BankDirector

Breakout 1:
From Risk-Averse to Risk-Smart: Strategies for Cultivating a Culture of Risk

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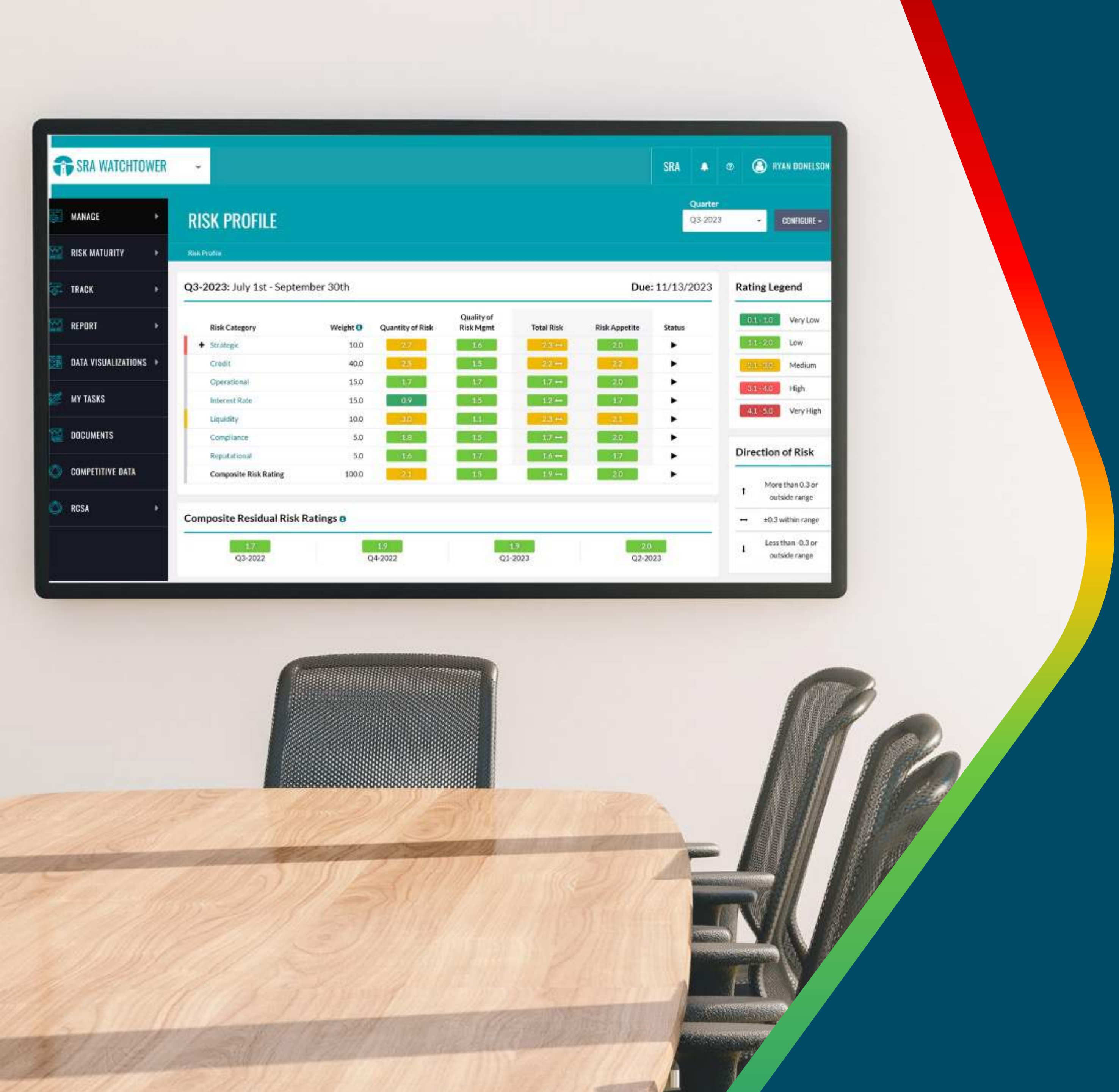
#BDAudit24



