



# **Practical Insights for Launching ERM**

North Carolina State University  
Enterprise Risk Management Roundtable  
April 15, 2005

# Objective

In previous Roundtable Presentations, you have heard from many experienced individuals based on their years of experience in ERM or their particular specialty within ERM. Our objective today is to:

- Provide an overview of BB&T
- Help put ERM in context with an existing risk management structure
- Identify ways to build internal support for ERM
- Determine ways to leverage available external resources
- Demonstrate how a common risk language can solidify the ERM foundation
- Identify subtle, but practical, ways ERM can add value
- Identify opportunities within your own organizations

# Agenda

*While the COSO ERM Framework describes the essential components, principles and concepts of ERM, it does not include rules-based guidelines. Therefore, each company must determine how to implement ERM within their own organization.*

## ***BB&T Corporation***

- . Overview of BB&T
- . Strategy and Risk Culture
- . Risk Management Processes

## ***Building the Foundation***

- . Building Internal Support
- . ERM Organizational Structure
- . External Environment
- . Common Risk Language

## ***ERM Initiatives***

- . SAS 70 Reviews – S/O Compliance
- . Economic Capital & RM Program
- . Risk & Control Self-Assessments
- . Emerging Issues
- . Involvement in Corporate Initiatives

## ***Next Steps***

- . What's Next?

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## ***BB&T Corporation***

# Overview of BB&T Corporation

BB&T Corporation is a regional financial holding company with more than \$100 billion in assets. In addition to a comprehensive array of products and services, we can offer our customers the convenience of more than 1,400 branch locations, spanning the Carolinas, Virginia, Maryland, Georgia, North Carolina, South Carolina, Alabama, Tennessee, Kentucky, West Virginia, Florida, Indiana, and Washington, D.C.

BB&T is the ninth largest financial holding company in the United States.

