile examples.

People risk

"Crédit Agricole will suffer a 250m (\$348m) hit to third-quarter profits at its investment banking arm after a rogue trader in its New York office made unauthorised bets on credit markets, Calyon, the group's investment banking unit, said in a statement on Tuesday night." [FT, September 2007] "Five investment bankers from Barclays Capital who spent more than £44,000 on wine at a top London restaurant to celebrate a successful deal have left their posts." [FT February



2002] "Nick Leeson - lost \$1billion: Peter Young - lost \$600million: Toshihide Iguchi lost \$1.1billion: John Rusnak lost - \$691million: rogue traders fall into a crazy web of deceit, covering up his losses while losing yet more in a desperate effort to recoup debts." [Source Financial Scandals, <http://www.ex.ac.uk/~RDavies/arian/scandals/#top>]

"The problem usually comes back to an individual," May said. "I once worked for a highly intelligent risk manager whose opinion was that there is no such thing as people risk and everything comes down to proper and due process and systems." In his experience, this opinion could not be more wrong. "Nearly all operational steps in an organisation depend on the quality, commitment and honesty of the people performing them..... people risk has its roots in the underlying competencies, attitudes and motivation of employees," was

how Gilbert Renel of Deloitte put it in the PRiM Risk Newsletter in December 2006. May continued that, "The extreme example is fraud for personal benefit, where the avoidance of controls and checks is deliberate, but the examples above rarely have their roots in a deliberate intention to defraud; it is the snowball effect of finding oneself in a pickle and being unwilling or unable to come clean before the situation gets out of control."

Checks & measures not enough

"It is true that the reasons for people-driven failure can be traced back to other root causes," he said, "but the individuals are all agents with free choice, rather than pre-programmed robots. Put 100 individuals through an identical scenario and the vast majority will choose action that avoids the error and cost. Yet one may be undergoing personal stress outside work, may have been ill-prepared or not adequately trained for the job, and may be operating in a very manual process where volumes have placed the process under strain, or may be suffering from poor management and supervision. Any one of these can be the weakness that exposes the limit to the checks and controls."

Jonathan Howitt of Man Group, in a presentation made in London in 2004, observed that in matters

of operational risk "frequently we only have ourselves to blame... Operational failures arise from human fallibility - a failure to communicate (negligence, simple errors) or a problem of conduct (fraud, abuse, business practices). In a people business, your greatest assets are your greatest liabilities and your internal culture is the key driver of your risk. People are the ultimate root cause."

Good people management goes a long way

Despite all this, very little research has been done and/or published on the subject of people risk - and this is something May intends to see change in Luxembourg. "The shortage of real recognition of this problem is chronic - we seek models and predictive programmes, often leaving the impression that we believe the whole affair is a matter of science." Therefore, in the coming months, PRiM will be seeking to explore the topic of people risk and how it can increase awareness that better management of people and their working environment can go a long way to complementing more traditional risk management tools and techniques.

PRiM events planned for the near future are; 13 November - "Model Risk - Pricing of Complex and Structured Products", and "The 2007 Summer Liquidity Crisis" (date to be confirmed). For full details www.prim.lu.



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