FROM RISK AVERSE TO RISK SMART:

STRATEGIES FOR CULTIVATING A CULTURE OF RISK

WATCHTOWER

The Holistic Risk Intelligence Platform™

AGENDA

1. Risk Culture
2. Land of “No”
3. Effect of Risk on Efficiency
4. Impact of Risk on Strategy
5. Outcome of Risk on Shareholder Value
6. Summary

RISK CULTURE

1 **Tone at the Top:** The importance of senior management and the board of directors in setting the right tone and demonstrating a commitment to risk management. Leadership should embody the values and principles of sound risk management.

2 **Accountability:** Clear delineation of risk management responsibilities and accountability throughout the organization. Employees at all levels should understand their roles in risk management and be held accountable for their actions.

3 **Effective Challenge:** The ability to challenge decisions and practices constructively, ensuring that risk considerations are thoroughly examined. This involves open communication and a culture where questioning and critical thinking are encouraged.

4 **Incentives:** Alignment of compensation and reward structures with the institution's risk appetite and long-term interests. Incentive systems should promote behaviors that support sound risk management and discourage excessive risk-taking.

5 **Risk Awareness:** Continuous efforts to raise risk awareness among employees through training, communication, and education. Employees should be aware of the risks associated with their activities and the overall risk profile of the institution.

THE LAND OF “NO”

Risk and Audit Leaders can sometimes be made to feel like…

- *an outsider*
- *not part of the team*
- *you don’t have a seat at the table*

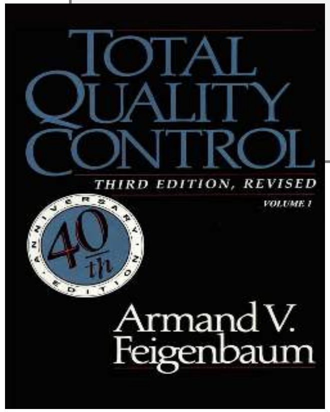
EFFECT OF RISK ON EFFICIENCY

WHAT IS A HIDDEN FACTORY?

According to a Harvard Business Review (HBR) study, a hidden factory **refers to any set of activities or processes within an organization that operates outside of established protocols or prescribed procedures.**

- ✓ Dr. Armand Feigenbaum, author of "Total Quality Control", said hidden factories **account for 20 - 40% of an organization's total capacity**.
- ✓ Activities may <u>not</u> be readily apparent or documented, hence the term "hidden."
- ✓ While not malicious in nature, hidden factories arise **due to systemic inefficiencies, gaps in technology, or reliance on outdated methods.**
- ✓ Encompasses a wide range of activities, from manual processes to deviations from standard procedures,
- ✓ Contribute to inefficiency, errors, and increased risk within the organization.

> *An estimated **$3.1 trillion dollars per year** are spent on poor data quality or the hidden data factory*
> **- HBR Study**



WHAT DOES A HIDDEN FACTORY LOOK LIKE INSIDE A BANK?

Unplanned Inefficiencies

Hidden factories in banks often involve unplanned activities or workarounds that occur outside of prescribed procedures. These **inefficiencies can include manual processes, reliance on outdated technology, or ad hoc methods** to address operational challenges.

Technology Gaps

Banks may encounter hidden factories due to gaps in technology infrastructure or reliance on outdated systems. For example, using **legacy software or manual data entry processes can create bottlenecks and increase the risk of errors or data breaches.**

Cultural and Strategic Misalignment

Hidden factories can undermine the bank's culture and strategic objectives by promoting behaviors that are inconsistent with organizational values or goals. For example, **employees may prioritize speed over accuracy or engage in shortcuts to meet performance targets,** compromising long-term sustainability and reputation.

Deviation from Top-of-House Expectations

Hidden factories represent a deviation from top-of-house expectations, reflecting a disconnect between stated organizational norms and actual practices. This misalignment **can erode trust and confidence among stakeholders and hinder the bank's ability to achieve its strategic objectives.**

HOW CAN TECHNOLOGY HELP?

