Defining Risk Management within an Organization: Results of the 2012 Survey for Japanese Risk Managers

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Abstract

Tokyo Risk Managers Association (TRMA), a voluntary group consisting of risk management practitioners in Japan, conducted a 2012 survey regarding the status quo of the risk management framework in the Japanese financial institutions. More than 300 practitioners answered the survey. In this paper we summarize the results of the survey and discuss what we can learn from the survey. On one hand, we found the fact that senior managers in the financial institutions became more interested in risk management than our last survey executed on 2009, but on the other hand, we also found many risk managers were in the process of trial and error for solving the implementing issues of the advanced risk management framework in their organizations.

Keywords: risk management, ERM, risk governance, CRO, risk appetite, stress test

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1. Introduction

In this paper we summarize the results of the survey regarding the implementation of the risk management structures in the Japanese financial institutions and discuss what we can learn from the survey.

This survey was conducted early this year by the Tokyo Risk Managers Association (TRMA) as a follow-up to the TRMA financial crisis questionnaire in 2009. TRMA is a voluntary group consisting of risk management practitioners in Japan for the purpose of promoting risk management practice in Japan. Main activities of the TRMA are holding seminars, publishing books and conducting the survey regarding risk management. The authors are now co-principals of the TRMA.

Six themes were selected for the survey from among the themes in the 2009 questionnaire, taking into account the themes selected for the IIF/Ernst & Young questionnaires of 2009 and 2012. These are; A) risk governance, B) risk appetite, C) capital management, D) stress testing, E) liquidity risk management, and F) risk data and IT systems. These themes were deemed as having the strongest relationships with Japanese financial institutions. The survey was created comprising 24 main questions and 16 additional questions.

Responses to the survey were obtained from 301 TRMA members, which are more than twice the number of responses to the previous survey. 61% of responses were received from members affiliated with the three main types of financial institutions (banks, securities companies, and insurance companies).

Following is the summary of what we learned from the survey result.

➢ First of all, the involvement of senior management in risk management has increased.

➢ On the other hand, there were many responses stating that effective discussions at Risk Management Committee meetings had not progressed very much; that the status and authority of Chief Risk Officers (CRO) had not been strengthened very much; and that sufficient resources are still not being allocated to Risk Management Divisions. These responses suggest that although senior management are expressing an increased interest in risk management, this interest does not necessarily tie into concrete reinforcements.
Regarding the risk appetite, more than half of respondents were of the opinion that risk should be used as a standard when creating business plans, but at the same time, it became clear that this approach has not penetrated or become entrenched as part of actual operations.

Regarding capital management, two opinions were at odds; the opinion that regulatory capital and economic capital are approaching one another, and the opinion that they are drifting apart. Responses also indicated continued struggles with regard to the structure of approaches and frameworks regarding capital management, and a greater number of respondents expressed the opinion that there is meaning in creating recovery and resolution plans.

Regarding stress tests, there were indications that integrated stress tests are being employed more broadly, and it appears that reports to management on test results have already become commonplace. The issue raised most frequently with regard to stress tests was the “establishing appropriate scenarios.”

Although many respondents indicated that liquidity risk management has improved, these opinions were not yet in the majority. There were also conflicting opinions regarding whether or not the strengthening of liquidity risk regulations reduced liquidity risks.

Regarding risk data, although many respondents said that there have been improvements, it became clear that many members are concerned about the fact that this data continues to be stored in various systems in a scattered fashion.

Overall, despite an increased interest and involvement in risk management by teams in charge, risk managers are not confident with the top management’s distribution of resources. The survey also indicated that the persons involved are struggling to promote “risk-culture,” or understanding of risk management, within the companies and organizations in question.

On the other hand, the responses in general were more concrete than in the previous questionnaire, suggesting that the level of financial risk management in Japan has increased. The high level of awareness among the respondents was also notable, for example in a large number of essay-type answers.