## BB&T Market Coverage effective December 31, 2004

### Branches

410 in VA

334 in NC

125 in MD

119 in GA

98 in KY

99 in SC

91 in FL

81 in WV

46 in TN

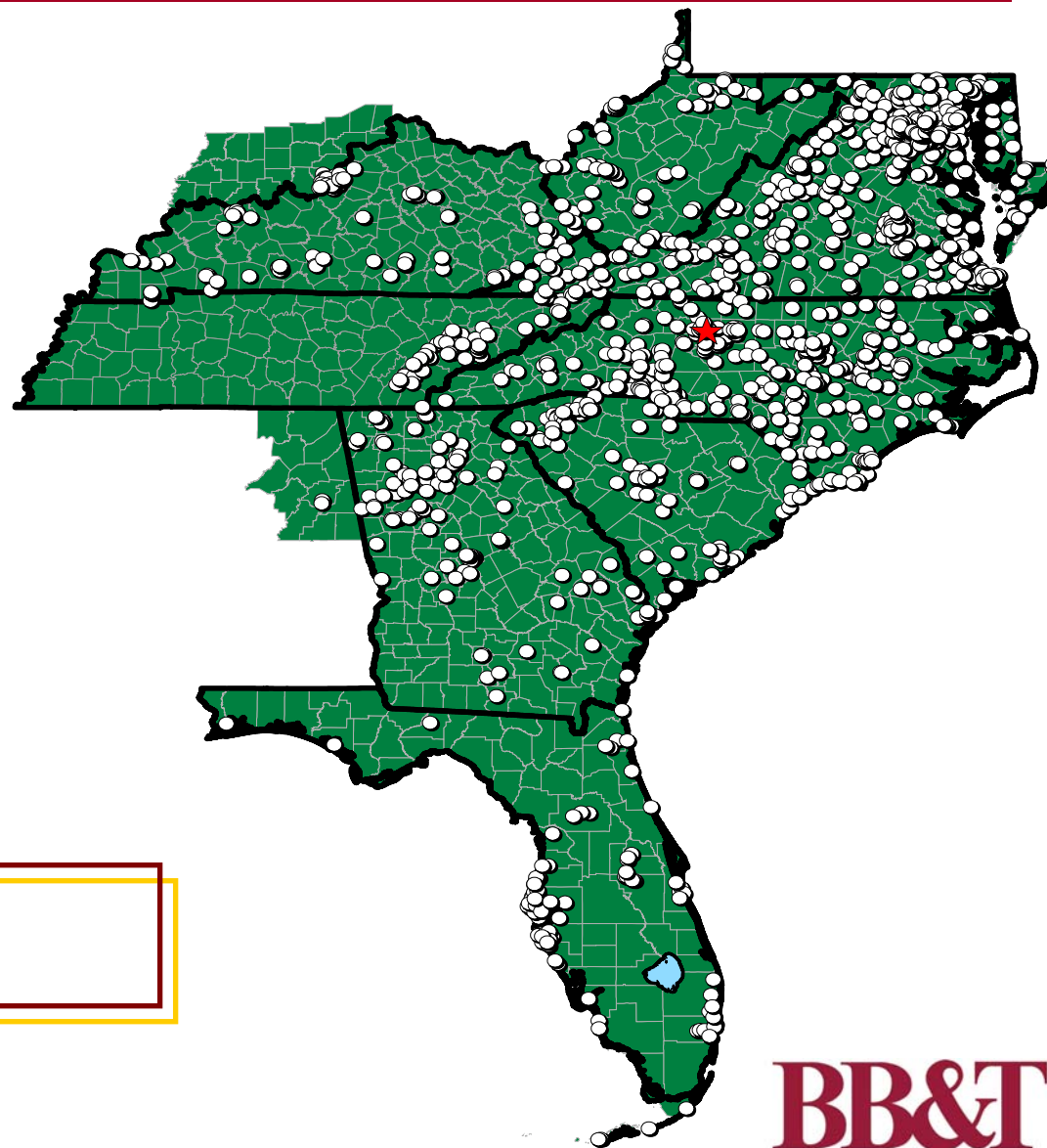
8 in DC

2 in AL

1 in IN

1,413 Total

- BB&T Community
- ★ BB&T Headquarters



# BB&T

# BB&T in the National Spotlight

Headquartered in Winston-Salem, N.C., BB&T Corporation is consistently ranked among the country's most sound and profitable financial institutions.

BB&T is included in the S&P 500 index and listed on the New York Stock Exchange under the trading symbol "BBT".

Our web address is [www.BBandT.com](http://www.BBandT.com)

- **Forbes** magazine named BB&T to its Platinum 400 list of America's "Best Big Companies" for the fourth consecutive year.
- **Fortune** magazine's 21st annual survey of *America's Most Admired Companies* ranks BB&T at No. 4 in the *Super regional Banks* category.
- The **U.S. Small Business Administration** currently ranks BB&T as the No. 1 "small business-friendly" financial holding company in the nation. This is the fifth time in the past seven years that BB&T has received this designation.
- **Money** magazine ranks BB&T No. 29 overall in its annual "*Corporate America's Best Benefits*" survey of Fortune 300 companies, and second among banks.
- For the second consecutive year, BB&T has been named to **Training** magazine's 2004 "Training Top 100" list, a national survey of organizations that excel at workforce development.
- During the past four years, ten BB&T Capital Markets research analysts have been recognized as *Best on the Street* by **The Wall Street Journal**.
- Ranked No. 1 in the nation among banks in home mortgage customer satisfaction by **J.D. Power & Associates** for three years in a row.



## Other Corporate Distinctions

*BB&T is committed to building and growing a comprehensive offering of specialized financial services.*

- Ninth largest financial holding company in the nation with more than \$100 billion in assets
- More than 1400 branch locations spanning the Carolinas, Virginia, Maryland, Georgia, Alabama, Tennessee, Kentucky, West Virginia, Florida, Indiana, and Washington, D.C.
- 6th largest retail insurance broker in the nation
- 2<sup>nd</sup> largest wholesale insurance broker in the U.S.
- More than \$27 billion in trust assets
- BB&T Factors is the 8<sup>th</sup> largest domestic factoring company in the U.S.
- Ranked No. 1 for deposit market share in West Virginia; second in North Carolina and Virginia; and third in Kentucky and South Carolina
- Largest mortgage originator in the Carolinas



# BB&T Vision, Mission and Purpose

*BB&T is a mission driven organization with a clearly defined set of values. We encourage our employees to have a strong sense of purpose, a high level of self-reliance and the capacity to think clearly and logically.*

- ***Vision***

To Create the Best Financial Institution Possible - “The Best of The Best”

- ***Mission***

To make the world a better place to live by:

Helping our **clients** achieve economic success and financial security;

Creating a place where our **employees** can learn, grow and be fulfilled in their work;

Making the **communities** in which we work better places to be; and thereby:

Optimizing the long-term return to our **shareholders**, while providing a safe and sound investment.

