Managing risk from the front line

Risk in review 2017: Canadian insights

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Foreword

I'm very excited to announce the launch of our *Risk in review* report. For the first time, we've taken the Canadian-specific results from PwC's global study.

While Canada has come closer to its global peers in the past couple of years when it comes to managing risk, there's still a gap that needs to be addressed for Canadian businesses to develop the agility they need to continue to excel in the current economic landscape.

Companies excelling today have intuitively grasped that risk management must be shifted to the first line of defence—specifically the business units that undertake those risks. But that's not to say that the second (risk management/compliance) and third (internal audit) lines no longer play an important role in this process.

By moving risk management closer to the front line, management will have a greater understanding of risks and a greater capacity to manage them in an agile way. Given how dynamic the current business environment is, companies no longer have the luxury of time to be shifting risk management across the different lines to determine a course of action.

In this report, we've summarized the results of our survey into three key takeaways:

- Canadian businesses are more vulnerable to business disruption than their global counterparts.
- They're catching up with their global counterparts in terms of addressing risk management.
- They understand the benefits of front-line risk management but have confidence in their second and third lines.

There are some valuable lessons to be learned. And these findings will be a springboard to a larger conversation about how Canadian companies can develop the agility to make such changes.

Kishan Dial
Partner, Risk Assurance Services

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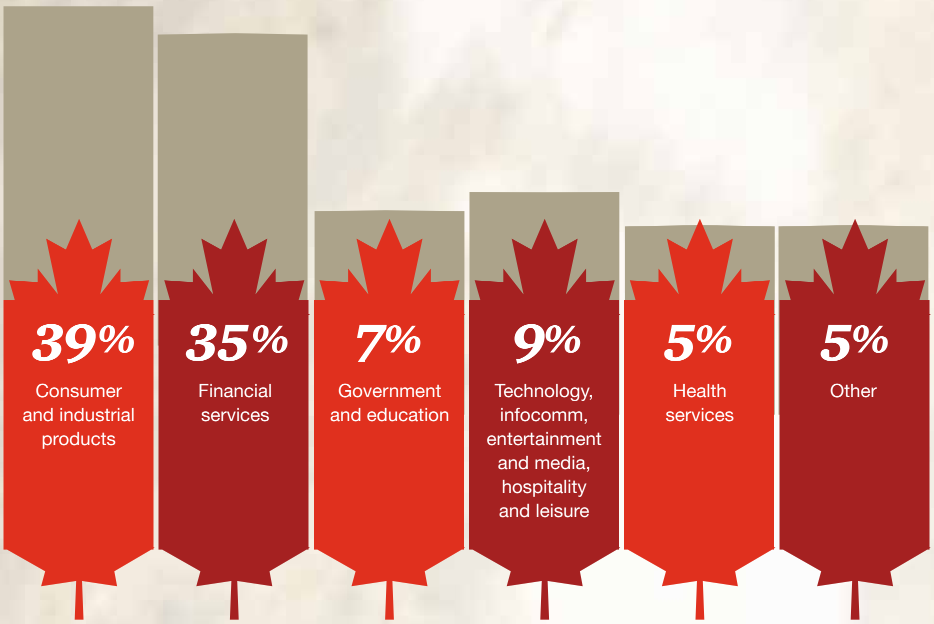
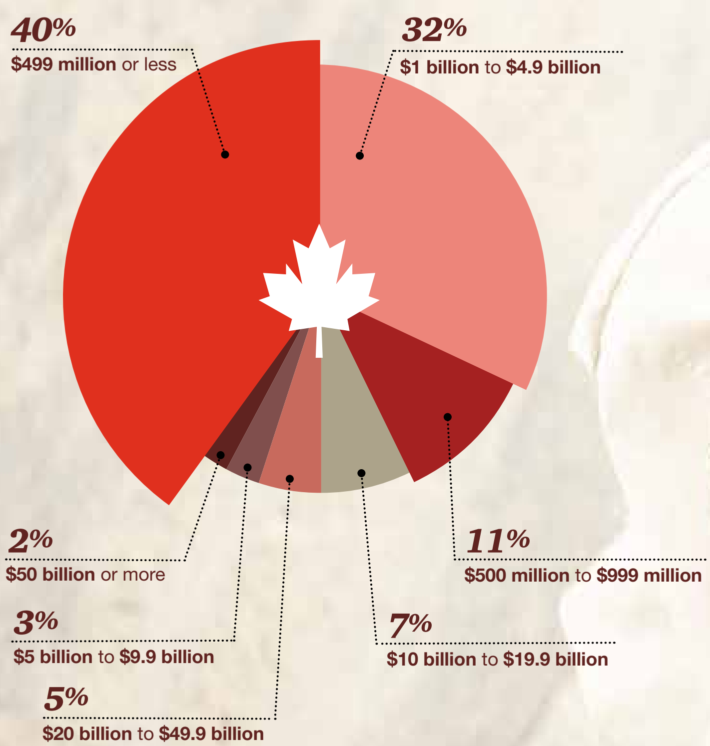
Figure 1: Canadian respondents by industry, company size

