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EWCRA and the Evolution of Compliance Risk Management

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The recent acute and rapidly evolving environment in the financial services industry has heightened awareness among financial institutions of the need to embed compliance and risk management processes into their broader strategic objectives to help better manage compliance risks and identify opportunities. Author Catherine Brown discusses how prevailing notions of compliance risk management have proved largely ineffective and costly – even for those institutions with perceived robust enterprise risk management (ERM) programs – and why institutions should explore moving beyond ERM to implement an enterprisewide compliance risk assessment (EWCRA).

Perhaps at no other point in the history of banking and financial services has there been a stronger case for banks to take an enterprisewide approach to compliance risk management. This need to view risk management holistically becomes more pronounced as the U.S. government continues to revise and expand the financial rules and regulations governing financial service companies. With new banking laws and regulations come increased expectations for banks to maintain comprehensive risk management programs to ensure compliance. In this environment of heightened scrutiny, financial institutions can benefit from taking a closer look at their compliance risk management practices and determining whether these practices will withstand regulators' tests.

Historically, compliance has been treated as a “check the box” exercise focusing on a number of individual compliance tasks with the goal of minimizing overall costs. The result was inconsistent, duplicative efforts and compliance risk management that was often fragmented and reactive.

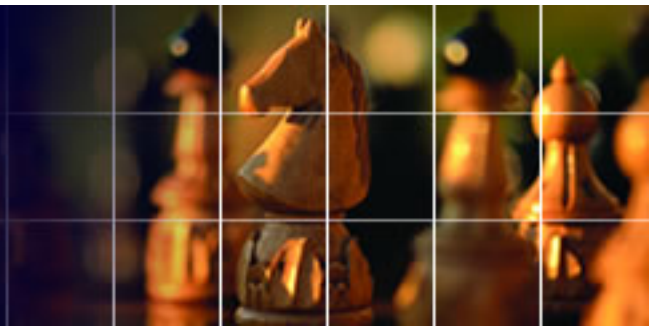
Alternatively, a holistic approach to compliance risk management that establishes the framework for identifying, assessing, controlling, monitoring, and reporting compliance risks across an organization can substantially increase the efficiency of a risk management program. Improving an organization's program ultimately can reduce the organization's costs related to compliance and change its program into one that adds considerable value to its strategic objectives.

Enterprisewide Compliance Risk Assessment

In general terms, an EWCRA provides a means for a bank to assess all of the laws, regulations, and other requirements that affect the organization's entire enterprise; it is based on a defined methodology, includes an inventory of the institution's specific requirements, and reflects the institution's unique operations and risk profile.

An EWCRA begins with identifying and assessing regulatory risks at both the enterprise and business line levels and determining which areas pose the greatest risks to the institution. In addition, an EWCRA provides managers with a consolidated picture of the organization's regulatory risk levels for all products, services, activities, business lines, and legal entities. The EWCRA then guides the institution through establishing standards and processes commensurate with the size, complexity, culture, and risk tolerance of the organization.

Specific components of the compliance risk management program – such as scope and frequency of compliance monitoring and testing, as well as the type of controls appropriate to mitigate a particular risk – can be determined based on the results of an EWCRA. A comprehensive, formalized EWCRA provides managers with the unique and valuable perspective of assessing otherwise distinct lines of business or legal entities on both an absolute and relative basis.



EWCRA Model

Each of the primary steps of an EWCRA includes more granular processes designed to allow institutions to make risk-based decisions about managing compliance risks. Some of these processes include training, resource management, and the appropriate level of automation of controls.

Central to the success of an EWCRA is buy-in from the business line managers and other organizational stakeholders such as the legal, internal audit, and other risk management functions. This commitment helps the assessment consider all substantive risks and relevant areas of an institution and make certain that the approach is consistent with – and not redundant to – existing processes. An organization considering developing and implementing an EWCRA, or one weighing whether to change an existing program, should tailor the program by carefully defining and documenting the methodology based on the organization's specific needs and objectives.

An EWCRA provides a foundational view of all relevant compliance risks and should be used to establish the basis on which all other compliance risk assessment activities are completed. Specific areas of compliance such as anti-money laundering, privacy, and fair lending – where more rigid risk-assessment requirements and higher regulatory exposure exist – should be managed based on the results of the EWCRA.

Managers need to continually update the EWCRA to identify and reflect changes in the organization's risk profile – such as new products and services, changes to existing products and services, organizational restructuring, the addition of new technology, the loss or addition of key personnel, and expansion through mergers and acquisitions. Key risk indicators should be defined, documented, closely monitored, and incorporated into the periodic EWCRA process, and the EWCRA should be repeated regularly – generally every 12 to 18 months.

The Far-reaching Benefits of EWCRA

Beyond meeting the expectations of regulators and other key stakeholders, the benefits of a more evolved approach to compliance risk management via an effective EWCRA are significant, particularly as the activities of financial institutions become more global and complex. The more practical benefits of EWCRA include:

- Using existing risk management activities such as ERM and internal audit to provide managers the ability to proactively manage compliance risks within the organization's broader risk management framework;
- Providing an impetus for the organization to more deeply consider its compliance risks on a risk-based basis;
- Providing a means to embed compliance into day-to-day activities and overall business strategies;
- Methodically identifying the organization's most significant risks and directing resources accordingly;
- Mapping requirements to related control points and determining the type, scope, and frequency of appropriate testing; and
- Increasing awareness, collaboration, and consistency among divergent lines of business and legal entities, thereby enhancing their compliance efforts and how they monitor and control their respective risks.

Each of these benefits enhances the overall effectiveness of an institution's compliance management program and can help serve to diminish an organization's compliance-related expenses. Indeed, embracing a more integrated, enterprisewide approach to compliance risk management is essential for flourishing in this new era of banking.

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