

# Overview of ERM

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Virtual Meeting #1

# Enterprise Risk Management

ERM asks *What are the risks that could prevent us from achieving our institution's objectives?*

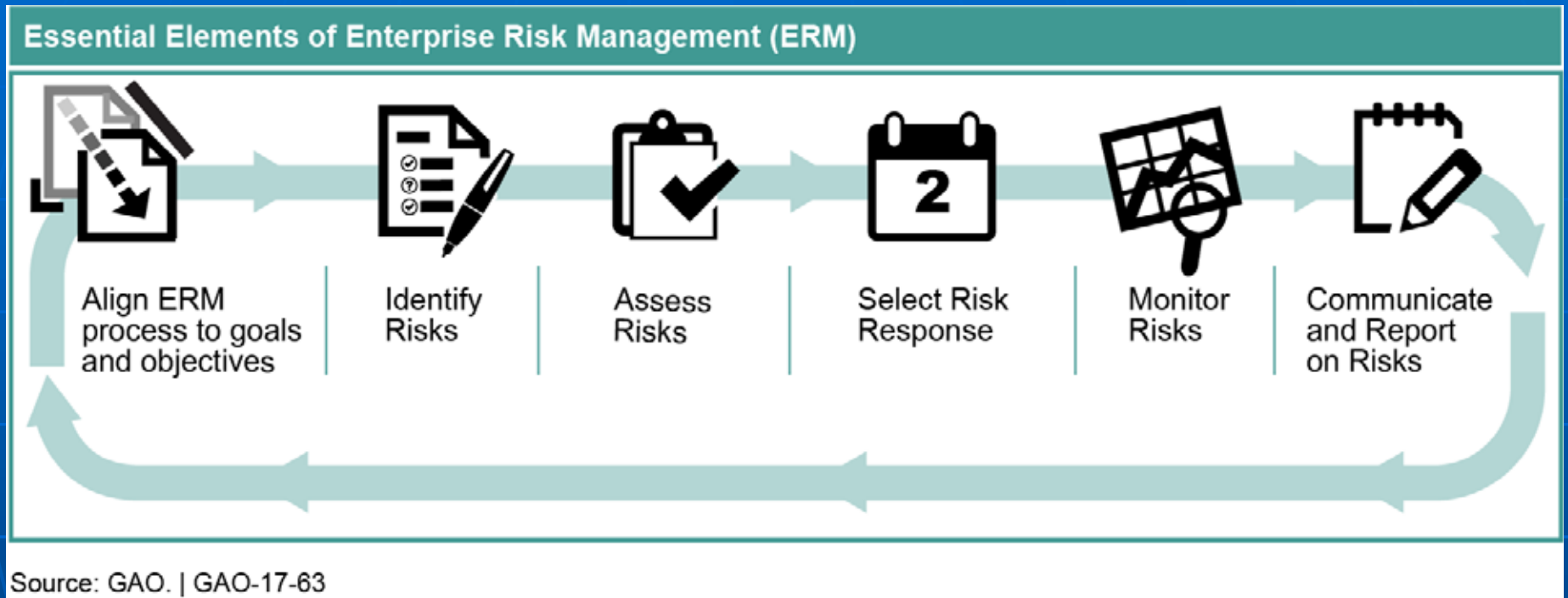
- ERM focuses on major risks – those that can threaten your organization's ability to carry out its mission
- Organizations can become distracted trying to address multiple smaller risks
- Standing still while the environment changes can be a major risk

# Defining ERM

“ERM is a discipline that addresses the full spectrum of an organization’s risks, including challenges and opportunities, and integrates them into an enterprise-wide, strategically aligned portfolio view. ERM contributes to improved decision making and supports the achievement of an organization’s mission, goals, and objectives.”