Canadian respondents by industry



Canadian respondents by company size



Navigating disruption
Canadian companies vulnerable to business disruptions

Compared to their global counterparts, Canadian companies say they're more liable to undergo disruption in a variety of business areas while being less successful at dealing with these disruptions. More Canadians report they've experienced business disruption over the past two years, particularly in the areas of human capital, technology and finance, with Canadian respondents undergoing disruption in these areas at a rate of at least eight percentage points higher than the global average.

The good news is Canada has bridged the gap over the last two years. Specifically, regulated industries such as banking and other financial institutions have made progress in dealing with risk and disruption relative to non-regulated industries.

But greater preparation will be needed, as Canadians are more likely than global respondents to expect disruption over the next three years.

Canadian companies expect to undergo disruptions in technology advancement (70% expect this area to be disrupted compared to 55% globally), human capital (49% compared to 40%) and operations (37% compared to 26%).

This lack of preparation relative to the rest of the world has already been an issue, as Canadian respondents that have experienced disruption report they are less likely to have managed it well. For instance, only 35% of Canadians that experienced a disruption caused by digital innovation managed the issue effectively (compared to 42% of global respondents). Human capital disruptions had a similar effect (24% in Canada compared to 36% globally).

Again, non-regulated private organizations are less likely to manage disruptions effectively than companies within regulated industries.

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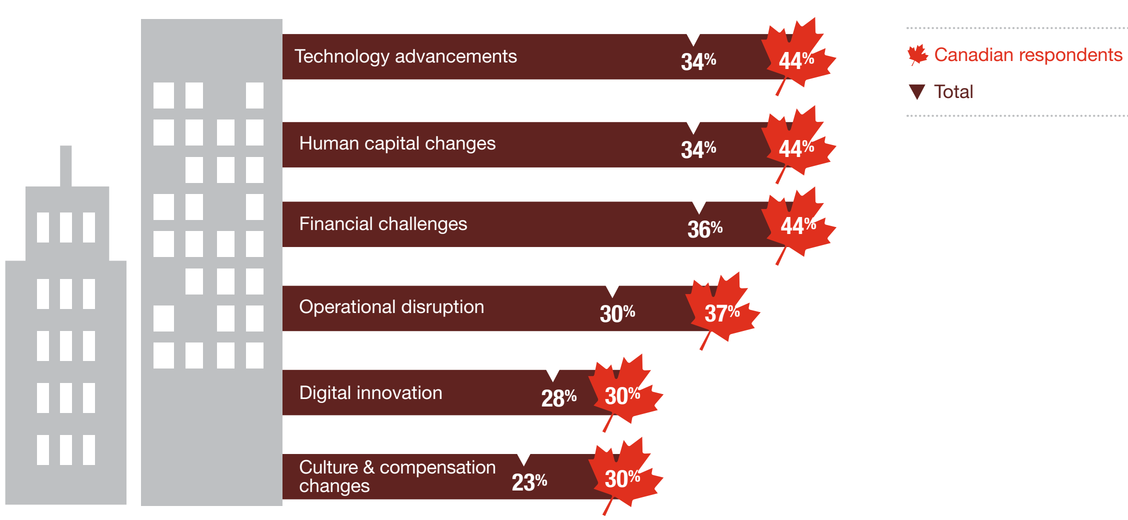
Figure 2: Canadian respondents more likely to have experienced disruption

