Developing an effective governance operating model
A guide for financial services boards and management teams
A governance operating model has the potential to address this need and thus enhance management’s ability to implement governance and the board’s ability to exercise proper oversight.
Introduction

In recent years, many boards of directors in the financial services industry (FSI) have been working to bolster the effectiveness of their organizations’ governance models. For example, boards appear to have strengthened their governance frameworks and policies and reasserted their governance roles, established board-level risk committees, clarified the responsibilities of other board committees, and appointed chief risk officers (CROs) or reinforced the independence of existing CROs. Concurrently, senior executive teams have committed resources to enhancing governance frameworks.

However, many FSI companies may have come to realize that work remains if they are to operationalize the structures and institutionalize the principles they have adopted. Moreover, the expectations of regulators, investors, and other stakeholders regarding governance have shifted over the past few years (see sidebar: Drivers and expectations). Stakeholders now see boards as more accountable for the effectiveness of their overall governance process. This shift is real, and it is significant, and is likely to amount to an expectation of greater board involvement in the means by which governance is organized and effected, and for more active oversight by the board and its committees.

Greater involvement and more active oversight may be evident, but governance is also a work in progress, as reflected in Deloitte’s experience and research. A Deloitte review of bank board risk committee charters found that board members “want to clearly identify areas in which they are responsible for approval of decisions; where others (usually, senior executives) are responsible for approval decisions that they must as board members oversee, further approve, or simply be aware of; and how.” A governance operating model supplies the “how” that board members seek and can reveal gaps or shortcomings in board or management committee charters.

A Deloitte study of disclosures in proxy statements found that while FSI companies are bolstering governance and oversight, only 33 percent of those surveyed have management risk committees, 41 percent disclose whether risk management/oversight is aligned with strategy, and 19 percent note the board’s oversight with regard to corporate culture. The trend toward increasing disclosure regarding governance and risk oversight implies a need for reliable methods of operationalizing governance.

While the board is accountable for oversight of the governance process, management is responsible for implementing the policies and procedures through which governance occurs within the organization. The board is responsible for understanding—and for advising management on—the processes through which governance occurs within the organization, and is accountable for the results of those processes. Management is responsible for the governance processes and their workings, and for their results.

A governance operating model may assist the board and management in fulfilling their governance roles. Such a model is likely to enable the board and the executive leadership to organize the governance structure and the mechanisms by which governance is implemented. By the same token, the lack of a governance operating model may lead to an incomplete or faulty governance structure, or to inconsistencies, overlaps, and gaps among governance mechanisms. Such inadequacies may lead to failure to enact governance policies that the board and management have put in place.

The sheer complexity of governance and the huge number of related procedures and other mechanisms in a global financial institution may indicate a need for a governance operating model. The elements of such a model may exist within many large FSI companies. However, those elements may not have been connected, rationalized, and organized to provide the consistent guidance and incentives that executives, risk managers, and business unit leaders require. A governance operating model has the potential to address this need and thus enhance management’s ability to implement governance and the board’s ability to exercise proper oversight.

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2 As used in this document, “Deloitte” means Deloitte & Touche LLP, which are separate subsidiaries of Deloitte LLP. 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.

Drivers and expectations
Three main drivers familiar to FSI leaders have likely intensified the need for improved governance: the growth imperative, organizational size and complexity, and regulatory change.

- Growth must continue. Customers, investors, and the public recognize that a sound, robust, competitive financial services sector is a key component of a healthy economy. Customers want products and services, and investors want returns; meanwhile, regulators and the public want accountability, responsibility, safety, and soundness in institutions and the financial system. Balancing these desires calls for FSI companies that can grow within the purview of sound governance.

- Size and complexity are permanent. While the debate about whether financial institutions are “too big to fail” continues, many are significantly larger than they were before 2008. For the largest firms, global reach is a reality, as is complexity of products, markets, and regulations. Given this, boards should consider reliable methods of enabling executives and managers to implement governance.

- Regulations have proliferated. In response to the financial turbulence of the past years, many regulatory agencies and advisory groups have issued guidance relevant to board governance. Yet regulatory change and lapses in governance are likely to continue. This indicates a potential need to extend the governance process deeper into the organization.