This paper is organized as follows. In sections 2 to 7, we discuss the six themes respectively. Some selected questions for the theme and responses as well as the
comments are shown in each section. Section 8 is the concluding remarks followed by the reference (section 9) and appendix (section 10).

2. Risk Governance

More than half of the respondents answered “improved dramatically” or “improved to some degree” to the question whether the involvement in risk management by Boards of Directors and senior management at Japanese financial institutions has improved (see Figure 1 in Appendix). We can reasonably evaluate that management body has become more interested in the overall risk management. In response to the questionnaire, we can find comments such as “management attitudes have changed from that they do not see or half-listen since the risk management is difficult to understand to that they ask questions in detail since the risk management is difficult,” and “In the process of the decision-making, opinions from the risk management viewpoint have become always asked and used in the process.” Some comments indicate that the financial crisis and the Great East Japan Earthquake triggered the increased interest among the management bodies.

On the other hand, in response to multiple choice questions about the current status of risk management committees at Japanese financial institutions, the “Committees in general tend to become mere formalities, and it is difficult to conduct practical discussions” and “Risk Management Committee meetings have increased as a result of inspections and strengthened regulations by authorities, but conversely, they have become simply a formality” are the top two answers selected (see Figure 2). In the free-answers, we found many comments pointing out the difficulty of conducting practical discussions at committee meetings because of the increased number of the cases and related handouts and because of the busyness of the participating senior members. Since similar opinions were seen in the 2009 survey, we can conclude that facilitating the substantive discussion in the risk management committees is one of the continuing issues. Some of the respondents expressed that reducing the number of participants and making the chair of the committee induce the real discussion were the key for the better committee.
We also asked about the role of the Chief Risk Officer (CRO) in the Japanese financial institutions (see Figure 3). 70% of the respondents chose “Japanese financial institutions have begun assigning CROs and Directors in charge of risk management, but their status and authority remain modest” or “Japanese financial institutions emphasize the regular personnel change, so staff suitable to the position of CRO is still not being trained, and it is difficult for them to execute their role.” It is interesting that we see various opinions about the personnel change. Some respondents mentioned that the institutions should take actions for cultivating the human resource capable of CRO by for example shifting personnel change for specialist carrier development, while other respondents pointed out that since CRO should acquire various experiences, current personnel change should be kept. We also found the comments that CRO should exchange opinions and/or horizontal network among CROs, such as the European CRO Forum.

In the survey 2009, many indicated that more resources should be allocated to risk management divisions. This time we asked the changes since then, and found that many respondents answered either “more management resources are being allocated to risk management divisions than in the past, but not enough” or “there has been no significant change in the allocation of resources to risk management divisions” (see Figure 4). Overall, most responses indicated that sufficient resources are not being allocated to risk management divisions.

3. Risk Appetite

Risk appetite is defined as the amount and type of risk that a company is able and willing to accept in pursuit of its business objectives. An idea of risk appetite has been promoted after the financial crisis. The 2009 survey indicated that risk appetite had become accepted to some degree (“Risk appetite needs to be clearly established” was chosen by 50% of the respondents). In this survey we asked in what extent the concept of risk appetite has been discussed or entrenched at Japanese financial institutions over the past two years (see Figure 5). The most common response was that “it is extremely difficult to incorporate the concept of risk appetite into Japanese
organizations,” followed by “discussions of risk appetite have not necessarily become entrenched.” The result suggests that implementation of the risk appetite framework is still in the working process, and that risk appetite has not been entrenched in the practical risk management.

In a question regarding how the concept of risk appetite should be used, the most common response was that “it should be used as a standard when creating business plans.” On the other hand, in a question about the issues involved in the penetration of the concept of risk appetite, the most common response was “promoting the penetration of the basic concept of risk appetite into the organization as a whole” (see Figure 6). These answers indicate that many practitioners understand the importance of the concept but it has not been penetrated through the organizations.

