2018 FIRMA National Risk Management Training Conference

Fiduciary Monitoring, KRIs and Other Risk Metrics

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Introductions / Schedule

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- Schedule/Structure

  - 2:30 – 2:45 *Introductions*
  - 2:45 – 3:30 *Presentation and discussion*
  - 3:30 – 3:45 *Break*
  - 3:45 – 4:15 *Break out sessions / updates*
  - 4:15 – 4:30 *Wrap up*

Session Expectations and Topics

- Expectations
  - Engaged, open discussion on KRIs relating to fiduciary and asset management activities, including specific KRI examples and overall process management.
- Topics:
  - KRI/KPI reporting and development
  - Thresholds
  - Forward-looking v. Spot indicators
  - Governance & escalation

Definitions

- KRIs
  - "Key risk indicators (KRIs) are critical predictors of unfavorable events that can adversely impact organizations. They monitor changes in the levels of risk exposure and contribute to the early warning signs that enable organizations to report and accurately assess risks, prevent crises, and mitigate them in time." [1]
  - *KRIs are metrics of changes in an organization's risk profile*
- KPIs
  - Help to measure how well companies, business units, or processes are performing against stated goals/objectives
  - Consider linkage of KRIs to strategic KPIs
- Metrics
  - Specific and measurable information or data points

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[1] *MetricStream, "Integrating KRI Frameworks into Risk Assessments" risk.net, February 2016*

KRI/KPI Uses & Expectations

- Line of Business/Overall Firm
- OCC/Regulatory
- Internal Audit
- Enterprise Risk Programs
  - Linkage to Risk Appetite and Heightened Standards programs

Types of KRIs and Metrics (Examples)

- Operational
- Regulatory/Fiduciary/Compliance
- Investment-related
- Strategic/Financial
- System/Support indicators

Developing KRIs

- Key Characteristics of KRIs
  - Typically measurable – percentages, numbers, averages
  - Predictable and often used as *early warning signals*, while also tracking trends over time
  - Informative and must act as a catalyst for decision-making
  - Must be carefully designed and ‘owned’

Developing KRIs

- Developing KRIs – Considerations
  - Strategic – does it address risks associated with business goals or strategic direction?
  - Is the metric/indicator valuable to the business?
  - Is the metric easy to understand and relevant?
  - What is the composition of the metric? Is the information ‘clean’?
  - Is the metric built with regular reporting in mind? (i.e., takes into account existing escalation levels)
  - Is the metric long-term or short-term?
  - Is the number of KRIs reasonable and are they appropriately differentiated?

Developing KRIs

- <u>Developing KRIs – Process</u>
  - Begin with a thorough understanding of organizational and strategic priorities, along with regulatory requirements
  - Map key risks to strategic priorities and initiatives – allows for direct linkage to most critical metrics
  - Subject Matter Experts (including legal and compliance resources) as KRI designers/'consultants'
  - Not just a number that is easy to get or 'backing into' a current risk issue
  - Must be high-quality, repeatable data that is examined carefully before implementation
  - Reasonableness checks/committee review/peer review and discussion

Spot Metrics v. Forward-looking

- ‘Leading’ v. ‘Lagging’ indicators
  - Leading Indicators – indicators that usually change *before* economy as a whole changes.
    - Examples:
      - Manufacturer’s new orders
      - S&P 500 Index
      - Building Permits
  - Lagging indicators – indicators that usually change *after* the economy changes.
    - Examples:
      - Unemployment rate
      - Customer satisfaction
      - Business profit/financial results

Spot Metrics v. Forward-looking

- Application to Fiduciary KRIs – 'Spot' v. 'Forward-looking'
  - Strategic
  - Operational
  - Fiduciary

- Discussion item:
  - KRIs that use 'past' or 'spot' information as an indicator of a likely future event or trend

Reporting and Escalation

- Developing thresholds
  - Allowing for 'maturity' of indicators
- Escalation & governance
  - Linkage to strategy and appropriate governance structure
  - Senior/executive management visibility and understanding
  - Linkage to Enterprise Risk programs and processes
- Periodic re-evaluation
  - Feedback loop, adjust metrics where appropriate
  - Regular independent review; 'educated reader'
  - Over time must be augmented with new KRIs as new risks emerge, and older KRIs may not be sufficient
- Breaches/limits
  - Clear path for limit breaches

Reporting and Formats

- Representation
  - Red/yellow/green reporting
  - High/medium/low
- Trending
  - Time period
  - Subsets of trends
- Frequency
  - Linkage to enterprise reporting/risk-related

Considerations/Common Mistakes

- Difficulty in identifying KRIs for all significant risks
- Failing to align to big picture/strategy
- Human biases
- Balance between automation & judgment
- Consideration/focus on proper escalation
- Not developing KRIs in connection with existing KPIs

Gaining ‘Buy-in’

- Top-down endorsement
- View as value-added information/process
- Real, meaningful results
- Flexibility & focus on information as a business tool
- Start with ‘key risks’ and grow from there
- Key role of technology and MIS reporting – strong partnership necessary for success; also minimizes manual effort

Back-testing View

- Show how KRIs would have identified previous losses or compliance issues. If created based on past issues, need to ensure that KRI being created would have identified issue or situation.[1]

- Important when demonstrating issue resolution or the proposed effectiveness of new KRIs

[1] *MetricStream, "Integrating KRI Frameworks into Risk Assessments" risk.net, February 2016*

Experts Weigh In (Discussion)

- Consulting reviews – whitepapers
- Regulatory feedback
- Industry comments

Breakout Sessions (Materials Provided)

- Discuss/develop KRIs by category
- Reference starter set – basic ideas provided. Group tasks are to discuss and develop additional, specific KRIs for each category.
- Report-out after group discussions; further challenge and refinement/addition of more KRI examples
- Organize: metric title/what is specifically measured/ threshold considerations/escalation process?

KRI Examples – ‘Starter Set’

- Strategic KRIs
  - Business (financial) performance v. plan
  - Market penetration v. plan
  - Product distribution v. plan
  - Client/account type distribution v. strategy

KRI Examples – ‘Starter Set’

- Regulatory / Compliance / Fiduciary
  - Issues management:
    - Audit
    - Compliance
    - Regulatory
    - Self-identified
  - Policy/ethics violations
  - Complaints
  - Pending/threatened litigation, legal trends
  - Account Reg 9 review-related

KRI Examples – ‘Starter Set’

- Operational (including system/technology KRIs)
  - Significant technology outages
  - Employee turnover/attrition
  - Non-credit losses and trending

KRI Examples – 'Starter Set'

- Investment-related
  - Product performance (incl. proprietary fund performance)
  - Investment account documentation exceptions
  - Market/credit/concentration risk

Next Steps/Wrap-Up

- Review updated listing of meaningful KRIs for each category
- Review results v. expectations
- Additional questions?