Business Line Advocacy: The Evolution of the Risk Manager

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Can a Risk Manager act as a 'Business Line Advocate' without compromising the independent nature of the role?

My answer to this question is not only 'yes', but I even argue that acting in this manner should be the goal of all risk managers. While the preservation of independence may immediately seem to be at risk, the interjection and conflict inherent in the traditional oversight role only rarely emerges in this model. The primary interaction between risk takers and risk oversight is a positive one, making the conflicts that are virtually inevitable, more accepted and less damaging to the overall effectiveness of the independent risk oversight function. Unlike the 'Risk Manager as Cop' model, this one is sustainable.

Why? If one considers that all risks, or the costs of risk 'events', have a human origin, the need to manage human relationships becomes the primary form of risk management. Oversight, quantitative modeling and policies only supplement this.

The structure of risk management at U.S. Bancorp Piper Jaffray is built on this premise, and is thus centered on strong consultative relationships. Make no mistake, there is a clear and known backing of the risk oversight function by senior management. So, a more traditional stick, so to speak, is readily available. Still, it is rare that the stick needs to be used at our firm, and I am convinced that this has to do with the model of risk oversight that we employ.

The foundation of this risk management framework is the following premise: business lines 'own' the risk, and the company or its shareholders own the risk capital. We may then begin to see where the risk manager's relationship with business leaders can be positively focused. If business units must compete for the firm's capital, either through actual risk capital allocation, or implicitly through resource allocation. And, if the risk oversight models are used in determining either of these allocations, it is the risk manager who is best able to consult with the business unit leaders on how decisions will affect their allocation of risk capital and which decisions, either risk-taking or risk-mitigating, are most cost effective.

In other words, if resources go to the areas that are the most effective users of capital, there is an inherent pull for business line leaders to work with the risk oversight function to impact their line's relative performance in a positive manner. Thus, risk capital is used as both the carrot and the stick, allowing business line leaders to make choices and to be accountable for their risk-adjusted outcomes.

In the example above, it should be clear that the quantitative work of risk management is essential to the process. However, without the positively focused working relationship, the math can only deliver capital as a stick.

Some other examples of how this model differs from the 'cop' model may be helpful.

For most firms, capital is just one of a number of constraints that they face. The risk manager needs to oversee and implement internal policies that allow the firm to operate at some predetermined level of confidence and safely within its capital limits. Education about these policies, and clearly defined procedures for seeking exceptions to them, need to be defined in either risk management model: the 'cop' or the Risk Manager as Business Line Advocate model.

The difference is that the business line advocate will act as the guide through the process. The message thus delivered is that policies exist, exceptions can be granted, and the risk manager will help the business line to determine whether and how such exceptions could be possible. When the assumption of the risk takers is that the risk manager is a resource, rather than a potential obstacle, the relationship can be positively sustained, even if a requested exception is not granted.

We all know that regardless of the model we employ, risks will be realized and risk events are a certainty. Upon such realization, the 'cop' model calls for investigation of the events that lead to the loss and the parties who may have been responsible. In contrast, a more relationship-based approach, and one that I would argue is more beneficial to the firm, is again acting as a resource for the affected risk takers. Consider a team of problem solvers that is coordinated by the independent risk management leaders. Its sole function is to assist business lines in responding to risk events. The risk managers will not solve the problem for the business line, but will help to guide a process that leads to timely and effective mitigation. Depending on the size of the company, such a process can save millions of dollars for the affected business line. This type of activity is clearly one that builds relationships. It focuses on positive processes and targets positive outcomes. The 'cop' may never even be invited into such a process, thus multiplying the risks to the firm.

As relationships are always evolving, the independent risk manager needs continually to be managing those with the risk takers. These relationships are never perfect, nor are they ever completely formed. Because all risks are human in origin, we must stay engaged with the people taking the risks. It may seem that the Risk Manager as Business Line Resource is a more appropriate description of the model that I describe. Yet, when the relationships between risk oversight and risk takers are strong, the risk manager can help a business line to manage its risks to the point where he or she can comfortably serve as an advocate for their business plans before a body like a Risk Committee or an ALCO.

I argue that this early inclusion in the business planning process is support for the success of the whole business, again besting the 'cop' model.

I believe that the Risk Manager as Business Line Advocate is the model toward which our industry will evolve. Perhaps not surprisingly, making it work actually takes more time than most of us already dedicate to our quantitative work. Nevertheless, I would argue that such relationship management, supplemented with quantitative analysis, clear policies and senior management support will add significantly more long-term value to firms with scarce resources. In other words, to all firms.