Coupled with governance and risk management lapses before and since the downturn, these drivers have likely shaped regulators’ and other stakeholders’ expectations in the following ways:

- The board’s governance role includes responsibility for reviewing corporate strategies, shaping the culture, setting the tone at the top, and promulgating the organization’s vision, values, and core beliefs.

- The board is expected to oversee senior management’s collective ownership and individual accountability for regulatory compliance and risk management.

- The board should attain enough visibility into business operations, processes, and risks to understand the risks management is taking and how they are being managed.

- The board is accountable for all aspects of governance, including:
  - Decision-making authority that codifies who is responsible for making key decisions.
  - Organizational structures that define and clarify responsibilities for operational, control, and reporting processes.
  - Organizational design that is understood by managers, employees, and external stakeholders.

Although many FSI companies may have responded to these drivers and expectations (for example, by developing committee structures and establishing policies), they may still be grappling with operationalizing governance. A governance operating model could potentially assist in addressing this challenge.

This document, prepared for board members, board committee members, senior executives, and risk managers at FSI companies, aims to assist boards and others with key governance roles in developing a robust governance operating model. This document also provides suggestions to consider on how to begin implementation, although that is not its primary focus. Such a model may foster the information flows and visibility into processes that enable both the board and management to fulfill their respective governance responsibilities. For FSI companies with a governance framework and policies in place, this document outlines a next step—moving governance to the level of people’s day-to-day job responsibilities.

This document assumes that readers are broadly familiar with recent FSI regulatory developments and with key principles of governance, including those Deloitte has identified over the past several years in documents such as Risk Intelligent Governance: A Practical Guide for Boards: Improving Bank Board Governance, and The Risk Committee Resource Guide for Boards.

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4 Each of these documents is available at deloitte.com.
What is a governance operating model?

Exhibit 1 depicts the major components of a governance operating model and their relationship. This high-level view shows the major components—structure, oversight responsibilities, talent and culture, and infrastructure—and their key subcomponents. The nuts and bolts of the model (layers below the subcomponents in this depiction) include process flows, procedures, and reporting mechanisms that implement governance at the level of job responsibilities. Board and management choices regarding each component should define how the governance operating model will be implemented by management.

In practice, a governance operating model should:

- Organize operational, financial, risk management, and reporting processes such that the board receives the information it requires to effect good governance and management and the business units can conduct their activities in ways that comply with regulations and serve strategic ends
- Bring the organization’s governance framework down to the level of roles, responsibilities, reporting lines, and communications to bridge the gap between the governance framework (discussed in the following section) and operational realities
- Help people to answer questions such as, “Why are we doing this?” “Is this okay?” “Whose call is this?” and “Who do we need to tell about this?” and to know when to ask such questions
- Sustain governance by creating a feedback loop in which the board and management can identify and respond to new business, operational, competitive, and regulatory needs

A governance operating model may contribute to solving the common problem of “management by memo” in governance. It is rarely enough for the board or management simply to articulate principles and issue policies, no matter how clearly and forcefully they do so. They should also see to it that people have the understanding, motivation, and means to implement them, and that they do so.
The starting point, which many FSI companies have likely addressed, is the governance framework, such as that developed by Deloitte or another organization. The Deloitte Governance Framework (see Exhibit 2) was developed to help boards and executives assess their organizations' governance programs. Whether the board and management adopt or develop a governance framework, it articulates the various elements of the governance program, clarifies the governance roles of the board and management, and illustrates an appropriate relationship between governance, risk management, and organizational culture.

Exhibit 2
Deloitte governance framework

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Encircling all elements of the framework is the corporate governance infrastructure. The governance infrastructure is the collection of governance operating models—the people, processes, and systems—that management has put in place to govern day-to-day organizational activities. This infrastructure also includes the processes used to gather and report information to the board and external stakeholders, as well as to management.

The board’s role in various elements of the governance infrastructure ranges from overseer to active participant in the actual processes. The top half of the framework above depicts areas where the board’s responsibility is typically heightened. In these areas, it is generally not considered adequate for the board only to understand and monitor the company’s operating models; in addition, the board will be expected to play a role in developing the components and participating in the activities. These areas include governance (here meaning the board’s structure and composition), strategy, performance, integrity, talent, and risk governance. In these areas, due to legal or regulatory requirements or stakeholder expectations, the board is an active party in the structures and processes, and in decisions and duties that cannot be delegated to management, which vary by organization.