-- AFERM

# Key Aspects of ERM



Two key steps: (1) “conversations” and (2) “prioritization” – John Fraser

# Why ERM?

The risks you anticipate may not be the most important

e.g., a major community financial institution

Avoided subprime

Hit by cyberattack and major flood

Now a leader in ERM

# Why ERM?

## To Overcome Flawed Decisionmaking

Bad decisions come from:

1. An influential person (CEO? Agency head?) makes an error of judgment
2. Facts are not brought to the table to challenge the flawed thinking and expose errors and correct them before the decision is implemented

-- Sydney Finkelstein, Jo Whitehead, Andrew Campbell, *Think Again*, (Harvard Business Press, 2008)

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# Lessons from the Financial Crisis: Information Flow

1. Information Flow is Essential
  - Front line employees and stakeholders can surface major risks that top management doesn't know about.
2. There are warning signs
3. Investigating is less costly than ignoring warnings
4. Constructive dialogue is needed to understand risk-reward tradeoffs



# The Importance of Information Flow

Example: JPMorgan Chase identifies and analyzes an anomaly in October 2006, and acts to avoid major losses in the Financial Crisis

Example: A Goldman Sachs official reports unexpected losses to his superiors in December 2006; management investigates and acts to avoid major losses in the Financial Crisis



# Types of Risk –1

1. Operational Risk: The risk of harm from inadequate or failed internal processes arising from people, systems, or external events that impair those processes.
2. Strategic Risk: Risk that would prevent an agency from implementing its current business model to carry out its mission.
3. Capacity Risk: Risk of increasing demand for services combined with diminishing resources in a major program area.
4. Compliance Risk: Risk of failing to comply with applicable laws, regulations, or other requirements, or of failing to detect and report such violations.

# Types of Risk – 2

5. Governance/Cultural Risk: Risk that parts of the organization are not open to communication about major risks
6. Financial Risk: Risk of significant waste or loss of funds or other assets.
7. Reputational Risk: Risk of an actual failure or of perception of failure that could diminish an agency's stature, credibility, or effectiveness.
8. Mission Risk: Risk that political leaders significantly change the agency's mission so that past performance may not ensure that same level of performance in carrying out the new mission.

# Group Exercise

What are the five biggest risks to accomplishing this objective for your agency:

“Ensure that, at all times, the agency possesses the knowledge base needed to carry out essential functions”

Note how identification of major risks leads to insight about possible solutions.

# ERM and Agency Performance

“Why does a car have brakes? A car has brakes so it can go *fast*. If you got into a car and you knew there were no brakes, you’d creep around very slowly. But if you have brakes, you feel quite comfortable going 65 miles an hour down the street. The same is true of [risk] limits.”

