



The Risk Policy Model

Australian Risk Policy Institute

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The ARPI Risk Policy Model

New Times Need New Thinking

The Case for a New Approach to Risk

The first ten years of the 21st Century have brought us face-to-face with the reality that our world is confronting numerous challenges that defy simple solutions and require innovative ways of thinking about how to solve them.

In our increasingly turbulent and unpredictable world, making your business, your economy and society more resilient is the challenge we all face. When we talk about resilience we mean better able to deal with sudden shocks and inevitable challenges from our interconnectedness and interdependence and our scientific and technological advances. We also mean being able to make the most of the opportunities—some of which can arrive just as unexpectedly and are too often missed.

Competitive solutions are not likely to be sufficiently robust to meet modern demands. Equally, in the face of these challenges and opportunities, the public sector around the globe is in transition; transition to what is increasingly called the ‘public purpose’ sector. The public purpose sector description reflects both new roles of the traditional public sector and new ways of combining resources and expertise from the public, private and community sectors and civil society to deliver good outcomes for the public.

Leaders therefore need to be thinking about collaboration, not competition, as the way to handle future risk.

A Sense of the Challenges and Opportunities

The scale and importance of the challenges and the accompanying opportunities before us can be seen in a range of situations.

The global financial system has enabled substantial development to occur. Unfortunately, the modern risk management paradigm, including its intellectual foundations, of our global financial system collapsed in 2008 – nearly everyone was affected by its failure. The Global Financial Crisis brought to an abrupt end confidence that we had been able to manage the associated risks successfully. The Crisis was, and continues to be, a costly failure for global society. The challenge and indeed the opportunity is to develop new risk management policies and practices for the future.

Supply chains are integral to our wellbeing. Supply chain failures unfortunately have become an increasing phenomenon. While China has been the recent source of world-wide attention, it is not alone. While supply can be outsourced, liability cannot be outsourced.

Transformation of our trading systems is occurring as well. The convergence of industries and products is redefining the economic landscape. This transformation is creating huge

opportunities. The well-being of nations is increasingly dependent upon how they fit into the value chains of global companies. Much depends on how successful nations are in attracting foreign direct investment.

Turning to our political structures, modern life has seen power rationalised and institutionalised. Government has grown used to the centre taking more and more of the decisions. This is despite the fact that the knowledge, expertise and experience to inform these decisions are located well away from the centre. In the process, we have reached the point where 'nobody' seems responsible. With 'nobody' responsible, accountability seems to have all but vanished and governance is failing to meet the expectations of the people. In 2005, for example, Hurricane Katrina brought bureaucratic irresponsibility and lack of accountability to the forefront of community concerns.

At the broadest level, human beings for the first time have taken hold not only of the economy and of population dynamics, but most of the planet's systems. Regrettably we seem to be acting without regard to the long term consequences.

On climate change, it is now widely accepted that the consequences of damage to the environment will have a serious impact on us all, yet there is a lack of leadership in response to this risk through, for instance, revamped methods of doing business and changing consumer consumption patterns. The critical assumptions that have underpinned the development of our cities, and supporting infrastructure both institutional and physical, are now inadequate to meet our needs in the modern urbanised world.

For all these reasons the new global leadership environment must be about managing risk in a wide variety of man-made and natural systems – all of which we depend on for life, but in the process have proven damaging to the eco-system.

These 'Systemic Risks' must be front and centre as we consider how to move forward to build a future in which our children can thrive.

The challenge we now face, as a global society, is to rebuild faith in our ability to manage risk and thus restore public confidence and trust. This is the space in which ARPI intends to operate fostering a focus on leadership accountability and promoting the need for risk-based policy responses to all the challenges we face.

Opportunity, Uncertainty and Risk

Uncertainty is being uncertain as to what is happening or might happen and/or what to do. Opportunity lives in uncertainty, just as risk does. Opportunity is an uncertainty that could result in gain or advantage. Gain and advantage are also denizens of uncertainty because they are relative, to a current state of affairs or to an opponent.

