

Risk Management: The Evolving View



About Douglas R. McKibben



Prior to joining Gartner six years ago, Douglas McKibben held positions as Senior Manager

and Principal Consultant at PricewaterhouseCoopers; Vice President and Manager at Credit Lyonnais; and Vice President/Managing Director at Citibank, NA. He holds a B.S. in Business Administration from the University of Kansas and an M.B.A., Finance, from Georgia College.

At Gartner, McKibben focuses on thought leadership and research in banking topics. With other Gartner analysts, he recently co-authored "**Predicts 2007: Technology, Market Changes Will Drive Bank Innovation.**"

Teradata talks with Douglas R. McKibben, Research Vice President, Banking, Gartner Industry Advisory Services

Teradata: How are the risks that the financial industry faces today unique from risks other industries face?

McKibben: Risks in the financial industry aren't necessarily unique; industries of all types are exposed to risks. However, I do believe that the *risk is more concentrated in the financial industry*. All businesses and industries face risks, but for financial institutions, one of their primary businesses is risk management. After all, the very nature of financial business *is* risk. The three main categories of risk – credit, market and operational risks – are substantially embedded in the business of financial institutions. For example, other industries certainly have credit risks, but they're not as completely exposed to credit risks as financial institutions. The whole business of the financial sector is about purposefully taking on those kinds of risks and taking advantage of them.

Teradata: How has risk management changed over the past 5-10 years?

McKibben: Enterprise risk management (ERM) is about looking at risk holistically, across risk categories. In most non-financial companies credit and market risks – which are speculative risks – are typically the purview of the CFO or treasury function, while operational risk has been the responsibility of the internal auditor. The disconnect between these areas has frequently led to the misconception by some companies that ERM is just about managing operational risks. *But increasingly, over the past five to ten years there's been a demonstrated need for a more holistic approach to risk due to increased globalization of business and regulatory and market scrutiny.* Standardizing and sharing credit and market risk data has led to a deeper understanding of those areas. However, while operational risks can also result in financial loss, *many companies lack data for understanding those risks, which are still often managed in a separate and non-standard manner within business silos.*

With that isolation, managers also suffer from a lack of the information necessary to understand the interdependency and correlation of risks across the enterprise. For example, understanding how operational failures can lead to credit losses. Such events can decrease an institution's share value and/or can lead to a negative impact on reputation. We see examples of this in the press all the time. So, there's a growing awareness that fulfilling fiduciary responsibility requires understanding that the management of operational risks is as important as managing credit and market risks.

Enterprise risk management starts with integrating risk management strategies for credit, market and operational risks into business planning across the enterprise. Cultural change is critical to ERM. Companies must be willing to not only erase line-of-business boundaries and fragmented approaches to risk management, but also to evaluate business performance on a risk adjusted basis, with employee compensation linked to the results necessary to change practices at the operational level.

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Teradata: Do you foresee those risks evolving or changing again in the near future?

McKibben: *Stakeholders are increasingly unhappy with the level of enterprise risk reporting and want a “no surprise” approach to risk management and more transparent risk reporting.* Better risk reporting requires enterprises to improve and integrate risk management. That integration is complicated by many factors: globalization, real-time enterprise, and greater volatility of markets and business activities. With ERM, the difference is the enterprise taking a holistic approach and using common risk management processes and web-based applications to share information across the organization to enable a single, comprehensive view of relationships and risks. Additionally, an integrated technical plan and data management structure are foundational to enabling that single view.

Teradata: What pitfalls do financial enterprises face if they do not have in place an enterprise risk management strategy?

McKibben: *The biggest pitfall is a lack of communication within the enterprise; a failure to share information because there isn't an open structure or standard manner for recording and exchanging information.* That inhibits managers from understanding the relationship of risks and the threats and opportunities they present. In most organizations, risk processes are replicated in multiple silos, one for each business unit which track the same exposures but don't share information. Consequently, managers do not fully understand or record information, or report information up the line for aggregation.

Teradata: What role does IT and Enterprise Data Warehousing play in enabling financial enterprises to manage risk?

McKibben: Well, you can't manage what you can't measure, and you can't measure accurately if you don't have comprehensive, granular and consistent, cross-enterprise data. *Data is fundamental to establishing risk management priorities as well as to managing risks... and identifying risk opportunities.*

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