

Three Lines of Defence: No More D in 3LOD

Positioning Risk and Control Teams for Success

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The three lines of defense (3LOD) model, which has its origins in military planning and sports management, is now firmly engrained into the DNA of financial services firms. It is widely viewed as an important factor in the successful embedding of enterprise risk management. Designed by the Institute of Internal Auditors (IIA), the model distinguishes between the three groups (or lines) involved in effective risk management:

- functions that own and manage risks;
- functions that oversee risks;
- functions that provide independent assurance.

IIA argues that 'risk management normally is strongest when there are three separate and clearly defined lines of defense'¹.

This, of course, all sounds very familiar.

BUT...

In 2020, the IIA issued an update to the model². It retained the core concepts and the language of 'first line', 'second line' and 'third line', however advocated for a more collaborative approach de-emphasizing segregation and therefore removing the word 'defense', thus creating The Three Lines (3L) model.

While Internal Audit function remains independent, it is of significance that a softer and more integrated approach to 2nd line Risk management has been adopted.

The IIA states that first and second line roles may be 'blended or separated'² and emphasizes that the second line provides 'assistance with managing risk'².

- Old world - outdated: Risk department provides oversight and challenge;
- New world - current: Risk department provides expertise, support, assistance in addition to oversight and challenge.

Outdated 'defense' approach in Risk management gives rise to *diminishers* – risk practitioners who accentuate the need for the separation between business units and Risk. They are frequently physically segregated on a different floor or isolated area; are formal and unapproachable. Under this model the first line, lacking sufficient explanation, support and advice ends up producing sub-optimal results and then facing criticism and adverse commentary. *Diminishers* diminish the work of first line business units and support functions, ultimately creating a negative risk management brand. This approach creates blockages and siloed mentality, resulting in bureaucratic and costly processes.

In contrast, within the updated, less bureaucratic and more commercial model, risk managers work in collaboration with the first line, actively positioning them for success.

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Successful Risk Managers are informal, approachable, likeable and do not hesitate to work closely with business units and support functions. They are supportive yet firm, providing constructive challenge and retaining their own opinion and authority.

This is key – being liked and respected does not mean shying away from expressing own opinions. On the contrary, *engaging* and *collaborative* approach must be combined with the *authority* of the risk function to act as a safeguard, being strong and decisive. A delicate balance, which has been proven to succeed by academic research³, and is very effective when implemented in practice.

The IIA paper came out amid the covid-19 pandemic, and arguably was not given full attention due to other urgent priorities. Four years after the publication, there is still the original 3LOD model, with *defense* prominently embedded in letter and in spirit, in organizational policies and practices, signifying that more work is needed to change the attitudes and behaviors.

In conclusion

Creating a meaningful, value-added and commercial risk management structure involves a combination of contributory factors, which range from very complex, such as getting the culture right, to very simple, such as having clear role profiles. There is great power in the model of collaborative 2nd line Risk Teams working closely and cooperatively with embedded Risk Champions.

References

¹ IIA (2013) *The Three Lines of Defence in Effective Risk Management and Control*

² IIA (2020) *The IIA's Three Lines Model*

³ Ashby, A, Bryce, C and Ring, P (2019) *Risk and Performance: Embedding risk management*

There is, of course, an additional challenge of first line (usually referred to as 1.5 line) Risk Coordinators. To embed good risk management practices, processes and behaviours, business units and support functions commonly appoint Risk Coordinators. In theory, placing risk experts in the first line should double the benefits. It is the same discipline, after all, so risk practitioners in both the first and second lines must work together, completely in sync, towards a common goal of augmenting the value of risk management within the organization.

In practice, however, models are implemented by people; consequently, a great deal depends on the personalities of the individuals and the way they embody the different lines.

An opportunity to work collaboratively?
Or to generate conflicts, trip over each other and duplicate tasks?

How We Can Help

Contact elena@theopriskcompany.com to discuss:

-  Assessment of current model, roles and responsibilities
-  Elevating Risk Brand
-  Practical Workshops: Developing successful Risk and Control Teams
-  Risk Culture evaluation and embedding
-  Risk Training and Education



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