This means that opportunity is also faced with risks. The risks have to be identified early, watched, and prepared for. Opportunity also introduces a dual set of risks: not only does the organisation have to be watching for all of its identified risks and its areas of uncertainty (for new risks), it also now has to be watching for anything that threatens the new opportunity.

One of the known times of increased vulnerability of an opponent or enemy is when they are focussed on an opportunity - for that is the time they will lose diligence about their established focus. Seeing opportunity therefore is a function of leadership and vision and a product of risk policy in practice.

Effective, High Quality Leadership

Appropriate responses to society's apprehensions and mistrust require effective, high quality decision-making from top level leaders of significant organisations, internationally and within our countries. Personal relationships that develop among the decision-makers who lead these organisations will also be critically important. Above all, we will depend upon leaders being prepared to get out front and do something; we know that waiting for someone else to act just perpetuates increasing damage to the fabric of our society.

Society is very demanding regarding accountability for the things that go wrong when there are suitable means for dealing with uncertainty and risk. There are three steps that we need to take:

- The first step is to recognize that 'new times require new thinking'; new thinking about (risk) policy and about the nature of systemic risk.
- The second step is to be prepared to question the adequacy of current policies and risk management processes and identify what needs to be done to correct deficiencies. To improve risk management our thinking needs to be deeper about the very notion of risk and how risk occurs in our modern systems.
- The third step is to be prepared to accept deeper change in the manner by which risks are identified, and brought under management.

It is only through such a paradigm shift that businesses, governments and the public can all succeed and global trust can be restored.

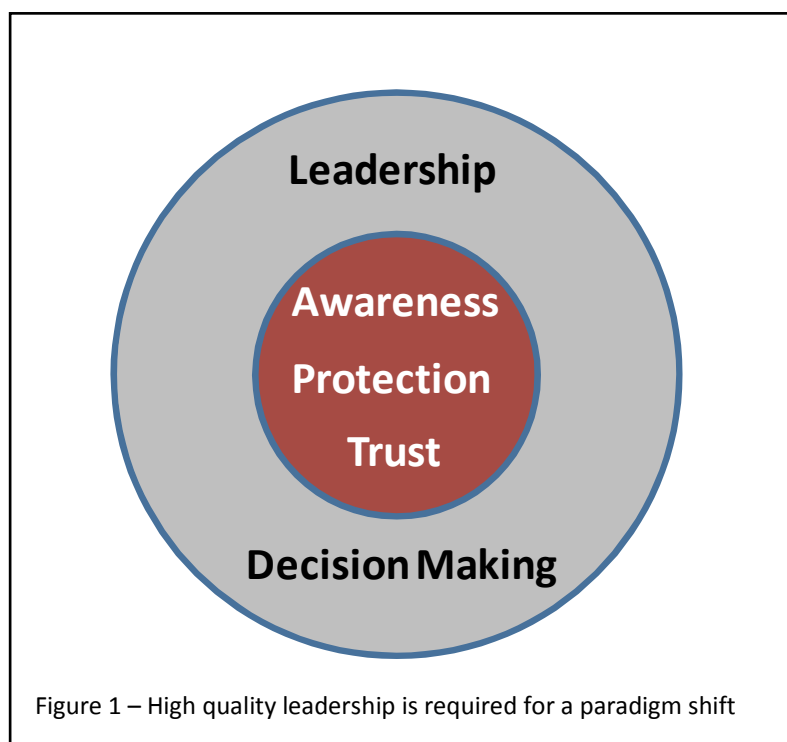
Shifting the Paradigm

The new paradigm begins, firstly, with deep thinking about systems and the leveraging of networks. We benefit from, and are reliant upon, the systems we have created. It is this interconnectedness and interdependence on a network of organisations and institutions that magnifies the impact when whole systems fail. Our thinking about risk, and indeed opportunity, has to shift from organisation-centric to network-centric thinking, and acting.

