

## Financial Services Firms Strengthen CRO Role

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Between the broad net of problems that have resulted from the subprime mortgage meltdown, the subsequent liquidity crisis, the havoc raised by a single rogue trader in Paris, and the run on Bear Stearns, it's not surprising that risk management – and risk management failures – have captured the spotlight for months.

With investors and analysts, journalists, politicians and others clamoring for a better understanding and control of the risks that financial services firms inevitably deal with, we have seen several prominent firms replace their Chief Risk Officers (CRO). But this is only one aspect of the truly significant changes that have already started to take place, and should continue to occur, relating to the CRO function.

Much of this evolution has not attracted publicity until recently. But as the largest – and potentially most vulnerable – financial firms are developing a better understanding of the essential skill sets, career backgrounds, and organizational models that will best enable Chief Risk Officers to perform their jobs adequately, they are increasingly relying upon new strategies to fill this essential position.

The pool of qualified executives is limited, at least for now. But as supply and demand continues to evolve, the CRO function seems likely to emerge from today's problems as one of tomorrow's most critical leadership positions within the financial services sector.

### The CEO Connection

If one considers the CRO role from a purely organizational perspective, it seems clear that Boards and CEO's now consider this an executive role that must report directly to the CEO. At firms in which this doesn't happen, significant risks may not "bubble their way up," as may well be warranted, to a level of prominence at which they can attract the chief executive's attention.

In the past, we have seen organizational structures in which the Chief Risk Officer might report to the firm's president, COO or CFO. But this is changing at firms throughout the industry. After all, in at least one case, Merrill Lynch, one could argue that the company's risk reporting structure played a major role in costing the CEO his job.

It seems likely, moving forward, that the investment community will expect this position to report directly to the CEO – and that chief executives will insist upon this approach as well. And, indeed, at Merrill, where Noel Donohoe was recently appointed co-Chief Risk Officer with Edmond Moriarty, who has held this position since September 2007, both men will now report directly to the firm's Chairman and CEO, John Thain.

Similarly, recent changes across the industry reflect this trend: at JPMorgan recently appointed CRO Barry Zubrow reports directly to CEO Jamie Dimon; at Citigroup newly appointed CRO Brian Leach reports directly to CEO Vikram Pandit; at Bank of America long standing CRO Amy Brinkley reports directly to CEO Ken Lewis; at Morgan Stanley newly appointed CRO Ken deRegt reports directly to CEO John Mack; and at Lehman Brothers newly appointed CRO Chris O'Meara reports directly to CEO Dick Fuld.

The one outlier may appear to be Goldman Sachs where the risk function reports to CFO David Viniar. However, one might observe that in practice Viniar functions as the de facto CRO at Goldman. Beyond the widely regarded talent



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of this particular executive, the structure at Goldman may also reflect the importance of managing capital structure and liquidity risk in the highly leveraged securities industry. At the universal bank platforms, for example, we are now seeing a clear trend in establishing stand alone CRO's within the securities divisions who are taking a holistic approach to risk within the business rather than the siloed approach taken in the past. This development is seen not only as essential for managing risk across a complex mix of businesses but also begins to address bench building and succession issues. Examples of this include: John Hogan, well regarded CRO of the investment bank at JPM Chase; Richard Evans, recently named CRO of the investment bank at Citi; and Tom Daula, recently named CRO of the investment bank at UBS.

There's another element worth mentioning, as we talk about the importance of CROs reporting directly to the chief executive. Increasingly, the key to getting – and staying – in the corner office, will be the CEO's ability to manage risk. In the past, financial services firms might have chosen their chief executives because they were charismatic business builders with outstanding client relationships or maybe they possessed a valuable legal background. But today's CEOs need to possess extremely strong risk management skills themselves, since this will so clearly impact the company's share price. Indeed, boards now consider strong risk management skills to be essential for today's successful CEO's – along with the traditional necessities of strategic vision, the ability to attract and retain human capital, and the always important “will” to lead.

This scenario means that the CEO and CRO should be strongly aligned when it comes to their expertise as well as their priorities. That's an important development and it should enhance the effectiveness of any well-qualified Chief Risk Officer who has access directly to the top.

### The Right Qualifications

Organizational models are not the only things that are changing on the risk management scene. The financial services sector is developing a different perspective on the CRO function and the type of person required for the role. Contrary to what we have previously seen at many firms, there is now an appreciation of the proactive nature of this role, as well as the business acumen required of the person sitting in this chair.

To put it bluntly, financial firms have learned the hard way that this isn't just a “green eye shade” kind of staff job, which can be filled by quantitative people who might simply understand the credit risks underlying a particular business or product line without a larger, deeper understanding of the overall business and its various risks. They need to bring relevant line experience and credibility, the ability to effectively communicate up down and across the organization, especially with the CEO, line of business heads, and external constituencies such as board members, regulators and analysts. For many companies, this is part of a major transformation.

What we're seeing, in fact, is the emergence of enterprise wide risk management as the key definition of a CRO's role and responsibilities. Actually, this trend has been underway for some time now, without attracting much in the way of publicity outside of risk management circles. But the current crises in the subprime mortgage and credit markets have emphasized to industry experts that financial firms simply cannot segregate their different categories of risks and look at each one in a vacuum – putting their faith in a credit risk professional, and a market risk professional, and an operational risk professional, and so forth. A holistic approach is paramount.