The bottom half of the framework depicts areas where the board’s responsibility can be described more as active monitor. Here, the board understands the operating models, ascertains that they are adequately developed and resourced, and monitors results of business activities and any issues identified in the process. For many companies, the areas in this category align to planning, operations, compliance, reporting, and risk management.

A governance operating model is the mechanism used by the board and management to translate the elements of the governance framework and policies into practices, procedures, and job responsibilities within the corporate governance infrastructure. In developing the governance operating model, the board balances competing goals (such as the pursuit of growth and the preservation of assets), defines responsibilities (such as those of a business manager and those of a risk manager), and allocates resources to implementing governance. (For more on the Deloitte Governance Framework, see Framing the future of corporate governance: Deloitte Governance Framework.)

The remainder of this document presents an enterprise governance operating model that may be suitable for a large FSI company and discusses the characteristics of such a model, elements that might be included, potential benefits, and development and implementation. As an enterprise governance operating model, this model could be adapted to the needs of an entire company or those of specific business units or functional areas.

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Components of a governance operating model

A governance operating model defines the mechanisms and interaction points by which governance will be implemented. It enables the board and the executive leadership—as appropriate to their roles and responsibilities—to organize these mechanisms and points of interaction across the organization’s business lines, legal entities, and jurisdictions. An enterprise-level model, like the one described here, may be adapted to any functional or operating area to promote effective implementation of governance.

As shown in Exhibit 1, the governance operating model consists of four major components:

- **Structure**, which includes organization design and reporting structure, committee structures and charters, and control and support function interdependencies
- **Oversight responsibilities**, which define board oversight responsibilities, committee and management responsibilities, accountability matrices, and management hiring and firing authority
- **Talent and culture**, which enable the behaviors and activities required for effective governance by establishing compensation policies (particularly regarding incentives), promotion policies, business and operating principles, performance measurement and management, training, and leadership and talent development programs
- **Infrastructure**, which comprises governance and risk oversight policies and procedures, reports, measures and metrics, and management capabilities, and the enabling IT and communications support

Within these components, some of the key aspects of an effective governance operating model to be addressed will include:

**Board oversight and responsibilities**: The board carries out oversight responsibility across the organization in areas such as business and risk strategy, organization, financial soundness, and regulatory compliance. In this regard, the governance operating model should help the board to:
- Articulate the skills and knowledge it requires to effectively execute its oversight responsibilities, and to assess its composition against those needs
- Engage management in providing the information the board requires to exercise governance and risk oversight
- Advise management on policies that ultimately influence the manner in which governance is conducted
- Understand governance activities that occur at various levels within the organization, and support management in its efforts to enhance program efficiency, and effectiveness

**Committee authorities and responsibilities**: Effective board committee and management committee structures can help define the number, terms, and qualifications of members, committee responsibilities, reporting and escalation mechanisms, and ways in which board and management committees will interact. For example, for a management committee, the model could:
- Include committee charters that define the committee’s responsibilities and addresses linkages between the committee, the broader executive team, and the board of directors
- Define the types of decisions, investments, events, risks, and other items that should come to the committee’s attention (and, when applicable, thresholds or amounts)
- Delineate methods of escalating and reporting significant matters to the appropriate person or committee

**Organizational design and reporting structure**: A clear, comprehensive organizational structure normally defines reporting lines for decision making, risk management, financial and regulatory reporting, public disclosures, and crisis preparedness and response. In an enterprise governance operating model, the organizational structure could enable executive management to:
- Establish the independence and authority of the control functions of compliance, risk, legal, finance, and audit
- Define a process of overseeing the spectrum of risks across all regions and businesses, including strategic, operational, market, credit, liquidity, legal, compliance, property, IT, reputational, and other risks
- Maintain a governance structure that is understandable to internal employees and external stakeholders
Management accountability and authority: Well-understood authority and accountability for key responsibilities are needed at all levels and in all areas of the organization. A sound governance operating model could:

- Balance global and regional strategies by delineating the authority and accountability for key roles and specifying a process for resolving or escalating disagreements
- Balance the decision-making authority of business units against that of risk managers, such that risk tolerances and exposure limits are set and observed and risk managers have the authority to challenge those who are taking the risks
- Define clear decision rights such that people understand the authority—and the limits of the authority—associated with their positions
- Provide direction to control functions to assist overseers in determining that businesses are managed within appropriate limits on both global and regional bases

Performance management and incentives: Goals, performance measures, compensation, and incentives should reflect an organization’s overall commitment to governance as well as principles of asset preservation and risk taking for reward. In this area, the model should help the board to:

- Establish performance objectives that balance asset preservation and risk taking in the pursuit of value creation
- Align incentives to reflect a balance between asset preservation and risk taking
- Specify qualifications and performance evaluations that establish and reinforce the desired corporate culture and tone at the top

A robust enterprise governance operating model helps enable the execution of governance responsibilities at all levels. It does so by clarifying reporting lines and linkages; identifying decisions, risks, and other matters to come to the boards’ or its committees’ attention for review or approval; and promoting an understanding among managers of roles and responsibilities, limits of authority, and means of escalation, and of the balance to be sought between centralization and decentralization, autonomy and collaboration, and risk and reward (see sidebar: Striking a balance, repeatedly).
The power and benefits of a governance operating model

The power of a governance operating model can lie in its specificity. The required or desired level of specificity in the operating model will vary from organization to organization. This is appropriate. Governance frameworks define principles and, usually, responsibilities. But they largely leave individual organizations to define how governance roles will be assigned, how roles will interact, and how responsibilities will be fulfilled.

FSI companies may benefit from an effective governance operating model in the following ways:

- **Improved clarity**: The board and management face the challenge of translating governance principles into practices. The governance operating model could provide a vehicle for the board and its committees to address this challenge by clearly defining the roles, responsibilities, accountabilities, information flows, and guidelines that people need in order to implement governance.

- **Greater visibility**: To fulfill its governance responsibilities, the board should have clear lines of sight into management’s decision-making and risk-management processes. In the governance operating model, the board could establish those lines of sight, for example, by stating the types and amounts of investments and transactions and the risk exposures that should come to its attention.

- **Improved coordination**: Addressing the complexity inherent in governance of multiple businesses across a global organization requires coordinated action. It also entails balancing considerations regarding centralization versus decentralization and considering local business, customer, compliance, legal, and other stakeholder needs—which the model should be able to address.

- **Increased effectiveness**: A model that specifies the information that the board and its committees require—and from whom, how often, and under what circumstances they will receive that information—may assist the board in executing governance more effectively.

The model should arrange the governance and risk oversight process—and the related infrastructure and IT support—such that responsibilities are carried out in a reliable manner. The overarching benefit of a sound governance operating model is that it could enable the board and its committees to execute their responsibilities properly and with greater assurance that they have done so.
Developing an effective governance operating model

Each component of a governance operating model consists of subcomponents comprised of activities, only a sampling of which are listed in Exhibit 3 by way of illustration. A governance operating model can provide substantial detail regarding the ways in which activities will be conducted to implement governance. Indeed, one of the main reasons to create a governance operating model is to define and document the processes, procedures, and reporting mechanisms that will constitute governance, along with the training, IT, and other resources that will be needed.