Secondly, in a rapidly changing and increasingly disorderly world, we need a new approach to identify and assess risks; the proper starting point from today and into the future is to think about 'vulnerability'. Many of the serious threats we face today seem to be of a nature and kind not seen before.

Thirdly, we must embrace 'time' in our thinking about and acting upon risk. Our strategic choices about the nature and extent of possible consequences of risk, and what action we can and should take to deal with risk, may be directly related to the time provided by early warning and a clear understanding at what point in time a particular risk applies.

Finally, and most importantly, we must have a pre-occupation with outcomes. Our most important outcome is protecting critical systems from future failures; failures which can potentially cause catastrophic damage to any other systems connected to them. In a business sense, focusing on outcomes means identifying and managing the right risks, at the right time, to achieve the right business outcomes.



The Risk Policy Approach

The World Economic Forum of 2009 in an effort to improve the state of the world called for society to commit and ‘rethink, redesign and rebuild’ in order to address pressing challenges and future risks associated with economic interdependencies, governance gaps and systemic risks.

The Australian Risk Policy Institute has responded through a fundamental rethink of the notion of risk and redesign of risk management in creating the ARPI Risk Policy Model. Its pinnacle and focus are on systemic risk.

The Notion of Risk

The development of an appropriate understanding of the distinction between Risk and Vulnerability is one of the most important policy problems in the world right now. We place a priority on the need for this distinction to be recognised and understood properly because many people cannot get their thinking past risk.

The starting point to shape this kind of thinking must focus on the very notion of risk and its measurement.

We need to measure our risks in terms of the adverse consequences if we fail to avert some threat based on vulnerability, as well as the opportunities they present. The vulnerabilities must be assessed, not merely in terms of the probability, or chance that a certain event might happen or not happen, but also the seriousness of the possible consequences. It is the specific vulnerability that has to define our risk. Vulnerabilities are the precursors to consequences.

Systemic Risk

The significance of systemic risk depends on an appreciation that in complex adaptive systems the consequences of failure of the system can be universal—that is, everyone and everything connected to the failed system suffers consequences. In such cases, unlike conventional risks, vulnerabilities that flow from a thorough assessment of Systemic Risks cannot be corralled into one ‘affected area’ of the system.

Systemic risks may, by their nature, exist as risks inside networks; risks in or associated with networks of organisations, institutions and individuals that make up such systems. This matter of network risk is not so much a different kind of risk but a different kind of ‘place’ than the organisation. But, crucially, it is a ‘place’ that is not necessarily a location.

Some networks permit risks to enter the system without proper management controls, and some networks actively exploit unmanageable ‘parts’ of systems for their own gain regardless of the Vulnerabilities of others.

So, if we are to understand and manage systemic risks we have to work on whole systems. This is where leadership is so critical.