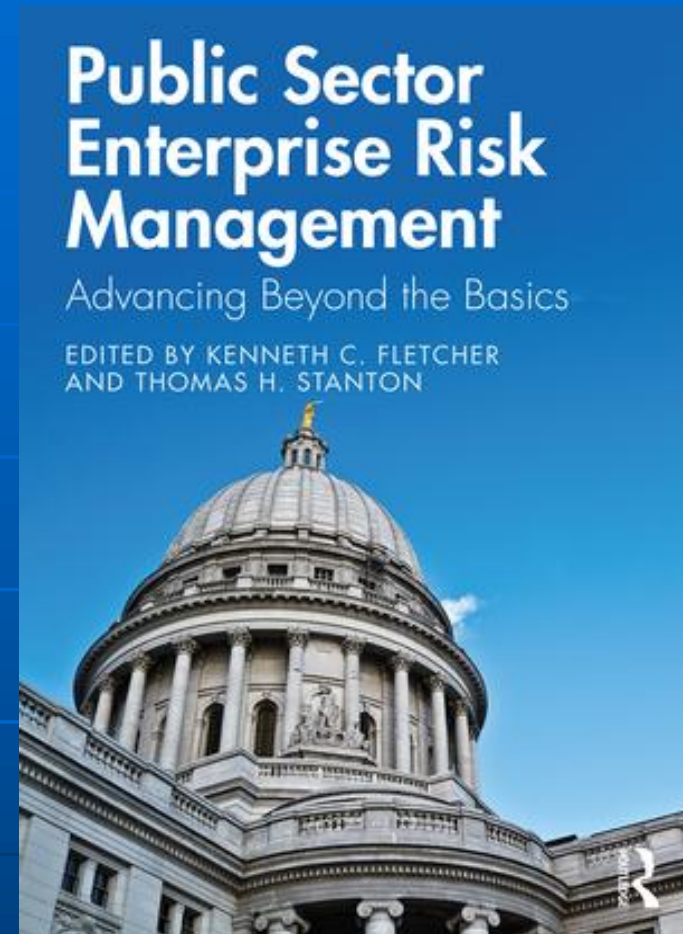
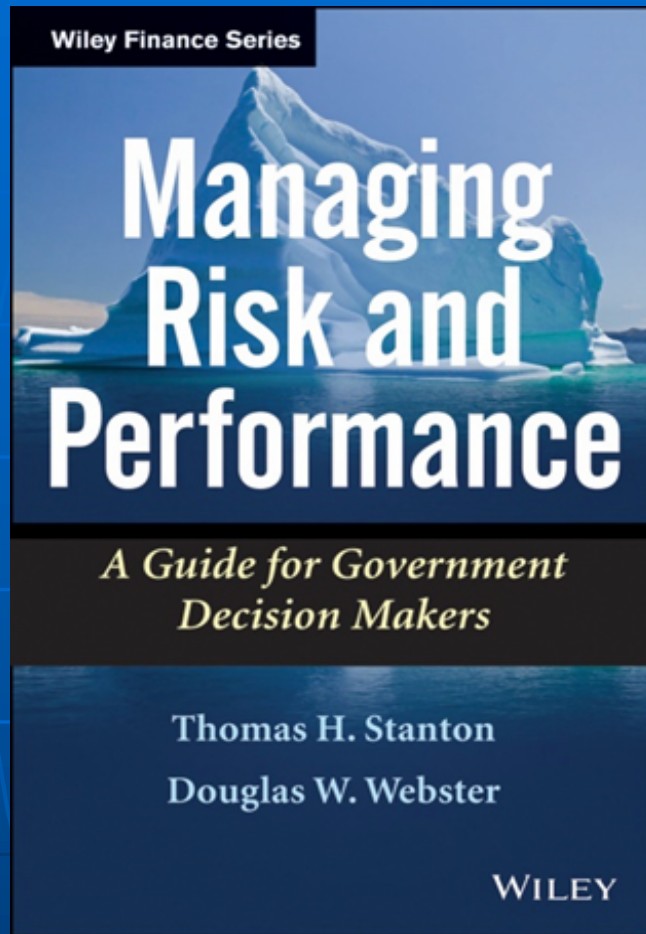
-- John Reed, former CEO of Citigroup to the Financial Crisis Inquiry Commission

# Background Readings

- Kenneth C. Fletcher and Thomas H. Stanton, eds., *Public Sector Enterprise Risk Management: Advancing Beyond the Basics*, Routledge, 2019
- Thomas H. Stanton, "Enterprise Risk Management (ERM): A Powerful Federal Management Tool," guidebook prepared for the Association of Government Accountants (AGA), February 2017, available at <https://www.agacgfm.org/Research-Publications/Online-Library/Research-Reports/An-Agency-Guide-for-ERM-Implementation.aspx>
- Thomas H. Stanton and Douglas W. Webster, eds., *Managing Risk and Performance: A Guide for Government Decision Makers*, John Wiley & Sons, Inc., 2014.
- Douglas W. Webster and Thomas H. Stanton, "Improving Government Decision Making through Enterprise Risk Management," IBM Center for the Business of Government, 2015, available at [www.businessofgovernment.org](http://www.businessofgovernment.org).

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# Government Documents About ERM

- Office of Management and Budget, OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, July 15, 2016.
- Chief Financial Officers Council and Performance Improvement Council, *Playbook: Enterprise Risk Management for the US Federal Government*, July 29, 2016.
- US Government Accountability Office, *Enterprise Risk Management: Selected Agencies' Experiences Illustrate Good Practices in Managing Risks*, GAO-17-63, December 1, 2016.



# The Association for Federal Enterprise Risk Management ( AFERM)

AFERM's mission is to create a community of practice in Enterprise Risk Management (ERM) in the federal government through thought leadership, education and collaboration. We provide programs and opportunities to educate members and stakeholders on the benefits, tools and leading practices of Federal ERM. AFERM also fosters collaboration with other organizations and stakeholders to promote policies to establish Federal ERM in federal agencies and departments.

Networking opportunities and ERM resources can be found at [www.AFERM.org](http://www.AFERM.org).

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