Which of the following have caused disruption for your company in the past two years?



Managing risk

Canadian organizations catching up with global counterparts

Managing risk in Canada is an ongoing challenge. In every area surveyed, Canadian organizations were below global respondents in terms of how effective they are at managing risk, although they continue to catch up.

Part of the issue here is that in most areas, Canadian organizations manage risks from the second or third line. In fact, there are only two areas in which Canadian respondents report they're more likely than the global average to manage risks from the front line—regulatory and compliance risk (33% compared to 26% globally) and technology risk (44% compared to 42%).

It's clear this approach of deferring to the second and third lines isn't paying off. This is particularly an issue in non-regulated industries, as those companies seem to be falling behind their global peers in terms of how they manage risk overall.

Obviously, Canadian non-regulated industries aren't looking for more regulation, but these companies can learn from regulated companies in terms of effectively managing risk and ultimately creating a more agile organization. But Canadian non-regulated companies that have a global footprint and operate in other places—especially the United States, United Kingdom or Europe—tend to be better at assessing and managing risk proactively.

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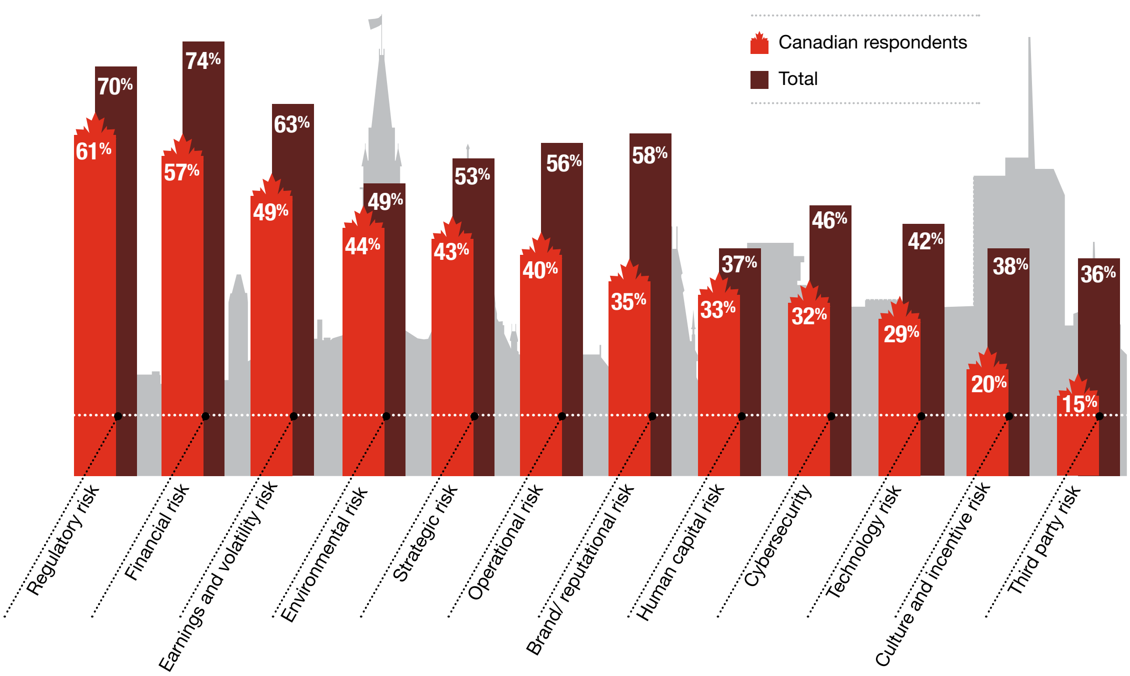
In every area surveyed, Canadian organizations were below global respondents in terms of how effective they are at managing risk.