From free comments, on one hand some indicated that preparedness of the senior management is absolutely imperative for penetrating the risk appetite framework since it is the declaration of the intention from the senior management, while on the other hand, other indicated that since risk appetite is the concept of top-down and European/US approach, it is difficult to penetrate the concept into Japanese bottom-up management. In the survey conducted by Institute of International Finance also revealed “there is a degree of commonality in the hurdles firms are facing and the need for proven practical solutions” to the implementation of effective risk appetite frameworks. So we can say that the challenges in the implementation process are not Japan specific but the universal issues.

4. Capital Management

Regarding the questions about the recent development of capital management, the answers were dispersed (see Figure 7). The most selected choice was “a greater emphasis is placed on regulatory capital,” (69 respondents selected) followed by “capital management methods have not changed significantly” (65) and “the results of stress tests are reflected in capital management” (63). Taking other answers selected such as “capital management methods have changed in keeping with changes to regulatory capital” (56) into consideration, we can say that the recent regulatory
movement, namely Basel III and Solvency II, has driven the increasing interest on regulatory capital within capital management.

In response to a question regarding the relationship between approaches to regulatory capital and economic capital, the most common response was that “the relationship has not changed significantly,” followed by the “the approaches to regulatory capital and economic capital have converged.” Among the free comments, some indicate that in the insurance industry economic capital and regulatory capital will converge since Japanese Financial Services Agency aims to introduce economic-value based regulation, while others indicate that in the banking industry, the Basel III proposals have made regulatory capital overly conservative and have made economic capital less relevant. Both comments suggest that the regulatory capital framework affects the risk and capital management in the institutions strongly.

To a question regarding the challenges and issues involved in the improvement of capital management, the most common response was “the construction of frameworks for and approaches to capital management,” followed by “gaining the common understanding of the parties involved in capital management.” These results indicate that in the context of improving capital management, more respondents are concerned about the difficulty of establishing frameworks and approaches within organizations, rather than the technical issues such as data and systems.

5. Stress Testing

From our survey, stress testing can be seen as the progressed areas in the risk management during these few years. In response to the questions about the current status of these tests at Japanese financial institutions, 40% of the respondents selected the choice “integrated stress tests are conducted to cover multiple risks” or “integrated stress tests are conducted on a group basis to cover multiple risks” (see Figure 8). By adding the answers “stress tests are basically implemented in individual categories such as market, credit, and operations, and the results are combined as required,” we can say that more than one-half of the institutions implemented the integrated stress testing into practice. This is a significant change from the 2009 survey, in which 45% of
respondents said that it would be desirable to conduct integrated stress tests, but only a small number (25%) said that such tests were actually being conducted.

Almost 60% of the respondents chose “stress test results are reported to senior management (e.g., Risk Management Committees),” but only less than 20% of them answered that “dedicated venues have been put in place to discuss the results of stress tests with the management team” and less than 10% answered “depending on the stress test results, frameworks are created and implemented to tie these results into management action; e.g., reducing limits, re-examining risk appetite, etc.” From these answers, we can say that stress testing itself has been implemented, but how to apply the results of the tests is still a challenging issue.

The main challenge in conducting stress tests is “establishing appropriate stress scenarios,” which was selected more than 70% of the respondents. A significant number of respondents also mentioned “the understanding of the parties involved” as a challenge.

6. Liquidity Risk Management

In response to a question regarding liquidity risk management, although a large number said that “liquidity risk management has (somewhat) been improved in Japanese financial institutions,” others felt that “not many have adopted this stance” (see Figure 9). Areas of development in the liquidity risk management are more on the qualitative side such as “senior management involvement” and “liquidity contingency planning,” and only the small number of respondents indicated the development of quantitative side such as “preparation of IT systems related to liquidity,” “increases in the level of liquid assets,” and “re-examination of transfer prices and in-house funding costs.”

