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**Special issue on Enterprise
Risk Management**

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Editorial

How should an Enterprise Risk Management department be organised? And what should it do?

Since the financial crisis, financial institutions have focused much more heavily on capital adequacy and therefore on measuring all risks across the enterprise in a coherent and consistent manner. Over that same period, the risk profile of financial institutions has continued to increase in interdependent complexity. As a consequence, interest in enterprise risk management (ERM), which can assess risk across the traditional risk silos, has continued to grow as well.

Some financial firms have responded to these trends by setting up separate ERM departments while others are considering establishing an ERM function or updating an already existing ERM function. Structuring an ERM department is not straightforward, however, as ERM functions must be sharply distinguished from the activities that the mature risk disciplines such as market, credit and operational risk already perform. How should an ERM department be organised? And what should it do?

To help financial institutions answer these questions, we have invited contributions from authors who have experience in ERM to present in this special issue their views on how an ERM department should be configured and what its functions should be. Generally speaking, there is consensus on the core activities of an ERM function — defining the risk appetite of the firm, risk identification and firmwide risk governance — although the precise definition of those activities varies. Hans Helbakkmo, Cindy Levy and Olivia White in ‘Creating the Bank Enterprise Risk Management Function of the Future’ emphasise that these core functions need to be dynamic so that they can rapidly respond to a firm’s changing profile. Risk identification, for example, rather

than being a relatively static exercise should focus on developing surveillance procedures that quickly identify not only new and emerging risks but also weakness in controls. Jeffrey Brown, Michael Duane and Til Schuermann in ‘What Is Enterprise Risk Management?’ explain the organising principles that determine how an ERM function should be specified and how its functions should work together, highlighting, for instance, the importance of linking a comprehensive risk identification exercise directly to the firm’s risk appetite. In contrast to Brown, Duane and Schuermann, who suggest that stress testing is a ‘nice-to-have’ function in ERM, Fabrice Fiol in ‘Enterprise Risk Management: Towards a Comprehensive Yet Practical Enterprise Risk Function’ argues that stress testing is an integral ERM function. Greg Hopper in ‘The Enterprise Risk Management Function in Financial Institutions’ agrees that stress testing is an essential function of an ERM department and also argues that ERM departments should develop special expertise in assessing and managing new and emerging risks that are multidimensional in nature. As firmwide stress testing is of interest to ERM specialists, we also include in this special edition Paul Kupiec’s paper ‘Stress Testing and the Representative Bank Model’, which illustrates the importance of using firm-specific rather than representative firm models to obtain accurate results in firmwide stress tests.

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