FOUR CORE CAPABILITIES
FOR BUILDING STRONG
RISK GOVERNANCE
Governance enables an institution to effectively manage its risk-taking activities. Establishing a sound governance process in any institution requires the board and senior management at the forefront leading the effort, continually reinforcing what is expected. The following core capabilities are essential for building strong risk governance:

### 1. CULTURE

A strong risk management culture accomplishes two organizational objectives, summarized as follows:

- **It helps the company make well-informed decisions.** A company with a strong risk management culture promotes, encourages, and rewards behaviors that avoid herd mentality, conformation bias, or groupthink.

- **It helps the company identify rogue individuals and/or groups.** It is said that 99.9% of people show up to work every day intending to do the right thing. However, there are times when individuals or groups (the other 0.1%) are more interested in their own personal gains than in doing what is right. In such cases, a strong governance and risk management culture identifies those individuals and purges them.

The process starts with senior and executive management, the people who set the proverbial “tone at the top.” And it’s not just what these people say but, more importantly, what they do. Therefore, senior management needs to come to a consensus on what the company values are, and they need to live those values every day without exception. Similarly, the board and senior management need to develop clearly articulated statements about risk appetite and tolerance that spell out, unequivocally, the company’s philosophy on risk acceptance.
Although there are various models, there is no right governance structure. Ultimately, each institution must determine which structure is best suited for its organization, i.e., one that will support information flow, escalation, decision making, and accountability. A typical governance structure has the following components:

- The board of directors.
- The board’s risk committees.
- The chief risk officer.
- The management committees.

Policies communicate the company’s risk appetite to all stakeholders. They describe what the company is willing to do and not willing to do. The statement of risk appetite is operationalized through policies (“What should we do?”) and procedures (“How should we do it?”). Policies should be brief—no more than two or three pages—and express the following:

- **Overview of the policy**: What is it intended to accomplish?
- **Authority**: Who is accountable for implementing the policy?
- **Implementation**: How will the policy be implemented?
- **Exceptions**: How should exceptions be handled?
Internal control is frequently defined as the systems, processes, and policies that enable an organization to meet its strategic goals. An internal control framework exists to align the amount of risk assumed by the company with its accepted risk appetite and risk tolerance. However, it’s not as simple as it sounds.

A good internal control environment is critical to ensuring sound operations and achieving the risk management goal of “no surprises.” A truly effective and efficient internal control structure requires taking a deliberate and fundamental approach to the design, execution, and monitoring of the controls, rather than just creating them to address perceived outcomes.
Strong governance can help an organization ensure that:

- The risk appetite implicit in the company’s business model, strategy, and execution is appropriate.
- The expected risks are commensurate with the expected rewards.
- Management has implemented a system to manage, monitor, and mitigate risk, and that system is appropriate given the company’s business model and strategy.
- The risk management system informs the board of the major risks facing the company and how they are being managed.
- An appropriate culture of risk awareness exists throughout the organization.
- There is recognition that management of risk is essential to the successful execution of the company’s strategy.
- A well-developed capital plan is in place to support the established risk appetite and strategic plan.
- A stress-testing program is in place to help determine sufficient capital availability based on the bank’s strategic plan and risk appetite.

*RMA’s Governance and Policies Workbook* further examines the core capabilities required for a strong risk governance culture, structure, policies and procedures, and internal control environment. The workbook provides detailed examples of governance structures, risk committee charters, and risk dashboard in its appendix.
ABOUT RMA

The Risk Management Association (RMA) is a not-for-profit, member-driven professional association serving the financial services industry. Its sole purpose is to advance the use of sound risk principles in the financial services industry. RMA promotes an enterprise approach to risk management that focuses on credit risk, market risk, operational risk, securities lending, and regulatory issues.

Founded in 1914, RMA was originally called the Robert Morris Associates, named after American patriot Robert Morris, a signer of the Declaration of Independence. Morris, the principal financier of the Revolutionary War, helped establish our country’s banking system.

Today, RMA has approximately 2,500 institutional members. These include banks of all sizes as well as nonbank financial institutions. RMA is proud of the leadership role its member institutions take in the financial services industry. Relationship managers, credit officers, risk managers, and other financial services professionals in these organizations with responsibilities related to the risk management function represent these institutions within RMA. Known as RMA Associates, these 16,000 individuals are located throughout North America and financial centers in Europe, Australia, and Asia.

No part of this publication may be reproduced, by any technique or process whatsoever, without the express written permission of the publisher.

- Phone: 800-677-7621
- Fax: 215-446-4101
- Website: www.rmahq.org

RMA UNIVERSITY

In today’s rapidly changing financial services industry, you need practical, day-to-day knowledge that will help you excel in your profession. RMA provides quality education to advance sound risk principles in the financial services industry. Traditional classroom training and online learning resources are available as open enrollments or as in-bank training. Visit http://www.rmahq.org/events-training/rma-university to learn more.

ESTATEMENT STUDIES

RMA’s eStatement StudiesSM is the only source of comparative data that comes directly from the financial statements of small and medium-size business customers of RMA’s member institutions. Round-the-clock online access gives you the ease and flexibility to use this wealth of information at your convenience. Visit http://www.rmahq.org/tools-publications/tools/estatement-studies to learn more.

ARE YOU AN RMA MEMBER?

An RMA membership provides many benefits. In addition to a free subscription to The RMA Journal® and discounts on RMA events, products, services, and training, membership also provides countless networking opportunities and exposure to the industry’s key decision makers and managers. RMA’s local and national events keep you up to date on industry trends and issues while allowing you to meet new people and swap successes with peers. Visit http://www.rmahq.org/about-rma/member-benefits to learn more about membership.