Working on Whole Systems

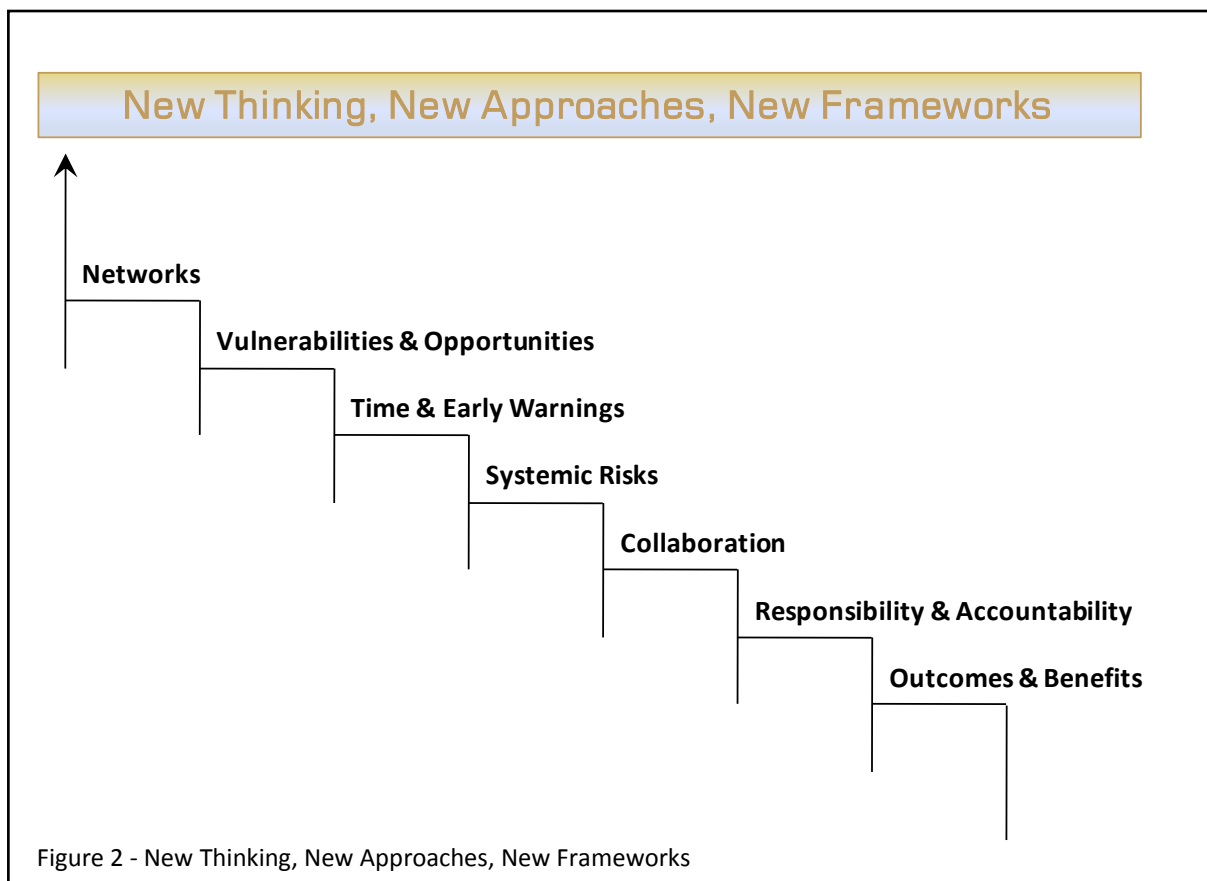
There are at least two reasons why working on whole systems often proves difficult for governments. The first reason is that the challenges are new. The great degree of control humans have over our social and physical environments today has not existed before.

A second reason is that it is difficult to assess the risks involved in changing whole systems; thus the attempt at change is avoided. Changing systems also creates the potential to create new systemic risks.

To move forward we need a new mindset about systemic risks. This new mindset is as much about networks and network-centric thinking as it is about the primacy of policy when thinking about how to move forward.

Construction of responses to systemic risk is a policy mountain to be climbed. The imperative is to elevate the role of policy and to shift risk management onto a solid footing.

Our challenge is to foster strategic leadership, find new policy drivers, promote new thinking, and establish new accountabilities to address these issues. In particular, we need to think structurally through new metaphors about the role government might play. The power to regulate also implies an obligation of responsibility, and responsiveness. While we might not always succeed, the virtue is to try.



The Risk Policy Model Framework

Our Definition of Risk

Risk is all possible future events or actions which might impact on society, or on achieving business or policy goals, objectives, plans, strategies, relationships, decisions, expectations, events or outcomes. Risk is also about opportunity: opportunity not recognised by other people.

A paradigm shift is needed by society to accept risk thinking and its application through risk management as a strategic, often preventive, and inherently positive and valuable business process rather than as a governance add-on process. Taking risk into consideration enables maximum leadership and management performance at minimum resource cost.