### Exhibit 3
Illustrative activities in designing the governance operating model

<table>
<thead>
<tr>
<th>Components</th>
<th>Subcomponents</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structure</strong></td>
<td>• Committee structure and charters</td>
<td>• Outlines board and management committee structures, mandates, membership, and charters</td>
</tr>
<tr>
<td></td>
<td>• Organizational structure and reporting lines</td>
<td>• Establishes design of governance framework</td>
</tr>
<tr>
<td></td>
<td>• Control and support functions’ roles</td>
<td>• Delineates organizational structure, reporting lines, and relationships</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Highlights role and independence of control and support functions from business owners</td>
</tr>
<tr>
<td><strong>Oversight</strong></td>
<td>• Committees authorities and responsibilities</td>
<td>• Outlines the type of committees (board and management) and associated responsibilities</td>
</tr>
<tr>
<td><strong>responsible</strong></td>
<td>• Management accountability and authority</td>
<td>• Specifies functional accountabilities for day-to-day management of business practices across the enterprise</td>
</tr>
<tr>
<td></td>
<td>• Board oversight and responsibilities</td>
<td>• Delineates board and management approved policies supporting delegation of authority (decision rights) including reporting, escalation, and veto rights</td>
</tr>
<tr>
<td><strong>Talent &amp;</strong></td>
<td>• Business and operating principles</td>
<td>• Aligns governance with operating and business principles</td>
</tr>
<tr>
<td><strong>culture</strong></td>
<td>• Core beliefs and risk culture</td>
<td>• Articulates core beliefs and foundation for culture</td>
</tr>
<tr>
<td></td>
<td>• Leadership development and talent programs performance</td>
<td>• Highlights characteristics of risk culture</td>
</tr>
<tr>
<td></td>
<td>• Management and incentives</td>
<td>• Outlines leadership succession, assessment, and development responsibilities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Aligns performance management, approach, measures and responsibilities to compensation and incentive plans</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>• Policies and procedures</td>
<td>• Establishes design and content of policy manuals and associated procedures</td>
</tr>
<tr>
<td></td>
<td>• Reporting and communication</td>
<td>• Outlines type and frequency of internal reporting and communications</td>
</tr>
<tr>
<td></td>
<td>• Technology</td>
<td>• Defines scorecards, measures, and metrics to track performance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Aligns technology and governance requirements</td>
</tr>
</tbody>
</table>
Developing the governance operating model entails defining and documenting the subcomponents and activities at the level of detail the organization requires to inform peoples’ decisions and actions. The goal is not to dictate, but to define decisions and actions in ways that will be meaningful from a governance standpoint. The process of documenting the governance operating model can create as much value as the resulting documents. If an organization has an undocumented governance model, documenting it may focus decision makers on balancing competing objectives, defining responsibilities, allocating resources, and devising solutions—activities essential to implementing governance.

In defining its governance operating model, the organization may assess its current state, define its desired future state, and identify the steps required to achieve the latter, that is, to effect implementation. In this exercise, the organization should consider addressing the following considerations and objectives:

- **Compliance issues:**
  - Achieve compliance with multiple, sometimes conflicting, requirements
  - Reconcile business requirements with regional and/or parent-company country regulations
  - Align regulatory compliance and risk management to address needs in an integrated, globally coordinated manner

- **Cultural shift:**
  - Move toward one corporate culture across the organization
  - Resolve the tension between local customs, regulations, and business-unit needs and the desire to set the tone from the top
  - Resolve the tension between centralization of risk policies and decentralization of business decision making

- **Governance and management decision rights:**
  - Establish ownership for decisions for strategy, budgets, funding, liquidity plans, recruitment, performance management, compensation, risk management, and new business and product approvals
  - Clarify board oversight roles and responsibilities and their relationship to management roles and responsibilities
  - Define who takes the lead, who has consultation/veto rights, and how conflicts and disagreements are to be resolved

- **Process and system issues:**
  - Enhance processes and systems for business-line managerial and risk reporting to support regional and divisional risk management
  - Upgrade processes and systems to generate data and reports required by local regulators
  - Rationalize and harmonize controls to enhance performance and reduce costs

- **Regulatory relations:**
  - Designate an on-site point person to respond to local regulators’ questions when required or useful (rather than routing them to headquarters)
  - Establish virtual (or actual) holding companies at the local level with key executives who can respond to regulators’ requests regarding multiple local business units
  - Address regulatory requirements regarding subsidiaries, affiliates, and alliance partners

- **Human resources:**
  - Identify job specifications and roles required in a matrix reporting structure, and the required skills, experience, and expertise
  - Account for skills, experience, and expertise required at the board level, particularly in areas of governance and risk oversight

When crafting governance and exercising oversight, boards and executive teams may do well to bear in mind the goal of creating a risk intelligent culture (see sidebar on page 11: A Risk Intelligent Culture).
A Risk Intelligent Culture

While policies, procedures, and rules are useful and necessary, the organization’s risk culture largely determines how it manages risk and the attention paid to guidelines.

