Deloitte.

Decision Rights in Financial Services

Defining the new normal

What are decision rights?
Decision rights are a component of organization design. They identify what business decisions need to be made both to drive the business and to drive alignment to strategy; who is involved in making them; and define the framework for how they will be made through operating processes and support tools.

Too smart to fail

Popular portrayals of financial services institutions leading up to the 2008 crisis emphasize behaviors of individual and corporate greed, predatory lending, vaguely defined risk appetite and minimal to non-existent monitoring of that risk tolerance threshold. In a compelling report, the Financial Crisis Inquiry Commission's 2011 findings described the cause of the collapse as "systemic breaches in accountability at all levels."[1]

When taking a closer look at the actions of executives and management within these institutions, a tangled web is revealed of unevenly distributed risk tolerance, short-term objectives trumping long-term judgment, and unclear lines of responsibility for outcomes. In sum, many of the breakdowns were at their core, breakdowns in the process of organizational decision-making.

In fact, the bank failures that rocked the markets in 2008 are best understood as the culmination of thousands of individual decisions made at all levels within the financial services industry. In some cases, these decisions led to the collapse of lines of business, and in other cases, the wholesale failure of institutions, yielding extensive losses for clients and shareholders.

When lines of authority for decision-making are unclear, unaligned or duplicative, and when the true cost of decisions are not felt by the decision-makers themselves, incremental poor choices can compound into profoundly negative outcomes. The financial crisis is a painful reminder of the compounding nature of small, individual choices that amount to much larger forces, making more effective structures for decision-making an urgent strategic imperative.

The good news is that there are a number of steps that financial institutions can take to strengthen both individual and collective decision-making and accountability internally, while responding to oversight and public opinion externally. Doing so effectively can yield immense savings – not just in terms of cost avoidance and efficiency of management processes, but in stakeholder perceptions and brand reputation as well.

1 Conclusions of the Financial Crisis Inquiry Commission, 15 January, 2012 http://fcic.law.stanford.edu/report/conclusions.

The path forward

Recent economic events have demonstrated, yet again, that there is an urgent need for financial services senior executives to improve their decision-making and management of risks. And this begins with the role of information, its transparency, accuracy and efficacy in the decision-making process, but continues with defining who will be responsible for which decisions and how those decisions will get made collaboratively across an enterprise.

Beyond the board: The C-Suite's role in Decision Rights

It's tempting to assign and transfer ultimate corporate governance authority to the board. However, it is the behaviors established in the C-suite that most readily cascade throughout the rest of the organization, allowing for the impact of bad decision-making processes to be felt as far as front line employees. At the top of the organization where the stakes are highest, decision rights are costly to ignore.

The C-Suite is responsible for establishing and executing a sound decision rights framework, and for translating and cascading that framework throughout the leadership team and organization.

Every seat at the table is vested in the enterprise's decision-making process, but where does the proverbial buck stop? Who owns each strategic-level decision? How do they gain access to the right information in a timely fashion to make those decisions? And how do they work together to improve their respective perspectives in a more informed process?

Improving risk management through effective decision making

As financial institutions have responded to the new regulatory environment, an integrated approach to risk, regulatory and compliance management has ascended to the top of the agenda. Enterprise Risk Management (ERM) is a critical piece of the governance picture, as it provides a framework to understand, gather, analyze and report on risk information across the organization. With a focus on creating transparency and awareness of risks to the business, ERM has emerged as a strong solution. However, as learned from the financial crisis, the establishment of a risk framework is incapable of mitigating risks effectively alone.

To adequately identify, assess, and manage risks that range from strategic, reputational and operational in nature, to core business focused risks like credit, liquidity and market, these activities must be closely tied to nuanced behavioral aspects of decision-making cascaded throughout the organization's governance structure. Without an associated social component, existing risk management frameworks rely on the ability of employees to execute tasks and check boxes without the proper levels of awareness and understanding.