Among the free comments, some mentioned that they do not regard the liquidity risk management as the high-priority task in the Japanese institutions in the current situation, since the liquidity has not been a big issue in Japanese financial institutions even during the financial crisis, back by the consistent liquidity surplus from household sector.
7. Risk Data and IT Systems

Regarding the risk data and IT systems, the largest segment of respondents replied that Japanese financial institutions “have somewhat improved their risk data” (see Figure 10). This is more than twice the number of respondents who selected the second largest response; Japanese financial institutions “have not improved.” These results suggest that progress has been made in the preparation of data over the past two years. However, in response to the question about the challenges in preparing the risk data, many respondents selected “the data is stored on various 'silo-'systems scattered throughout the company, making it difficult to gather the data.” Since the data requests from regulators and the business operations themselves have become more complex, integrated database is needed. However, as we indicated, allocation of the resources to the risk management is not enough. So, as in the free comments, “it is necessary for the senior management to understand and support the importance of building the integrated database.

8. Concluding Remarks

In our 2009 survey, many respondents pointed out that the involvement of the senior management was critical for the progress of risk management. After two years, this year’s survey showed that senior management became more interested in the risk management. It is partly because people reaffirmed the significance of risks embedded in the financial businesses through the events such as the Great East Japan Earthquake and Euro crisis. In addition, it may be because of the significant changes of the regulatory environment such as Basel III and Solvency II.

On the other hand, risk management practice in Japanese financial institutions still faces a lot of challenges. Resources are not allocated enough to risk management divisions, while the requirements from the regulatory body are increasing. In addition, it is a big challenge for risk managers to entrench new concepts such as risk appetite in the organization. Some practitioners find it difficult to apply these concepts born in
the U.S. and Europe directly because of the cultural difference.

Many things have happened and been told in the field of risk management for recent few years after the financial crisis. However, we strongly believe that there is no "one-size-fits-all" solution for risk management. Each risk management practitioner should not only follow what other organizations do or what the specialists, or even regulators say, but also consider by themselves what are most important issues relevant to their organizations and how they should tackle against these issues. In other words, they should discuss issues about the risk management in their organization based not on the borrowed tongue but on their own faith and term.

9. References

Institute of International Finance (2009), “Reform in the financial services industry – strengthening practices for a more stable system.”


Institute of International Finance, Ernst & Young (2012), “Progress in financial risk management.”
10. Appendix

This Appendix shows the selected questions in the survey directly referred in this paper and responses to these questions.

Figure 1
Risk governance: The role and responsibilities of senior management

- Since the recent financial crisis, the responsibilities of CEOs and Boards of Directors in risk management at financial institutions has been emphasized. Do you think that involvement in risk management by Boards of Directors and management teams at Japanese financial institutions has improved?
  a. Improved dramatically
  b. Improved to some degree
  c. No change
  d. Decreased
  e. N.A.
  f. Other (please elaborate)

Responses to the Question

Figure 2
Risk governance: Risk Management Committee

- What do you think of the current status of Risk Management Committees at Japanese financial institutions?
  a. Risk Management Committees at Japanese financial institutions, well participated by senior management teams, have no problems with regard to governance.
  b. Risk Management Committee meetings have increased as a result of inspections and strengthened regulations by authorities, but conversely, they have become simply a formality.
  c. Committees in general tend to become mere formalities, and it is difficult to conduct practical discussions.
  d. Risk Management Committees at Japanese financial institutions are required by regulating authorities; practical discussions are conducted outside of these committees.
  e. N.A.
  f. Other (please elaborate)

Responses to the Question
Figure 3
Risk governance: The authority of the Chief Risk Officer

• There are suggestions that independent Chief Risk Officers (CROs) should be given a high level of status and authority within senior management. How would you describe the situation at Japanese financial institutions?
  
