



Sir Robert Peel on ORM

Summary

Risk managers are fond of saying they are not policemen. This attitude does not do justice to either risk managers or the police. In fact, the principles set out by Sir Robert Peel in 1829 for the Metropolitan Police Force are easily translated into sound risk management principles. And when we view policing as a community service rather than a hostile external force to be avoided, it actually makes all the sense in the world to see risk managers as policemen. But think Bobbies rather than CSI and think crime prevention rather than car chases.

Dear reader,

In the well-worn phraseology of banking governance, Risk Management (RM) acts as a second line of defence. RM is assumed to be close enough to the real process owners (the first line of defence) to be merely one step removed, capable of close monitoring and of swift action should the limits of acceptable risk be in danger of being broken. Much has been said about how RM can achieve these objectives. This newsletter looks for inspiration at an unusual source and applies the notions identified there to the establishment of sound risk management in banks.

In 1829, Sir Robert Peel¹ set out the principles of Law Enforcement. It is striking how relevant the principles that were set out then for effective policing can be translated into today's RM principles. Not many people will like the idea at first, but try to read the following principles while substituting *Risk Managers* for *Police* and *Business* for *Public*. It makes excellent sense as we shall see, and it holds important lessons for banks. Here are the principles:

1. The police, at all times, should maintain a relationship with the public that gives reality to the historic tradition that **the police are the public and the public are the police**; the police being only members of the public who are paid to give full-time attention to duties which are incumbent on every citizen in the interests of community welfare and existence.

This is the key principle for effective RM. There is a real danger that banks invite moral hazard by shifting the responsibility for adhering to the risk principles to the RM function. That would be disastrous for any institution. To make sure the business plays its part, banks must include RM tasks in all job descriptions. To make this truly effective, banks should also add specific risk measures to their business KPIs.

2. The police seek and preserve public favour not by catering to public opinion but by constantly demonstrating absolute **impartial service to the law**.

The independence of RM is best demonstrated by adhering to a clear set of guidelines and rules that are purely risk focused. This may sound counterintuitive since it is often believed that risk should facilitate the business first of all. That idea, however, devalues the risk function and is not in the bank's best interest. Rather, a transparent set of RM programmes and accompanying rules makes it easier for risk managers to explain to the business what their role is and why it is in the ultimate interest of the bank when all lines of defence co-operate.

¹ The British Conservative statesman (1788–1850) who established the London Metropolitan Police Force. The principles can be found in Charles Reith, 1948, *A Short History of the British Police*. Oxford University Press, Page 62



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3. The ability of the police to perform their duties depends on **public approval** of police actions.

The importance of cooperation between the first and second lines of defence is a sadly neglected topic. Banks achieve the full benefit of effective RM if the business endorses the RM programme and agrees with its objectives. Banks that manage to secure business commitment to RM will save on costs, they will improve resilience and they will increase their bottom line.

4. The police must secure the willing co-operation of the public in voluntary observance of the law to be able to secure and maintain the **respect** of the public. The degree of co-operation of the public that can be secured diminishes proportionately to the necessity of the use of physical force.

The effect of the recent excesses in risk taking has made a mockery of the idea of self-governance for banks. But that is not what this principle is about. The principle of 'willing co-operation' refers to *respect* for the law. For banks, this is best translated as the business' understanding, acknowledgement and adherence to risk limits. Thus, the fact that RM has relatively few sanctions (the banking equivalent of physical force) helps rather than hinders. The challenge for RM remains how to enlist the business without the use of force or sanctions.

5. The police use physical force to the extent necessary to secure observance of the law or to restore order only when the exercise of persuasion, advice and warning is found to be insufficient.

The banking equivalent of physical force would be an SEC or FED sanction such as fines, cease & desist orders, or other restrictions. RM has no such powers, but it is necessary that the business understands that there are escalation paths and that they are worth avoiding. It is up to both the first and second lines of defence to be explicit about the consequences of not following RM programmes and rules.

6. The police should always direct their action strictly towards their functions and never **appear** to usurp the powers of the judiciary.

RM has its limits and is unlikely to impose sanctions directly, but the key word here is *appear*. If RM *appears* to be both judge and jury, co-operation will be severely impaired. To ensure that the business regards RM as fair and impartial, the governance structure should be such that the first line of defence has good access to the RM Committee and the board regarding any RM disputes.

7. The test of police efficiency is the **absence of crime and disorder**, not the visible evidence of police action in dealing with it.

Successful RM is not measured by the number of assessments or the follow up of losses but by the bottom line and the absence of events (not just the absence of losses). Focusing on managing risks requires RM to focus on prevention, not only on follow up of events.

Conclusion

Risk managers often say they are not the police. This is based on a misunderstanding regarding the role of the police and the role of RM. The first principle of policing is that *the police are the public and the public are the police*. If that describes the place of risk in a bank, it implies that risk has been truly incorporated in the banking culture. It will mean that the second layer of defence can be the police without being the business' adversary. That is something to aim for.