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In Search of a New Breed of Chief Risk Officer

WHITE PAPER

HEIDRICK & STRUGGLES

Paul Gibson and Avi Shatzkes, Ph.D are principals in the leadership advisory firm Heidrick & Struggles in New York. Gibson is a member of the firm's global Financial Services Practices where he primarily conducts Chief Risk Officer and other risk related searches. Shatzkes is a member of the Leadership Consulting group and previously worked as a leadership development executive for the global markets groups at Bank of America Merrill Lynch.

Executive Summary

The price for peace of mind has gone up and nowhere is that more evident than the compensation levels for chief risk officers (CROs). If you are a large or medium-size regional bank looking to hire a new chief risk officer, you should expect to pay up to $1 million in annual compensation and potentially more depending on the size of the institution or the skills and experience needed. Demand for this talent has risen but there is a premium to pay and compensation has in many cases doubled compared to a few years ago.

Why has the price risen so sharply of late? This has become a role that can make or break a bank's relationship with its board, shareholders and regulators. The CRO has become significantly more active in determining a bank's strategic direction and the shape of its asset portfolio, as well as continuing to monitor traditional risk functions. The skills sought today in a top CRO are broader than they have been historically, slimming the pool of available talent significantly. Additionally, the career risk for an individual stepping into the CRO role is extremely high, making the roles themselves less attractive. CROs are increasingly blamed for a bank failure and many former CROs are now either out of the market altogether or have changed career paths, moving into consulting or joining a regulator.

This article examines the skills and backgrounds needed for a chief risk officer and poses four questions boards should be asking.

Regulatory Concerns

Under the Dodd-Frank financial overhaul, any bank with more than $50 billion in assets is designated "systemically important," a categorization which requires additional regulatory oversight. Banks approaching that size now have to determine strategically if they should remain under the threshold, and thus avoid additional oversight, or continue to grow. Increasingly, CROs have a critical role in developing the business growth strategy. For financial institutions in the current market, a critical component of growth strategy is understanding the regulatory risk and being able to balance an increased regulatory focus, and the associated costs, against the potential benefit of that growth. The Federal Reserve Board of Governors has recently published new Enhanced Prudential Standards and Early Remediation Requirements for covered companies, generally banks with more than $50 billion in assets, and identified very specific criteria for risk oversight, the role of the chief risk officer, and the risk-related responsibilities of the board.

Public bank holding companies with assets over $10 billion must now have a risk committee of the board with at least one member having specific risk management experience in their background. This is new as a requirement, and puts additional pressure on the chief risk officer, as well as the risk management talent pool in the market.

There are many more stakeholders to consider when selecting a CRO. The CEO has traditionally been the key decision-maker but when it comes to a CRO, the board, shareholders, external policy makers and particularly regulators play ever increasing roles in defining the skills, experience and background needed. The amount of pressure simply applied by the regulators can materially impact the choice of CRO.

We would advocate that every bank needs a chief risk officer, or at least a senior officer responsible for risk management.

The common theme: Risk matters more than ever, and a bank's risk steward must be able to negotiate with, convince, and influence various stakeholders within their respective companies as well as externally.

As risk has emerged from banks' quiet back offices and into the limelight, the talent requirements of the CRO role have shifted. Now, as banks build out their risk functions, they have to address these important, possibly uncomfortable questions.

Does your CRO have the respect of board members and regulators?

Boards of directors have become more serious about governance and credibility, more focused on risk, and better staffed. While the CRO might report to the CEO, he or she will certainly have more direct exposure to the risk committee—and the full board.

Dialogue with directors is different than a technical discussion with a bank examiner. Directors are turning to the CRO for insights that will shape strategy and for a descriptive sense of the bank's risk profile, as well as a clear articulation of possible scenarios and plans for each scenario. They demand succinct framing of problems and proposed solutions, not detailed descriptions of quantitative analyses. And they appreciate a CRO who can demonstrate independence from the line business units. The CRO needs to be able to work with the lines of business to help construct deals and products to ensure that the enterprise portfolio is balanced rather than taking too much concentration risk or to identify where correlation risk might exist between two business lines that maybe aren't aware of what each other is doing.

The CRO must also be able to engage on a detailed technical basis with regulators, rating agencies and other third parties. He or she must gain the confidence of senior regulators by balancing the bank's agenda with a genuine appreciation for the heightened public interest levels in financial services and demand for regulation in the current market.

Does your risk team have the right skill set?

As the risk function has shifted from a largely back-office operation with little influence to be more strategic, regulatory agencies are now insisting that these functions be structurally independent and staffed with strong talent.

The mix of necessary skills has evolved as well. Traditional risk employees with strong technical knowledge and mathematical skills may fall short on leadership and the higher-level soft skills that banks increasingly demand, e.g. problem solving, strategic planning, management and influencing skills. Senior executive candidates now need to be able to demonstrate experience dealing with risk on a systemic level, beyond one product or geography.

Banks should look within their own ranks for high potentials who can be trained and developed for the new realities of risk. They can accelerate the readiness of high potentials by aggressively investing in them through focused leadership development and coaching.

But banks will also have to recruit outside as well. To attract broader groups of qualified individuals, they should consider looking in unconventional places or at alternative groups of candidates, such as divisional CEOs

Do you have an airtight succession plan?

The CRO role is increasingly viewed as a way to move into other C-suite leadership positions, whether at the top of a corporation or to lead a significant line of business. Just as equally, internal business leaders are now viewed as viable successors to the CRO role given its increased involvement in strategy and business decisions. We have seen these types of transitions at global money center banks and regional U.S. platforms. Demand clearly has outstripped current levels of talent. One move can set off a series of countermoves, so boards cannot afford to wait to plan for CRO succession.

The board should be assessing potential candidates now against the new profile of this position, developing emerging leaders internally and identifying potential candidates from outside. Executives in key risk, control and compliance functions should also start informal conversations about their succession plans with key regulators so they can get an early read on regulators' levels of confidence in the plans. While regulators are unlikely to advocate for a specific executive, their guidance is useful for thinking about appointing successors, and clarifying the skills, experience or knowledge someone needs to be effective in the top role.

Are you prepared to invest in the risk function? Can you afford not to?

The risk function has more to do these days. It sits right at the core of how a business uses its capital and earns a return for investors; it is critical to setting and executing strategy. At the same time, greater regulatory demands now mean that the risk function has to produce more data and reports. The costs of compliance and transparency have risen.

These new demands require more people, many with different qualifications than the risk teams of a decade ago. One major regional bank, transitioning from oversight by the Office of Thrift Supervision to the Office of the Comptroller of the Currency, has had to hire a new CRO and now is building a risk department of 40 people almost from scratch. Similar stories are happening across the industry as banks have to meaningfully expand their risk, compliance and control functions just to meet the reporting needs of the regulators. The investment is significant for many banks.

These four questions are not the only CRO themes that should be on the agenda at the next risk-related meeting of the executive team. But rich discussions of these topics—and appropriate talent-management decisions to follow—will go a long way toward ensuring that the right risk leadership is in place.