Yet managing specific connections requires in-depth understanding of the organization, knowing where vulnerabilities lie and making conscious decisions about which ones to accept and which to mitigate. Without the resulting transparency, the enterprise may be unprepared for either profound disruption or opportunity. And sustainable risk management requires that leaders and managers are able to think, contextualize and understand the implications and complexity of their decisions. That is, taking risk management out of the risk management function and ensuring management's understanding that decision making is a risk governance process that shapes the culture of the organization.

Where to start

Galvanized by the CEO, the C-suite can begin managing identified connections by clarifying and defining which decisions need to be made ("what"), determine who needs to be involved ("who"), and then define the process for actually making the decisions ("how").

Once established for the executive team, the decision rights framework can be expanded to the broader leadership team, and then even further to incorporate core oversight and governance committees where joint decision-making processes take place. Once the highest levels of decision rights have been defined, the model can be developed further to account for more granular regional, functional and divisional implications.

Ask yourself…

- Are the right roles engaged in the right way to share information to/from the CEO at the right time?
- What happens when external circumstances demand that tough decisions be quickly made by the C-suite in response to a new regulation or pending crisis?
- How well does each member of the executive team understand their level of accountability for making decisions and the way in which they should collaborate on cross-functional decisions?

As used in this document, "Deloitte" means Deloitte LLP and its subsidiaries. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Decision Rights Framework Element	Take action	Additional thoughts
What Decisions that need to be made in alignment with the business strategy	Determine what decisions need to be made	There are four types of decisions that span from strategy setting to delivery and execution. Establish an inventory of the decisions that need to be made. • Strategy Decisions — Shape the future business direction and commit significant resources • Direction Decisions — Provide overall management direction • Integration Decisions — Require coordination of various groups across different processes and functions • Delivery — Related to the day-to-day management of a specific process or function
Who The individuals and groups involved in making decisions	Determine who needs to be involved	Define the individuals and groups aligned with each decision type and document the associated roles and responsibilities based on the RACI-V model. • **R — Responsible** — For executing and doing the work • **A — Accountable** — For the outcome of the decision; for ensuring the decision is made with the participation of designated stakeholders (R's); for gaining alignment during the decision-making process; only one role is accountable for decision-making • **C — Consulted** — By the stakeholders (R's) to provide input to the process, but not directly involved in the decision-making activity • **I — Informed** — Notified about the decision after the decision has been made, but not directly involved in the decision-making activity • **V — Veto** — An individual or group who by their role or actions prevent decisions from being executed, formally or informally
How The operating processes and tools to help support decision making	Establish a framework that combines "what" and "who" into a process for "how"	Integrate the decisions that need to be made and the individuals and groups involved into a decision rights framework that addresses the gaps in the current state approach. Then establish supporting decision-making tools and templates, including appropriate communication and training materials.

Consider this

A recent Deloitte study found that Chief Financial Officers (CFOs) frequently find themselves seeking guidance from their General Counsel (GC). This finding is not surprising considering events like mergers, acquisitions, equity offerings, debt offerings, regulatory filings, and environmental disclosures require legal advice to ensure they are carried out correctly and with as little risk as possible.

Moreover, none of these typically CFO-driven activities can be properly executed without teaming between the CFO and GC, as well as collaborating with other C-suite members. But does that teaming between the C-suite happen on a regular basis? Could they work together more effectively to potentially improve results? And is there a formal decision rights framework in place to guide these interactions?

Results from this new Deloitte study shows that more than 60 percent of business executives said market volatility has increased collaboration across the C-suite. This is a very important and positive first step. But subsequent formalization of C-suite decision rights must follow to embed the processes and behaviors for the long haul.[2]

2 CFO Insights: Strengthening the Relationship with Inside Counsel. January 4, 2012. Deloitte LLP. http://www.deloitte.com/view/en_US/us/Insights/Browse-by-Content-Type/Newsletters/CFO-Insights/f76cb336689a4310VgnVCM2000001b56f00aRCRD.htm?id=us_email_CFO_CFOI_010512

What good looks like

Now more than ever is a golden opportunity to assess how financial institutions make decisions and allocate responsibility across business units and functions. This goes beyond traditional models of Corporate Governance and ERM that clarify the levels of authority within an organization. It is about investigating the nature of the business decisions themselves, assessing how and where they are being made, and exploring improvements to the allocation of authority and the integration across the executive team on decisions requiring collaboration.