In a governance context, risk ensures full consideration of possible implications and impacts including effects on stakeholders who must never be overlooked. In a governance context, risk is about tomorrow: compliance is about today: and audit is about yesterday.

Risk Policy

Risk policy authorises, informs, defines, drives, builds, maintains and accounts for the processes of risk management and risk governance.

Risk Management

Risk management forms part of policy, leadership and management decision-making and implementation processes to help achieve our goals, objectives and outcomes. It takes into account possible impacts and implications during the conception, design, development and implementation of decisions, including effects on stakeholders and other risks.

Risk management is also part of security and emergency planning and early warning processes in relation to identifying vulnerabilities and systemic risks, and also concerning prevention, mitigation and network collaboration in relation to possible future events ranging from minor to catastrophic in local or global impact.

In summary, risk management is a process to identify and manage uncertainties to advantage.

Risk Governance

Risk Governance is an assurance process that firstly, operates within a network or organisation to pro-actively ensure the articulation, adoption and implementation of risk policy in an effective, robust and compliant manner and secondly, provides an independent review process that risk policy and risk management have operated as intended, as well as identifying continuous improvement opportunities.



Risk Policy In Relation To Risk Management

Risk Policy Aims

Strategic leadership is concerned with envisioning, determining and achieving organisational outcomes. Strategic Risk Policy speaks to the purpose of identifying risks and bringing them under management.

Risk Policy is concerned with defining the boundaries for which risks are to be identified and brought under management, and so it is at the Risk Policy level that the organisation's participation in identifying and helping to bring *systemic risks* under management is established.

Risk Policy is equally about the leadership of the organisation in regard to establishing governance and management over identified risks.

Risk Policy is delivered and achieved through Risk Governance and Risk Management.

Strategic Risk Policy is equally concerned with evaluation and accountability for achievement of outcomes in the presence of risk. Evaluation and accountability operate across risk policy, risk governance and risk management.

Risk Management is the means through which Risk Governance measures Risk Policy in respect of organisational outcomes. Risk Management is a collaborative, distributed function.

The key mechanism of Risk Management is the bringing together of knowledge about vulnerabilities and threats in order to identify and assess risks.

Risk is not static; its constituent elements of vulnerability and threat may change at any time. 'Time' and 'vulnerability' are critical, new-age risk identification criteria. Risk assessment therefore incorporates early warning intelligence and alerts in order to better inform strategic decision-making and action. 'Networks' are also proposed by ARPI as the new-age key to risk identification – and by correlation, the new-age approach to risk ownership and risk management. Networks can be internal or external and bring attendant policy considerations of risk information disclosure and deployment. Thus, risk policy is what is needed to make risk management applicable to today's challenges as well as more strategic and more effective overall.

Key risk policy principles for risk management

1. Risk management must be mandated, rather than optional or voluntary, preferably through regulation or at least a promulgated Board or Executive policy. It must take a performance or outcomes-based approach and include the critical issues of authorisation, responsibility, recognition, disclosure, decision-making, a culture of compliance, formal reporting and both corporate and individual executive sanctions.
2. Integrated, whole-of-organisation risk management and risk information management processes must operate under a single risk policy framework.
3. Relationships with intelligence, governance, compliance, audit and issues management are articulated and implemented with maturity, and objectively assessed and measured.
4. A Risk Committee or Audit Committee sitting as a Risk Committee, including external expertise and independence, oversight coverage and implementation of risk policy, effectiveness of risk management and risk governance, and ensures risk strategically informs governance, compliance and audit programs.
5. Risk appetite and risk tolerance are articulated and understood in practice, and integrated in risk management processes.
6. Risk management is a standing agenda item for executive and management committees.
7. Escalation of risks occurs automatically and without interpretation, thus avoiding compromising the integrity of risk information and its decision-making value.
8. Risk management is an ongoing accountability for all executive appointments.
9. Key performance measures are clearly articulated and applied, including:
 - a. All known risks are recognised, identified and under management;
 - b. All presently unknown risks are recognised and brought under management as soon as they are known; and
 - c. Unknown risks are proactively looked for.
10. Risk Policy guiding risk management is evaluated at regular intervals for the purposes of quality assurance and accountability.
11. A strategic approach to risk control should be defined, including the effective use of:
 - Strategies
 - Structures
 - Processes