Figure 3: Canadian companies less effective at managing risks

How effectively does your company manage the following risk areas today? "Effectively" responses



Recognizing the need to define risk appetite

A risk appetite statement is at the centre of any strong risk management program—but fewer Canadian respondents have one. Without first defining your risk appetite, it's difficult to manage risk or make sure you're sufficiently prepared to deal with disruptions.

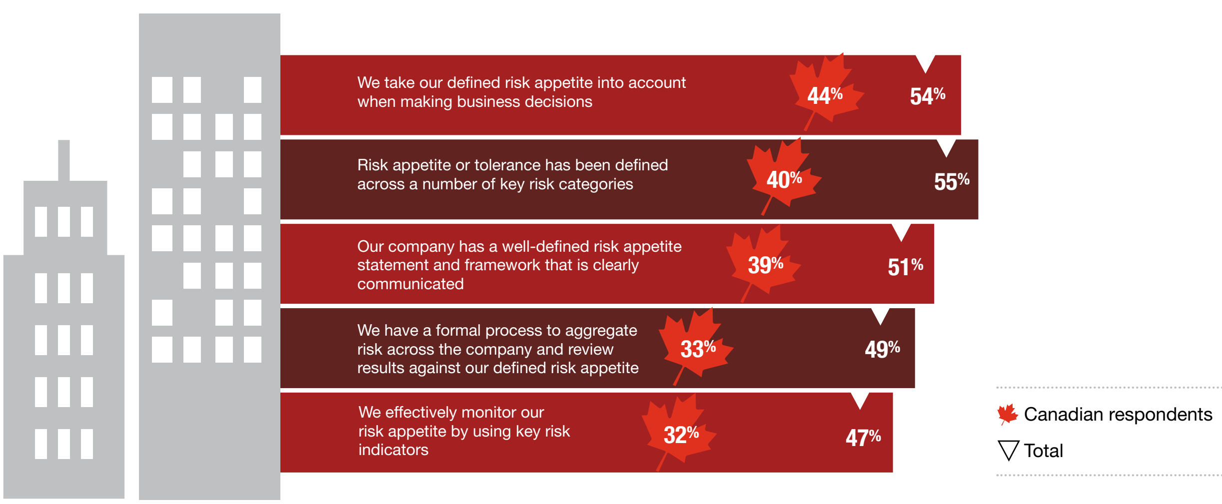
Defining a risk appetite involves understanding and substantiating the amount of risk you're willing to endure for various types of transactions or business deals. Managing various perspectives becomes a huge task when there's no consensus. By creating formalized guidelines, all decisions remain within those parameters, allowing companies to be more agile with their go-to-market strategies.

Canadian respondents reported they're less likely to use risk management tools and techniques such as risk rating systems (59% in Canada compared to 69% globally) and corporate risk dashboards (48% compared to 53%) to help define risk appetite.

Without first defining your risk appetite, it's difficult to manage risk or make sure you're sufficiently prepared to deal with disruptions.

Figure 4: Canadian companies fall behind on all measures of risk appetite

To what extent do you agree with the following statements about your company's risk appetite?



Our study suggests that Canadian respondents have slipped behind global respondents in several areas of risk culture. In general, building and maintaining a strong risk culture has proved an uphill battle—especially in the area of training.

For instance, just two thirds of Canadian respondents stated that ethics and compliance training is mandatory for all employees, compared to almost three in four of the global respondents. Further, less than one in three Canadians reported that they offer periodic staff education about new or existing potential risks, whereas almost half the global respondents do.