The following are characteristics of a risk intelligent culture:

- **Commonality of purpose, values, and ethics:** People’s individual interests, values, and ethics are aligned with those of the organization’s risk strategy, appetite, tolerance, and approach.
- **Universal adoption and application:** Risk is considered in all activities, from strategic planning to day-to-day operations, in every part of the organization.
- **A learning organization:** The collective ability of the organization to manage risk more effectively is continuously improving.
- **Timely, transparent, and honest communications:** People are comfortable talking openly and honestly about risk using a common risk vocabulary that promotes shared understanding.
- **Understanding of the value of effective risk management:** People understand, and enthusiastically articulate, the value that effective risk management brings to the organization.
- **Responsibility—individual and collective:** People take personal responsibility for the management of risk and proactively seek to involve others when that is the better approach.
- **Expectation of challenge:** People are comfortable challenging others, including authority figures. The people who are being challenged respond positively.

The board is responsible for advising management on the risk culture and for overseeing management’s efforts to maintain an appropriate risk culture.
Enhancing or establishing a governance operating model

The following is a suggested three-part approach to enhancing or establishing a governance operating model. While it is not practical for the board to perform the tasks in each of these steps, nor within its purview, the board is usually positioned to commission these tasks to be carried out within the organization or by external specialists.

Part 1. Define the governance operating model requirements

• Identify potentially useful governance frameworks
• Identify applicable regulatory and governance requirements
• Consider governance scope and needs, such as domestic, global, business line, and those involving existing and contemplated products and processes
• Define the current state of governance, as well as gaps and considerations

Useful steps within Part 1:
– Analyze peers at a summary level (for example, by means of their committee charters, which are often publicly available)
– Assess the organization’s governance vis-à-vis a governance maturity model
– Identify and prioritize governance needs and activities

Part 2. Design the governance operating model

• Define the desired future-state for the headquarters region, global business operations, and control functions, such as risk, legal, compliance, finance, audit, and HR (see Exhibit 3 on page 9 for illustrative activities in designing the governance operating components and sub-components.)
• Define a change-management plan to institutionalize the attitudinal and behavioral changes needed to implement the model

Useful steps within Part 2:
– Detail design of governance operating model and its components
– Develop matrix defining key accountabilities across the organization
– Develop matrix defining decision rights and escalation paths

Part 3. Implementing the governance operating model

• Create an implementation plan that:
  – Defines standards and metrics by which success will be measured
  – Maps governance requirements to organizational functions and business requirements
  – Allocates resources to implementation, per priorities and over time as requirements and resources permit
  – Defines schedule and components of review process
• Implement the plan and maintain governance practices
• Evaluate the plan, implementation, and practices

Useful steps in Part 3:
– Create an implementation plan in an electronic, visual format that enables the team to track progress on action steps and to log disposition of risks and related issues
– Obtain external assistance in creating a workable plan and format and in overseeing implementation, as necessary

Defining governance operating model requirements, designing the governance operating model, and planning and carrying out implementation are significant undertakings for any financial organization. In addition, it may be an iterative process, with aspects of the model subject to change or adjustment during or after implementation, and in response to changing regulatory or business conditions. However, the process outlined here represents one route toward enhancing governance at FSI companies, and one that can be rationalized, planned, resourced, monitored, and evaluated.
Getting governance done

In some FSI companies, the need for a clearly documented governance operating model has become acute. This is understandable. Board responsibilities have increased due to the need to continue to oversee management of growing, complex, global institutions amid challenging business conditions and rising stakeholder expectations. The board and its committees now have more to oversee, and management and its committees have more regulatory and governance considerations to address—as well as more risk to manage.

Although boards at FSI companies may have adopted governance frameworks and strengthened their risk governance, work remains to be done if the many governance needs of large, complex institutions are to be met. A well-documented governance operating model may assist the board and its committees in meeting these needs.

The desired governance operating model—meaning the right model for the organization—assists the board to get governance done. The right model should promote clarity and understanding of the ways in which people in governance roles and in management roles execute their responsibilities. It can do so by assisting the board and management to specify ways of implementing governance. Despite significant recent progress in the area of governance, this is an apparent urgent need at many, global financial services companies.