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Integrating systems to mitigate risk

Mahesh Sharma | *March 18, 2008*

JEROME Kerviel made international headlines earlier this year when it was revealed he had racked up losses of $US7.2 billion ($7.7 billion) at French bank Societe Generale, and he was able to get away with this because he found a way to work around the bank's risk management systems.

Jerome Kerviel found a way to work around Societe Generale's risk management

SocGen's stunning loss and the activities of other rogue traders show that risk management software is no magic talisman to ward off disaster.

David Jacobson, founder of risk management specialist Jacobson Consulting, says risk management systems play an ever more important role in corporate governance as the technology becomes more complex, but the systems are only ever as good as the people and processes supporting them.

"These systems can generate reports hourly, daily," Jacobson says.

"If you have a look at the different products on sale you will see some of them are quite capable in what they do - they track risks, report on them, as well as provide training and incorporate rules. That is, provided nobody tries to circumvent them, and provided the systems are in place to back them up.

"The system will work only as well as it is set up and as well as it is monitored.

"If people do not monitor the system, if someone seeks to circumvent the system, there is always the potential for the system not to work."

This was the problem for the National Australia Bank in 2004, when a handful of foreign exchange traders circumvented its risk management systems and exposed it to a $360 million loss, he says.

It was Australia's biggest trading scandal and led to the departures of NAB chief executive Frank Cicutto, chairman Charles Allan and three directors.

The Australian Prudential and Regulatory Authority came down hard on NAB and said the board needed to take a leadership role in transforming its culture and governance processes. It outlined a clear road map to improve key policies and systems in the bank.

"What happened with NAB was that the Australian Prudential and Regulatory Authority decided it was more of a cultural thing and NAB was focused on performance and making profit," Jacobson says.

"They took their eye off compliance. Only recently has NAB been fully released from the obligations and restrictions that were placed on it."

SAP risk management software product manager Stephan Goehring the NAB case indicates there is still a lot of room for improvement in organisations' risk management systems.

"What we see a lot is that systems are not integrated, which is the nature of the beast," Goehring says.

"A lot of regulation comes step-by-step: there is one regulation, then a new regulation. Most companies cater for that with new systems and throwing more people at the problem.

"At the end of the day you are building something that really does not serve the purpose."

The problem with these disparate systems piling up is that it takes more to manage the risk, Goehring says.

Organisations will be able to extract greater efficiency from their risk management if they integrate disparate systems.

"Risk management done in silos will not be an enterprise risk management exercise and companies will struggle with it.

"You need a platform, or holistic, approach so you can cater for new regulations without hiring new people," he says.

InConsult is a local risk management consultancy, and its managing director, Tony Harb, also says the integrated approach provides increased exposure to risk by making it more transparent in the business.

“Most organisations purchase ‘problem specific’ systems to help with say anti-money laundering, APRA compliance, internal audit, incident management or enterprise risk management” said Mr Harb. “Consequently organizations buy all these systems and of course none of them talk to each other.

"The key pillars of sound corporate governance include internal audit, risk management, compliance and incident management and they all share many synergies.

"What we are doing with our technology is to help organisations break down the silos that empede good corporate governance and have built those four pillars into one integrated system.

“So what happens is there’s more transparency across the whole organisation, auditors can verify controls identified by line managers, risk managers can pin-point high impact risks or ineffective controls, line managers are ‘reminded’ to evaluate their risks, compliance managers are reminded to complete key legal requirements. When things are not done on time – the CEO can know about it instantly by email.

However, Harb says, the risk managers need the support of their superiors to have the best systems and processes in place.

“Where it’s difficult is when a risk manager in an organization wants to implement a new, improved risk management framework or system but the board, CEO and senior management are supportive in principle but not in practice.

“Unless you get the ‘real’ buy in from the CEO and senior management, the systems and processes are going to fail. It’s a matter of time. That’s where we see some of the problems.

“That’s unless you have a strong regulator for example APRA, that says to the board, you are responsible for risk management. So what you see in insurance industry in general are very good risk management systems and processes."

Over the past couple of years between 30 and 40 per cent of local banks have experimented with the integrated approach, which has developed as they start to rethink the ways of managing risk, Goehring says.

"A lot of companies have changed their approach from waiting and reacting to being faster and more transparent," Goehring says.

"If your stock is listed, you have to release reports on your activity, which puts pressure on the business. Integrated solutions are easy to invest in and once you have that it is easier to spot irregularities."

However, he concedes, this attitude is the exception rather than the rule and the biggest driver of change is "when the pipes burst".

"If the names are in the headlines, banks tend to act faster. In all my discussions with companies, across any industry, I compare the biggest challenge with plumbing in an old house.

"Everyone knows the pipes are old but no one is really replacing the pipes until the pipes burst.

"Especially in the governance, risk and compliance space, you can't do that, because if your pipes burst, you are in the news."

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