Risk Policy in Relation to Risk Governance

Risk Policy Aims

Risk Governance is the third pillar in the risk hierarchy assuring an organisation and its stakeholders that risk policy is robust, comprehensive and appropriate for organisational needs and is being implemented in a way which produces effective risk management. Risk governance therefore looks back at how risk policy and risk management are being applied in the first instance and beyond that, measures the integrity, value and comprehensiveness of risk policies and risk management.

Strategically, therefore, Risk Governance is concerned with creating the conditions under which risks can be identified and brought under management. Risk Governance recognises that knowledge of risks lives in networks (of organisations, institutions and indeed individuals) and purposeful collaboration is required to ensure that this knowledge is accessible.

Policy on Risk Governance is about the statutory and other responsibilities of individuals and organisations. It is very succinct specifically in identifying and evaluating who is in charge, what is their authority and who is responsible (and liable) for effective risk management.

Risk Governance is therefore clear about executive authority, responsibility and accountability for risk management.

Risk Governance assures a demonstrable culture of risk disclosure and effective risk management.

Key risk policy principles for risk governance

1. Risk Governance ensures the proper development and implementation of compliant, strategic and operational risk policies and risk management processes.
2. Risk Governance ensures the creation and maintenance of a demonstrable culture of risk management compliance.
3. Independent, external assurance of risk policy and risk management must be incorporated in executive decision-making and external reporting.
4. Corporate and individual responsibility and accountability for effective risk policy, risk management and risk governance are articulated and objectively measured.
5. Duties of care and responsibility towards risk management are known, informed and monitored.
6. Sanctions for policy breaches are prescribed and applied through due process.
7. Accountability for risk policy, risk management and risk governance increases vertically in the organisation.

Implementation of the Risk Policy Model

Implementation of the Risk Policy Model requires:

1. Development, commitment to, and implementation of a Risk Policy suite suitable for a network or organisation incorporating the aims and principles outlined above;
2. Development, implementation, monitoring, evaluating and reporting on effective Risk Management processes in the network or organisation;
3. A sustainable cultural change program brought about by effective, high quality leadership from the Board and Executive – promoting a blame-free culture of disclosure;
4. An ongoing risk communication strategy facilitating a paradigm shift to:
 - a. Network-centric thinking and acting;
 - b. A new approach in identifying and bringing risks under management;
 - c. Embracing new criteria including vulnerability and time in risk thinking about and acting upon risk;
 - d. Focusing on outcomes –outcomes for the organisation and outcomes for the systems of which the organisation is a part; and,
5. Effective evaluation and accountability for progress on the journey to risk policy maturity.

Summary

Our sense of order and certainty has declined under the strain of change, which has come from expected and unanticipated, even unthinkable, sources. The Global Financial Crisis and other recent catastrophes have destroyed public confidence and trust in our ability to manage properly all the risks in our environment.

The Global Financial Crisis has also demonstrated that we live in a world of networks; networks of organisations and institutions. Risk lives in these networks and the knowledge of these risks lives there as well. Collaboration at many levels will be required to access this risk knowledge. Solutions to improve risk management will equally be implemented through Networks.

Management's inclination, and sometimes its ability, to devote people and money to dealing with risks are declining at the very time when the risks are growing. A new way to identify and manage risks in a disorderly world is needed. This new way must also place an emphasis on timeliness.

Society seeks to be protected from system failures and requires assurances that the failures of risk management are being addressed.

The ARPI Risk Policy Model addresses these challenges. It provides a suitable policy framework to guide leader behaviour and enhance performance in risk management and risk governance through the rigorous implementation of its key principles.