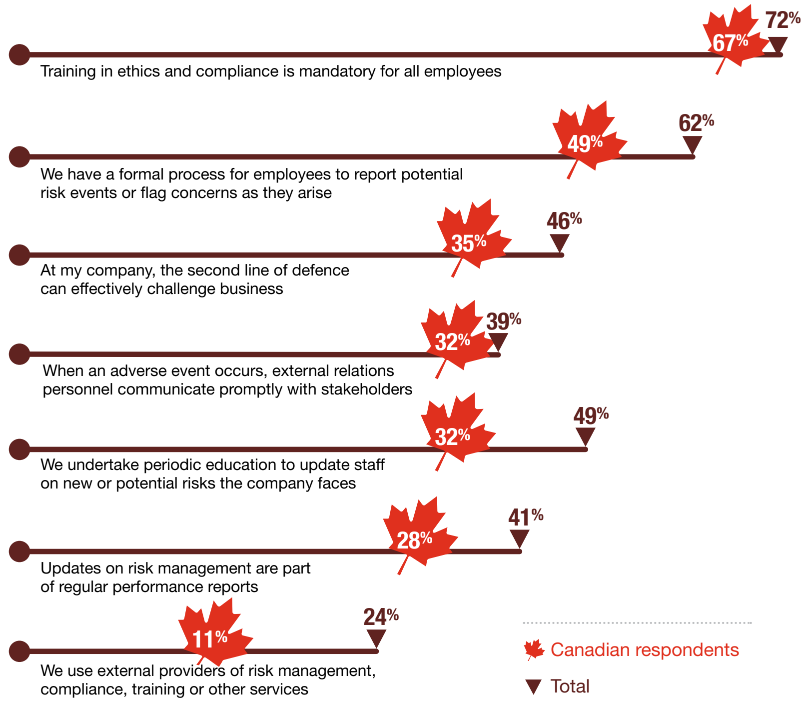
Our survey found that Canadian companies are far likelier to anticipate disruptions across a variety of business areas, so the training gap is particularly worrisome—not just for new employees but also for existing ones. To foster a more agile environment, ongoing training—as opposed to one-time orientation training—should be mandatory, as risk is continuously evolving. The risks a company faces today will likely be different from those it will face just a couple of months later.

Canadian companies are catching up when it comes to the second line of defence. Just 35% believe they can effectively challenge business units, compared to 46% of global respondents.

In general, building and maintaining a strong risk culture has proved an uphill battle—especially in the area of training.

Figure 5: Canadian organizations lag behind in many areas of risk culture

Which of the following statements about risk culture are true of your organization?



Embracing the shift

Canadian companies understand the value of shifting risk to the front line

Research indicates that when management (first line) is more aware of what the risks are, what their company risk appetite is and what they can do to manage risk, their decision making is faster. That level of agility will improve a company's performance and speed to market.