Qualified Chief Risk Officers must understand all of the various elements of risk in order to truly be capable of managing risk on an enterprise-wide basis. Noel Donohoe's background offers a good example, since it includes more

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than 20 years and a broad range of risk management experience in positions such as chief operating officer of firm-wide risk for Goldman Sachs. As COO of Dune Capital Management, he was responsible for risk management, finance, investor reporting, and operations.

To get a concrete sense of how recent trends have translated into a demand for expanded skills and backgrounds for CROs, consider a CRO search that my colleagues at CTPartners and I were involved with quite recently. In keeping with some of the developments that I have been discussing, our client, a leading global financial services firm, shared our “holistic” approach to credit and risk management, resulting in a search for a skilled and savvy veteran, a top quality professional who would be capable of leading a firm-wide enterprise risk management approach across a diverse and complex mix of global businesses.

As we defined the skills and experiences that would be most valuable in such a professional, the list came to include the highest levels of business acumen and commercial experience – a blend of actually taking and managing risk as both a line professional and evaluator of risk. It seemed clear to us that the combination of line and staff experience would be critical in preparing a successful candidate to tackle the challenges of this function.

A broad financial background and real product depth were equally important given the complexity of the role. And it was clear that the right professional would need to possess great communication skills. After all, there are numerous constituents to deal with, both internally – throughout business lines and senior management up to the CEO – and externally – including regulators and shareholders.

As my colleagues and I evaluated potential candidates, we knew that we needed to look for intangible qualities too. In addition to looking for people who were highly skilled, deeply experienced, and persuasive, the right candidate for this position would also need to be pragmatic, practical, and willing to take a point of view. An impactful Chief Risk Officer can't be “ethereal”. All the theories in the world about enterprise risk and specific types of risk are great. But strong CROs are capable of applying quantitative data to practical business situations. That's how they become truly impactful.

### The CRO Supply-and-Demand Imbalance

An executive profile like this one poses big challenges for any CEO, since a person who matches it could also turn around and run one of the firm's major business lines. If the company places this person into the CRO chair, the chief executive must completely break away from the assumption that the Chief Risk Officer is “just” a staff job. It's much more than that.

As a search professional who has spent over 20 years specializing in the financial services sector, I understand that the CRO role can sometimes be construed as “amorphous.” That's another reason why it can be difficult to connect the right person to the job, hugely critical as this may be. Many senior people who possess the kinds of backgrounds that I've discussed here might not be oriented to taking one of these jobs. They might have a preference to start a hedge fund or run a bigger line business.

But I would argue that the increasing importance of sound enterprise risk management to financial services firms should make the CRO position a terrific ticket to punch in gaining the right mix of experience in preparing for the CEO job. If a person has been running a business and has the kind of tangible and intangible skills I've been talking



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about, stepping into a Chief Risk Officer job will give any individual an invaluable experience – especially in today’s market environment.

If the individuals who are too close to being chosen to run a major business line won’t consider stepping into what they perceive as a “staff” job, companies might do well to look one level down into their organization for the right person. In addition, another theme playing out is that the relationship between the CRO and the CFO is tightening for a host of reasons. In today’s environment, capital structure and liquidity risk have proven to be as critical, if not more critical, than market risk or credit risk. Therefore, functional movement from finance to risk and risk to finance is becoming more commonplace. For example, Chris O’Meara at Lehman recently moved from CFO to CRO and Joe Price at Bank of America moved from the risk function to become CFO.

As financial services firms ramp up their demand for top professionals to fill CRO positions, we definitely see a supply-and-demand imbalance. In part this stems from the reality that the top global players in the financial services sector are unlikely to recruit this type of talent from mid-sized, regional, or less diversified competitors. The top firms need a breadth of skills and career experiences that these other firms are not likely to provide. Building bench strength has become an increasing priority. Particularly as demand for risk talent picks up in the insurance and the asset management sectors. Watch for this migration of risk talent from Wall Street firms to insurance companies and to asset management firms, continuing a trend that began a few years earlier when the hedge funds began recruiting Wall Street risk talent.

However, in the wake of the sector’s current difficulties, we are beginning to see Wall Street firms broaden their horizons beyond in-house candidates when looking for the absolutely best qualified professional. Second-best candidates just won’t do.

Barry Zubrow is a good example of this trend, bringing as he does blue-chip credentials from outside the company to his new position as Chief Risk Officer of JPMorgan Chase. Mr. Zubrow formerly served as Chief Administrative Officer at Goldman Sachs. He was previously Chief Credit Officer and was co-Chairman of the firm’s Risk Committee. Prior to that Barry was a Partner in the Investment Banking Division. At JPMorgan Chase, he will be a member of the global giant’s Operating Committee and will report directly to CEO Jamie Dimon. And this at a firm widely regarded to be a leader in risk management with a collection of some of the best risk talent in the industry.

Whether financial firms look in-house or to leading firms like Goldman for their next Chief Risk Officers, it’s clear that their standards will be higher than ever, and that other risk-management changes may also be in the offing. And that makes sense. After all, for any CEO dealing with the financial sector’s difficulties, there are few action-oriented changes that can have more impact on the company now or in its future.

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