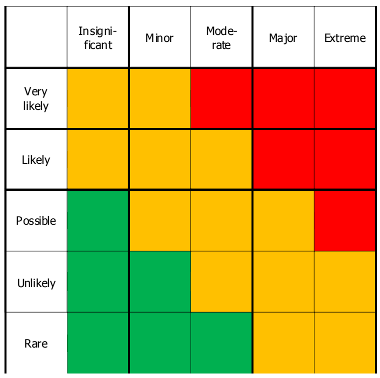
GRAS Newsletter 15

October 2009

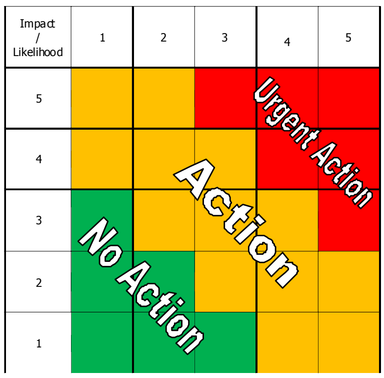
Cleaning up ORM reports

Summary
Many ORM reports have the excitement of last month's newspapers. Full of news that is already known and lacking insight in what has happened since. Some ORM reports even resemble food magazines that publish the same stuff over and over again, and can easily repeat a years issue without too many people noticing. This is all highly damaging. Better reporting is possible if we focus on the right elements in the report. This newsletters indicated the most relevant items and a fundamental change in thinking required to make that possible.

Dear reader,
Typical ORM reports contain an overview of the previous period's losses or incidents, the latest KRIs, status updates on selected outstanding actions, occasionally topped by a risk register and a few condensed dashboard pages. These reports are infrequent (monthly at best, but often quarterly) and generally lack urgency. A staple of many ORM reports is the five-by-five matrix of impact and likelihood estimates, which often underlies the colour coding in Red, Amber and Green. Simply by reinterpreting these five-by-five matrices, ORM reports can be made much more relevant, can become part of the focus for line managers and will have a much greater impact on the way the bank is run.



Reinterpreting the five-by-five
The five-by-five as depicted here is an attempt to quantify the risk exposure. Of course, some banks will use a nine-by-nine, six-by-six or any other symmetrical shape, sometimes getting all artisty with a fuzzy edged rainbow. That does not concerns us here. What concerns us are the labels used to indicate impact and likelihood, the two dimensions of the chart. The measure for impact is the simplest. It is often explained in monetary terms, either in dollar losses or percentages of revenue or cost. Likelihood is sometimes further quantified in a frequency, such as Unlikely equals one occurrence per four years.



A problem with this chart (leaving aside the trustworthiness of the measurement and the ugly graphics) is that it has the wrong focus and gives no information on what to do next. So now we know the risk is unlikely but extreme, now what? Any impact and likelihood measurement should be translated directly into a course of action. In other words, the labels used should be in terms of urgency of action, the combination being just a reinforcement of that. Seen in this light, the colours in the graph should be interpreted as follows:

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What do the ratings mean?
Note that the Impact and Likelihood labels have been replaced by ratings. These ratings should correspond with directions as to what kind of action is expected and how this will be reported. The ratings are constructed as follows:

Rating	Follow up	Expected proof of action
0	No Action Required	None required
1	No Action Required	Monitors for changes
2	Action Required	Draft high level plan
3	Action Required	Draft detail plan and identify resources
4	Action Required	Identify resources for detailed plan
5	Action Required Urgently	Monitor implementation on monthly basis
6	Action Required Urgently	Monitor implementation on weekly basis

By using a table such as this, we can get away from the senseless drive of quantification (like pinning an exact monetary value on a risk or a percentage likelihood) and move towards an ORM which is focuses on actions. Note that these ratings themselves can still be underpinned by monetary losses for impact and frequency estimates for likelihood but the five-by-five result is a *translation* of such estimates into actions. That ensures we do not have to debate the estimations ad nauseam, but can rather get to grips with the implications.

A better ORM report
Many ORM reports suffer from similar defects as the traditional five-by-fives: they report some kind of quant data (loss amounts, KRI statistics, the occasional R(C)SA outcome) as their main element. This is all useful information, but not what will get the business excited. It is largely what they already know and often not what they are interested in. That can change if we manage to shift the focus of the report to the outstanding actions. For that, four things need to happen:

- All ORM programmes that use a colour coding must translate that into an action coding and make sure that the specific actions are recorded in an action database.
- ORM cannot just be an administrator. It must be actively involved in the action tracking. This includes providing an opinion on the risk that the action is meant to address.
- The action database must include *all* outstanding actions that have an ORM angle, irrespective of their origin. The actions could thus stem from experienced losses, KRI data, RSA papers, Audits, IT proposals, business cases, process changes etc etc. In each case where there is an ORM impact, the corresponding action it should be included in the database and the subsequent overviews.
- The action overview must be made the main topic of the ORM report. This is the section that must always be discussed at the Operational Risk committee meetings. All other sections, like the KRI updates, loss data graphs and event analysis, are useful, but are appendices to the action report and need not necessarily be discussed.

There is a huge benefit in making the ORM report action focused. It shifts the attention from yesterday's events to today's activities. That is what ORM needs more than anything.