- ✓ *Aggregates and Normalizes Data*
- ✓ *Streamlines processes and tools to reduce redundancies*
- ✓ *Can identify anomalies and patterns*
- ✓ *Leverage risk and control self-assessment methodologies to identify gaps*
- ✓ *Centralized system of record*
- ✓ *Reduce time and inefficiencies pulling together information or reporting*
- ✓ *More time Managing Risk vs Managing the data!*

SRA WATCHTOWER

Risk Intel Podcast Series on Hidden Factories

1. **WHAT IS A HIDDEN FACTORY?**
2. **WHAT DOES A HIDDEN FACTORY LOOK LIKE IN BANKING?**
3. **DON'T WAIT FOR THE ACCIDENT TO HAPPEN:** UNCOVER YOUR HIDDEN FACTORIES
4. **SOX IN A BOX:** A HIDDEN FACTORY EXAMPLE
5. **INEFFICIENCIES OF SPREADSHEETS AND MANUAL DATA ENTRY:** A HIDDEN FACTORY LESSON
6. **IMPLEMENTATION TO OPTIMIZATION:** ADDRESSING HIDDEN FACTORIES WHEN ROLLING OUT NEW SOFTWARE
7. **COST OF OPERATING HIDDEN FACTORIES**...REAL WORLD EXAMPLES
8. **UNEARTHING HIDDEN FACTORIES:** ESSENTIAL DIAGNOSTIC QUESTIONS FOR FINANCIAL INSTITUTIONS

Subscribe: www.srarisk.com/knowledge/podcast

Impact of Risk on Strategy: Loan Growth Example

+ Indicator	Value	Weight	Rating	Risk Appetite	Very Low	Low	Medium	High	Very High
+ Loan Growth	Missed Budget (+/-1%)	20%	1.6	1.6	On Budget	Missed Budget (+/-1%)	Missed Budget (+/-2%)	Missed Budget (+/-3%)	Missed Budget (+/- >3%)
+ Total Risk Based Capital Ratio (TRBC)	10.252%	20%	2.8	3.0	> 13.000%	> 11.000%	> 10.000%	> 8.000%	≤ 8.000%
+ CRE Loans/Total Capital	333.04%	20%	4.7	3.1	< 100%	< 200%	< 250%	< 300%	≥ 300%
+ Net Loans/Deposits	96.28%	20%	3.7	3.1	< 70%	< 80%	< 90%	< 100%	≥ 100%
+ Charge-Offs	0.73%	20%	3.0	2.5	< 0.25%	< 0.5%	< 0.75%	< 1%	≥ 1%

Consider These Five Metrics:

1. **Loan Growth TTM** – Past performance gives insight into future potential.
2. **Capital** – How does capital stress testing fit into your strategic planning process and is it done on a risk-based approach?
3. **Concentration Risk** – Do you have remaining capacity in the space?
4. **Liquidity -** Just because you can source it doesn't mean you can fund it
5. **Charge-offs** - Found and funded the loan, but can you feel the risk of a charge-off looming?

RETURN SHAREHOLDER VALUE

Park Sterling Corporation Completes Merger With First Capital Bancorp, Inc.

$87.1 million January 4, 2016

Summary

1. **Risk Culture:** Focus on continuing to mature your risk culture from the top of the organization to every individual that shows up each day. **Everyone is a risk manager when a risk culture is strong.**

2. **Land of No:** Prioritizing and funding risk management shows a **strategy aligned risk culture**

3. **Effect of Risk on Efficiency:** Uncovering and breaking down hidden factories **drives positive earnings results**

4. **Impact of Risk on Strategy:** Spending more time managing risk than managing data **reduces the potential to miss key goals**

5. **Outcome of Risk on Shareholder Value:** A strong risk function is the **foundation to build on** whether organically or through a transaction

THANK YOU

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