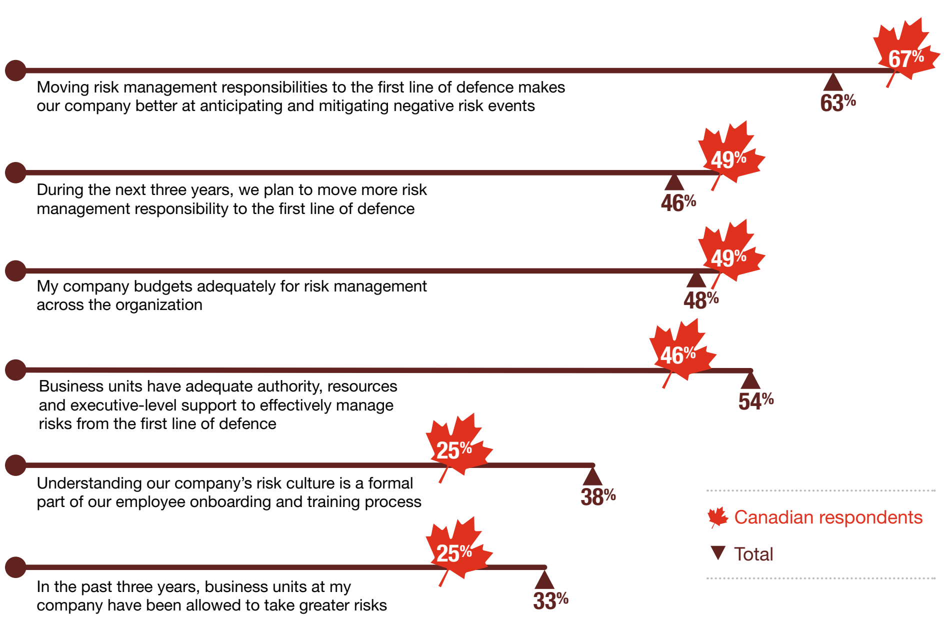
Canadian respondents indicate they're more likely than global respondents to plan to shift risk management to the first line, but they may lack the preparation needed for that move. They're somewhat more likely (67% compared to 63%) to agree that moving to a first-line risk management strategy will improve their ability to predict and mitigate negative risk events. But significantly fewer agree that their business units have enough authority and resources to manage risk from the first line.

The fact that Canadian companies recognize they'll be better off with a first-line strategy for risk management but aren't acting on it is one of the bigger surprises of our survey. This suggests that while Canadians acknowledge the benefits of shifting this responsibility to the first line, the change will take longer, as they're likely more confident in their second and third lines of defence.

When management (first line) is more aware of what the risks are, what their company risk appetite is and what they can do to manage risk, their decision making is faster.

Figure 6: Canadian companies understand the benefits of strong first-line risk management but aren't fully supporting that approach

To what extent do you agree with the following statements?



An integrated and coordinated model

Tone from the top is vital in setting the stage for a stronger risk culture and ushering in a more agile business environment. If the CEO and board continuously discuss risk and what it means to the company, they'll create a solid foundation focused on risk culture that will filter down throughout the organization. Sending the message from the top down is the most effective way to manage risk.

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Continuously monitoring and measuring effectiveness will increase an organization's agility and make sure a strong risk culture is maintained. This is where performance risk management comes in: by identifying their key performance indicators (KPIs) and mapping them back to risk factors, organizations will see where risk is being managed more effectively. CEOs must determine what they want out of a risk management program so performance management and incentives align with those goals.

Of course, defining your risk appetite or tolerance is only half the job. Using tools, techniques and methodologies such as risk aggregation, tracking and reporting is vital. Fortunately, there are solutions to help manage, measure, track, monitor and report risk. By differentiating between leading and lagging risk indicators, organizations will use past data to uncover trends and create a corporate risk dashboard that will help management become more agile, making forward-looking decisions.

The three lines of defence model of tomorrow

Optimal risk management requires agility to shift duties across the lines of defence. Ideally, the first line makes the decisions, the second line monitors the first line and the third line offers objective oversight. By assigning the management of the right risks in the right places and providing each line of defence with the information and resources it needs, organizations will lay the foundation for a strong risk management program while creating a more agile environment.

Use a clearly defined risk appetite guideline across the company and enforce it by defining the framework through an agreed-upon glossary of terms to help you aggregate, track and predict risk. Where possible, use technology and data analytics to track and monitor the effectiveness of your program.

Follow up with a risk reporting system so that the first line of defence can carry out its responsibilities. The risk functions must be set up to enable the first line but also allow the second and third lines to monitor the first line's effectiveness.

Risk management needs to be part of both strategic planning and tactical execution for company management. This creates the agility needed to rapidly respond to risk and disruption and, ultimately, to get ahead of risk.

Canada has fallen behind in risk management, but the good news is the means exist for organizations to manage risk more effectively and produce a more agile company.

Optimal risk management requires agility to shift duties across the lines of defence.

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To have a deeper conversation about how this subject may affect your business, please contact:

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