a. Japanese financial institutions have begun placing an emphasis on CROs and Directors in charge of risk management
  
b. Japanese financial institutions have begun assigning CROs and Directors in charge of risk management, but their status and authority remain minimal
  
c. Japanese financial institutions emphasize rotation, so staff suitable to the position of CRO are still not being trained, and it is difficult for them to execute their role
  
d. There is no more need to give special authority to the CRO
  
e. A CRO or Director in charge of risk management has not been assigned
  
f. N.A.
  
g. Other (please elaborate)

Figure 4
Risk governance: Allocation of management resources to the Risk Management Division

• Do you think that the allocation of management resources to the Risk Management Divisions has improved at Japanese financial institutions over the past two years?
  
a. Sufficient management resources are now being allocated to Risk Management Divisions
  
b. More management resources are being allocated to Risk Management Divisions than in the past, but not enough
  
c. There has been no significant change in the allocation of resources to Risk Management Divisions
  
d. There has been a decrease in the allocation of resources to Risk Management Divisions
  
e. N.A.
  
f. Other (please elaborate)
A idea of risk appetite has been promoted to be established. Do you think that the concept of risk appetite has been discussed or entrenched at Japanese financial institutions over the past two years?

- a. Approaches and activities applying the concept of risk appetite to work operations have evolved and become entrenched
- b. The concept has not necessarily become entrenched
- c. It is extremely difficult to incorporate the concept of risk appetite into Japanese organizations
- d. The concept of risk appetite is itself ambiguous and so cannot be adopted effectively by organizations
- e. N.A.
- f. Other (please elaborate)

This question is for those who responded with b (the concept has not necessarily become entrenched), c (difficult to incorporate the concept), or d (the concept is ambiguous and so cannot be adopted effectively) in question B-1 above. What you think are the main issues involved in the penetration of risk appetite?

- a. Establishing appropriate risk management methods
- b. Incorporating risk appetite into division evaluation indexes
- c. Promoting the penetration of the basic concept of risk appetite into the organization as a whole
- d. Obtaining the understanding and support of top management
- e. N.A.
- f. Other (please elaborate)
Figure 7
Capital management: The current status of capital management

- Do you think that capital management methods have changed over the past two years?
  a. Capital management methods have changed in keeping with changes to regulatory capital
  b. Approaches to the allocation of economic capital have changed
  c. Capital costs are reflected more appropriately in capital management
  d. A greater emphasis is placed on regulatory capital
  e. The results of stress tests are reflected in capital management
  f. Economic capital and regulation capital are being managed more consistently with one another
  g. The use of capital is now being re-examined through portfolios
  h. Capital management is being emphasized on a consolidated base
  i. Capital management methods have not changed significantly
  j. N.A.
  k. Other (please elaborate)

Figure 8
Stress tests: Integrated stress test

- Various advisory documents published in 2008 and 2009 suggested that comprehensive stress tests should be undertaken throughout all areas of financial institutions. What do you think of the current status of these tests at Japanese financial institutions?
  a. Stress tests are basically implemented in individual categories such as market, credit, and operations, and the results are combined as required
  b. Integrated stress tests are conducted to cover multiple risks
  c. Integrated stress tests are conducted on a group basis to cover multiple risks
  d. Integrated stress tests are not emphasized (are not conducted)
  e. It would be desirable to conduct Integrated stress tests that cover multiple risks
  f. N.A.
  g. Other (please elaborate)
Figure 9
Liquidity risk management: Development of liquidity risk management

- Do you think that Japanese financial institutions have improved liquidity risk management over the past two years?
  a. Have improved liquidity risk management significantly
  b. Have somewhat improved liquidity risk management
  c. Have not improved liquidity risk management much
  d. Have degraded liquidity risk management than in the past
  e. N.A.
  f. Other (please elaborate)

Figure 10
Risk data and systems: Preparing risk data

- Do you think that over the past two years, Japanese financial institutions have improved preparing risk data?
  a. Have improved significantly
  b. Have somewhat improved
  c. Have not improved
  d. Have deteriorated
  e. N.A.
  f. Other (please elaborate)