- ***Purpose***

Our ultimate purpose is to create superior long-term economic rewards for our shareholders.



# Objectives, Strategy and Risk Culture

*BB&T's goal is to create a high performance financial institution that can survive and prosper in a rapidly changing, highly competitive, globally integrated environment.*

- ***Strategic Objectives***

1. Be the world standard revenue-driven sales organization
2. Execute the world standard client service strategy
3. Achieve superior performance and accelerate earnings growth
4. Simplify products, business lines, processes & information systems
5. Realize performance potential of new markets; increase scale of selected fee based business

- ***Long-Term Strategy***

1. Client-driven
2. Rational risk taking and exceptional risk management
3. Superior earnings growth
4. Targeted and consistent investments for the future

- ***Risk Culture***

1. A sound risk taking philosophy
2. Having sophisticated risk management systems
3. Maintaining a diversification of risks
4. Objectivity in our risk assessments
5. Maintain excellent standards of corporate governance

# Existing Risk Management Processes

creating a new  
Enterprise Risk  
management function, our  
goal was to leverage, not  
replicate, the many existing  
risk management processes  
that were already in place.

- ***LOB/Support Managers are Risk Owners***

They are responsible for managing the risks for their respective areas.

- ***Credit Risk Management***

Credit risk has been the largest single risk that faces most financial services organizations. Oversight of this risk has been performed through the Loan Policy Committee since the mid '80's.

- ***Market/Liquidity Risk Management***

Market and Liquidity risk, which includes interest rate risk, has been extremely important to the achievement of corporate objectives. The Asset & Liability Committee has had oversight for this risk for many years.

- ***Operational Risk Management***

While Operational Risk Management has been in practice for many years, the centralization and oversight of this function (which included operational, compliance, strategic and reputation) was established in 2002.

- ***Enterprise Risk Management***

Just like Operational Risk Management, Enterprise Risk Management has been in practice for many years. While a formal structure did not exist, the Board of Directors and Executive Management have been responsible for managing risks across the BB&T enterprise.

## Existing Risk Management Processes (continued)

Existing risk management processes included both formal and informal processes and structures.

- ***Common Risk Language***

BB&T formalized a common risk language in 1998 and included risk categories, definitions and examples. It was primarily used by Audit Services as part of their risk based audit program and annual plan.

- ***Audit Services***

Internal audit utilized a risk based approach to evaluate and improve the effectiveness of internal control, risk management, and corporate governance.

- ***Corporate Compliance***

Corporate Compliance acted in an advisory role to the various core bank line of business and support managers. They were a resource to these managers as they developed and implemented new products/services.

- ***Information Security***

Information Security also acted in an advisory role to the various core bank line of business and support managers. In late 2003, they performed a comprehensive, enterprise wide IS risk self-assessment study to determine a gap analysis, relative to both IS policy and emerging industry standards.

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## *Building the Foundation*

# Building Internal Support

When the rapidly changing internal environment (corporate governance and regulatory), the Board of Directors recognized that enhancement to our current risk management processes could be beneficial to the organization.

- ***Executive Management***

In August of 2003, the Board of Directors appointed a new member to Executive Management responsible for Risk Management. She was also named by the Chairman as the chair of the Enterprise Risk Management Committee.

- ***Enterprise Risk Management Committee***

The Enterprise Risk Management (ERM) Committee was created to focus on a cross-functional view of risks across BB&T and develop corporate wide strategies for measuring and mitigating risks at a corporate level.

- ***Credit, Market and Operational Risk Managers***

Dialogue between these managers and ERM was established early on and each of them were included on the newly formed ERM Committee. The Executive responsible for ERM is also a member of the Loan Policy, ALCO and Operational Risk Management Committees.

- ***Senior Leadership Team***

Formal presentations were made to the Senior Leadership Team on ERM (2/04) and Corporate Governance/Regulatory Environment (2/05) to help enhance their knowledge of the importance and value of risk management.

## Building Internal Support (continued)

h existing and potential  
ancements to our risk  
management processes and  
uctures have been  
cussed with all levels of  
management.

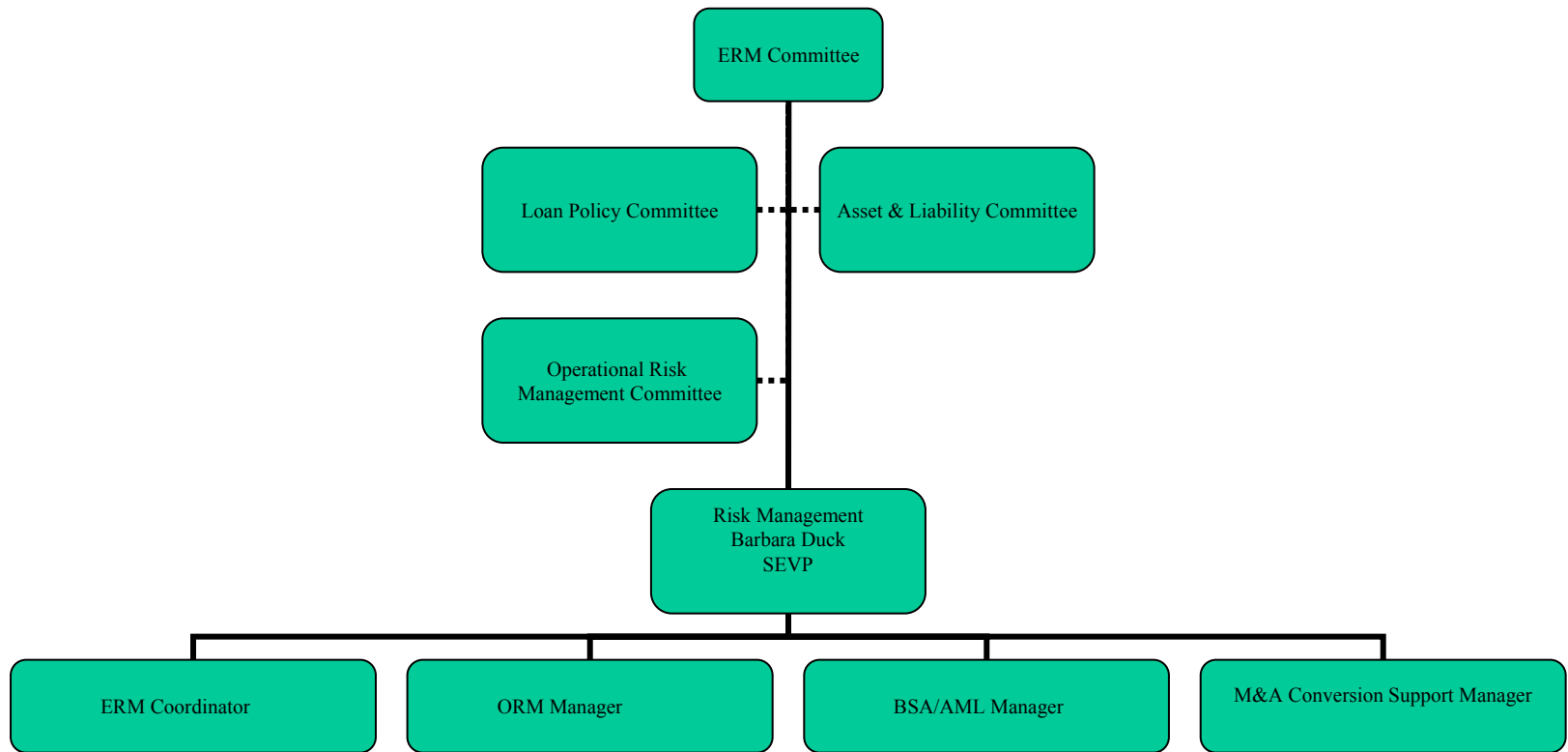
- *Line of Business/Support Managers*

Individual meetings began with these managers to discuss high level business risks, risk management processes and potential gaps. In addition, a general introduction of ERM was held. This early foundation has been extremely beneficial for establishing important lines of communication with the lines of business/support areas.

- *Audit Services*

Forming a partnership with Audit Services was one of the most critical components to establishing the ERM function. Their holistic view of the organization, knowledge of risk management opportunities, experience with risk assessments and commitment to helping BB&T achieve our objectives are just some examples of why this has been so important.

# ERM Organizational Structure



# External Environment

*establishing the new ERM function, a decision was made early on to leverage all available sources, both internal and external to the organization.*

- ***Regulatory Environment***

Dialogue between our primary regulators and ERM was established early on. The objective of these meetings is to provide timely information to the regulators on our ERM status and direction. Additionally, we obtain feedback from them as we continue to define and implement our ERM strategies.

- ***Financial Services Environment***

We established an external networking group of approximately 18 financial services organizations across the country. The primary reason for this group is to share ERM strategies, practices, etc., so that we can help establish 'best practices' within the industry. This has led to the recent development of an ERM Group which was established by the American Bankers Association.

- ***Non-Financial Services Environment***

Participation in the NCSU ERM Roundtable has proven invaluable in both networking opportunities as well as ERM practices.



## BB&T Risk Categories

Category	Definition	Examples
<b>Credit</b>	Risks that arise from a borrower's or counterparties' inability or unwillingness to repay their financial obligations as agreed. Components of credit risk can include collateral, market conditions, concentration, cash flow, credit ratings, portfolio and product issues. Credit risk extends beyond traditional lending and includes both on and off balance sheet commitments.	<ul style="list-style-type: none"> <li>•Loan Default (failure to meet the terms of the obligation)</li> <li>•Loan Losses and non-performing assets</li> <li>•Electronic Payments (ACH, Wire Transfers, and On-line Banking,)</li> <li>•Overdrafts and return items</li> <li>•Investment securities</li> <li>•Controlled disbursement accounts</li> <li>•Sub-prime lending</li> <li>•Off balance sheet (i.e. derivatives and letters of credit)</li> <li>•Official checks (issued for clients)</li> </ul>
<b>Legal/ Compliance</b>	Risks that arise from violations or nonconformance with laws, rules and regulations (federal, state or local), or prescribed practices which govern BB&T's business activities. It encompasses all laws as well as prudent governance and ethical standards and contractual obligations and includes the exposure to litigation from all types of financial services activities, both bank and non-bank. Legal/compliance risk also arises in situations where the laws, regulations or rules governing certain products or services we offer or activities of our clients may be ambiguous or untested. These risks could expose BB&T to fines, damages, civil penalties or prosecution.	<ul style="list-style-type: none"> <li>•Federal Reserve Bank, Federal Deposit Insurance Corporation and state banking regulations</li> <li>•Securities &amp; Exchange Commission, New York Stock Exchange and National Association of Securities Dealers regulations and rules</li> <li>•Major US banking laws (including but not limited to the Bank Secrecy Act, Fair Credit Reporting Act, Real Estate Settlement Procedures Act, Privacy Act, Financial Institution Reform, Recovery and Enforcement Act, Federal Deposit Insurance Corporation Improvement Act, Gramm-Leach Bliley Act, USA PATRIOT Act, Sarbanes-Oxley Act, and Check 21)</li> <li>•Contract negotiations and disputes</li> <li>•Litigation and administrative proceedings</li> <li>•Fiduciary responsibilities</li> <li>•Generally Accepted Accounting Principles</li> </ul>
<b>Liquidity</b>	Risks that arise in meeting our commitments when they come due because of the inability to liquidate assets or obtain adequate funding or the inability to offset specific exposures due to inadequate market depth or market disruptions without incurring unacceptable consequences. Factors which should be considered include regulatory requirements, accounting treatment, market conditions and potential losses.	<ul style="list-style-type: none"> <li>•Incorrect matching of assets and liabilities</li> <li>•Daylight overdrafts</li> <li>•Significant or unplanned loan growth</li> <li>•Over reliance on brokered deposits or run on deposits</li> <li>•Concentration ratios (i.e. public funds, clients, etc.)</li> <li>•Inability to make settlement payment</li> <li>•Funding limitations (investment portfolio, commercial paper)</li> </ul>

## BB&T Risk Categories

Category	Definition	Examples
<b>Market</b>	Risks that arise from changes in the value of the portfolios of financial instruments due to adverse movement in market rates or prices. Factors which should be considered include interest/exchange rate sensitive activities, accounting treatment, market conditions and potential losses.	<ul style="list-style-type: none"> <li>•Portfolio (i.e. investment concentrations, durations, correlations)</li> <li>•Trading account or inventory risk</li> <li>•Hedge effectiveness (improper or lack of hedging)</li> <li>•Interest rate sensitive activities (i.e. BOLI, MSRs, value based fees)</li> <li>•Modeling errors (i.e. assumptions, values)</li> <li>•Foreign exchange rates (foreign letters of credit, forward contract)</li> </ul>
<b>Operational</b>	The risk of loss associated with inadequate or failed internal processes, people, systems or external events.	<ul style="list-style-type: none"> <li>•Internal Processes (i.e. financial reporting misstatements, inadequate reconcilements, errors and omissions, missing/incomplete documentation, improper safeguarding of assets, inadequate internal controls, failed processor settlement, improper markups)</li> <li>•People (i.e. embezzlement and asset misappropriation, authorization/approval limits, keying/input error, management override, unethical acts (real or perceived))</li> <li>•Systems (i.e. IT systems failure, inappropriate information security access)</li> <li>•External Events (i.e. external fraud (real or perceived), legal liability, outsourcing, check kiting, counterfeit transactions, natural disasters)</li> </ul>
<b>Reputation</b>	Risks that arise due to negative publicity or public opinion (either real or perceived) that may adversely impact the BB&T brand image. Reputation risk can impact our clients, employees, communities or shareholders and is often a secondary result of one of the other six risk categories.	<ul style="list-style-type: none"> <li>•Corporate scandals (i.e. accounting irregularities, governance)</li> <li>•Industry related risk (i.e. insurance, mutual funds)</li> <li>•Inherent nature of business (i.e. payday lending, embassy accounts)</li> <li>•Third party relationships (i.e. clients, service providers)</li> <li>•Employee morale (i.e. layoffs, corporate change)</li> <li>•Employee activities (i.e. e-mails, rogue trading)</li> <li>•Regulations (i.e. fines, violations, untested regulations)</li> <li>•Litigation</li> <li>•Client Service (i.e. system availability, processing errors)</li> </ul>
<b>Strategic</b>	Risk that our business strategy and objectives (i.e. the Corporate Plan) do not allow BB&T to achieve our Vision, Mission and Purpose. The responsibility for managing this risk rests with the Board of Directors, Executive Management and the Senior Leadership Team. Any inability to execute the corporate plan generally is a result of one of the other six risk categories.	<ul style="list-style-type: none"> <li>•Integrated Relationship Management</li> <li>•Decathlon</li> <li>•Client Service Model</li> <li>•Financial goals</li> <li>•IT plans (i.e. outsourcing, hardware and software solutions)</li> <li>•Business, product, delivery channel or geographic directions</li> <li>•Succession Plan</li> <li>•Organizational Structure</li> <li>•Community Banking Model</li> </ul>

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## *ERM Initiatives*

## SAS 70 Reviews – Sarbanes/Oxley

*the high visibility of this new Sarbanes-Oxley requirement was an example of 'low hanging fruit' in which we could show the value of ERM.*

- **Benefit**

The Public Company Accounting Oversight Board – Auditing Standard No. 2 included additional requirements that our independent auditors had to consider because we obtained services from another organization that are part of our information system. As a result, these outside service providers are part of our internal control over financial reporting and within the scope of S/O 404.

- **Process**

ERM, working with IT Vendor Management, IT Audit and Financial Reporting, was responsible for developing a policy and standards that would allow BB&T management to evaluate the internal controls of these outside service providers. This evaluation was subsequently used by our independent auditors.

- **Future Plans**

Now that this process is up and going, ERM no longer needs to be the 'owner'. Therefore, it has been turned over to the financial reporting group for 2005.

# Economic Capital & Risk Management Program

*1988, the Basel Capital Accord was created to standardize international bank capital requirements. Its successor, 'The New Basel Capital Accord' was initially published in consultative form in 2001. It was intended to allow more flexibility in dealing with risk, emphasize bank's internal methodologies, and provide more risk sensitivity.*

- **Benefits**

Several external (Basel II, Investor/Analyst Disclosure Expectations, Competitive, Sarbanes-Oxley, etc.) and internal (enhanced risk management, credit risk scoring, pricing, capital management, etc.) factors were contributing to our need to improve our risk management and capital allocation processes.

- **Scope**

Four major IT projects that would look at the various components in a silo manner (data management infrastructure, credit risk management, operational risk management, and economic capital management) were planned for 2005.

- **Future**

These four projects were consolidated under one program in order to leverage the data infrastructure and resources required across all projects and coordinate the activities and needs between all projects. Going forward, ECRM Program issues will be reported to the ERM Committee.

# Risk & Control Self-Assessments

*Line of Business/Support managers, as risk owners, should have a thorough understanding of their risk environment. This knowledge should help them to better manage their business.*

- **Benefits**

The objective of the risk and control self-assessment (RCSA) is to allow BB&T to consider the extent to which routine and potential events might have an impact on our ability to achieve our goals and objectives.

- **Transition**

Risk assessments have been performed for several years by Audit Services. Given the changing regulatory, competitive and technological environment, the benefits of risk assessments extend significantly beyond the internal auditing arena. Therefore, ERM will develop and own the process and the technology solution that will be used to aid the Line of Business (LOB) and Support managers, as risk owners, in managing their risks.

- **Education & Communication**

As the new 'owner' of the RCSA, a more thorough understanding of the risk assessment methodology will be needed by the LOB/Support managers. Communication will include the value to the LOB/Support manager (i.e. the practical application) vs. just the concept. In addition to system training, they will also need training on risk terminology, appropriate risk responses, identifying all of the major risks causes across all risk types, and mapping their internal controls to the various risks.

- **Reporting**

High level 'dashboard' reporting will be communicated to the ERM Committee.

# Emerging Issues

*When a company makes the front page of either a local or national paper, it should be good news that helps, not bad news that hurts their business.*

- **Objective**

Given the changing external environment that public firms and financial services companies have experienced in the last few years, management needs to better understand the risks that can result from these changes. They also need to understand the potential impact, if any, on BB&T and determine if any action should be considered.

- **Examples**

Sub-prime lending (Citigroup, Wells Fargo)

Mutual funds (\$1.3 billion in fines since 9/03)

Insurance industry (Marsh)

Bank Secrecy Act (AmSouth, Riggs)

Sarbanes-Oxley financial restatements (Fannie/Freddie, Sun Trust, Krispy Kreme)

E-mail misuse (Edward D. Jones, Boeing)

‘Phishing’ scams

- **Process**

ERM discusses various current events with the appropriate LOB/Support manager to determine if additional research and/or action may be needed. The results of the most visible of these are discussed at the ERM Committee.

# Involvement in Corporate Initiatives

*Look for ways to partner, or  
in an allegiance, with  
the Line of  
Business/Support areas that  
are working to enhance  
their risk management  
processes.*

- **Benefits**  
ERM has a practical day-to-day opportunity to help LOB/Support managers, as well as Executive Management, with various risk related projects and/or initiatives.
- **Examples**  
Financial Services Roundtable  
Code of Ethics Review Committee  
Sarbanes-Oxley 404 Steering Committee  
Board of Directors Risk Management Presentations  
Senior Leadership Team Regulatory/Governance Presentation  
Compliance Inventory  
Process Reviews
- **Future?**  
Value Added



*Next Steps?*

# What's Next?

*What opportunities exist  
within your  
organizations?*

- **Top 10/High 5 Risk Assessment**

The objective of a high level risk assessment is to document the top residual risks facing BB&T, current and/or within the next 18 – 24 months, which can serve as a foundation for how we manage risks.

- **Regulatory Examination**

Our banking regulators have indicated that they will perform their initial examination or 'review' of our new ORM and ERM functions in the spring.

- **Modeling Standards**

There are numerous financial models that are used in different processes across the organization (i.e. ALLL, ALCO, MSRs etc.). These models may have been purchased or developed internally. We have just begun an initiative with Audit to identify these models and determine what corporate standards should be developed to manage the inherent risks associated with models.

- **Risk Policy**

Currently each Line of Business/Support area is responsible for developing policies and standards that are applicable to their areas for new products, services or processes. To help ensure that we do not use a 'silo' approach to manage risks, standards around this area need to be developed.

## Open Discussion

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