Developing an effective decision-rights framework involves being aware of three points.

There is no single "one size fits all" decision model, but several factors should always be considered	• Desired degree of centralized versus decentralized management control • Country of origin, US or otherwise • Skills and experience of the executive leadership team • Access to management information and degree of decision making transparency • Regulatory and risk management influencers • Corporate strategy • Numbers of businesses and geographical footprint
The executive team charter and composition is critical	• Determine stakeholder alignment — A number of companies operate on a basis of consensus decision making, leading to a high degree of required pre-meeting and stakeholder alignment • Reduce the number of review committees and shift to action oriented decision-making committees • Comprise the executive team with a mix of line of business leaders, regional executives and heads of functions • Revise committee members' performance objectives, incentives and rewards to align with the cross-functional goals of the executive committee • Account for geography and personal relationships as making and enforcing decisions on a global basis is a considerable challenge • Utilize temporary committees/task forces for discreet assignments to avoid creating additional standing bodies • Delegate decision authorities to empower executive leaders and drive local decisions close to the market/customer
It is important to invest in the right degree of support infrastructure	• Establish a permanent executive governance management office responsible for meeting management, dashboard control and follow-up • Develop the appropriate supporting tools to enable management of business performance, as well as impact assessments and business case development associated with identified decision requests • Establish and manage global "working teams" to tackle specific topics; with the goal of analyzing and formulating recommendations for decision making • Communicate decisions made/approved/rejected and provide rationale to broader organization • Publish executive committee meeting outcomes to reinforce strategy and drive transparency

The benefits of getting it right

Financial institutions that make decisions well differ from those that do not in one clear way: decisions are made through a clearly defined process and not as a single, isolated event. This structured internal process around decision-making embeds corporate governance and risk management at a different level — into the very fabric of the organization's consciousness.

By institutionalizing a decision-making framework, financial enterprises can seize an opportunity to operationalize a new standard. In the face of ongoing criticism that a large appetite for growth fueled misguided decision-making, a focus on decision rights can help to address the demands of the "new normal" and prepare for the financial services landscape of the future.

Conclusion

While aftershocks from the financial crisis are still creating economic disturbance across the globe, explanations for the confluence of events take a variety of forms, including overexposure to risk, the creation of new forms of risk, poorly regulated products, and in some cases, a combination of the above and more.

Regulatory bodies and financial institutions have zeroed in on enhanced governance, risk and compliance practices to mitigate further exposure. These efforts have been primarily tactical in nature, focusing on enhanced board-level oversight, repairing risk management practices in the business and reassessing the compliance organization itself. However, these reforms, whether imposed externally or deemed prudent internally, may unintentionally overlook the underlying organizational decision-making processes that led to the financial services crisis in the first place.

Proactively reviewing and improving the very process of decision-making presents an untapped opportunity for financial services organizations seeking to "right the ship". Doing so will set a new standard of what it means to be a "trustworthy part of a complex network that minimizes both the ability for abuse and the possibility of collapse"[3].

3 Financial Times, Seven ways to fix the system's flaws, January 23, 2012

Contact information

Steve Hatfield
Deloitte Consulting LLP
New York, NY
+1 212 618 4046
sthatfield@deloitte.com

Robin Jones
Deloitte Consulting LLP
New York, NY
+1 212 313 1706
robijones@deloitte.com

Hope Hughes
Deloitte Consulting LLP
New York, NY
+1 212 618 4405
hopehughes@deloitte.com

Tiffany McDowell
Deloitte Consulting LLP
Costa Mesa, CA
+1 714 913 1176
tmcdowell@deloitte.com

Jennifer Radin
Deloitte Consulting LLP
New York, NY
+212 618 4833
jradin@deloitte.com

Contributions provided by Denise Rotatori, Deloitte Consulting LLP; Hilary Boller, Deloitte Consulting LLP; and Anne-Claire Roesch, Deloitte Consulting LLP.

This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Copyright © 2012 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited