GRAS Newsletter 63

October 2013

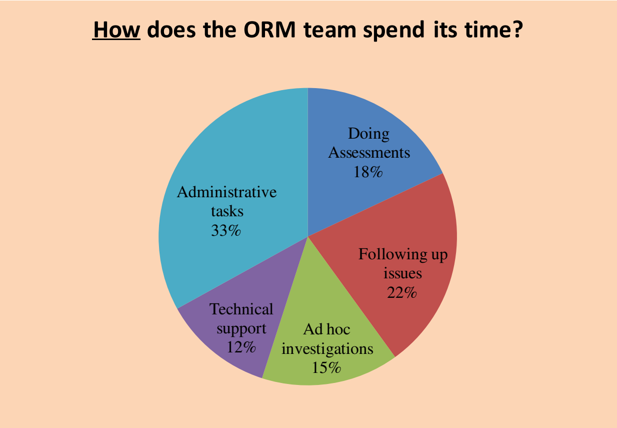
A Three Ring Circus

Summary
Risk management is supposed to be a second line of defence, firmly wedged between the business and audit. The ORM function is a bit different. Although part of the second line, it also needs to be very close to the business and has similar objectives to audit. In fact, most ORM functions have more than one foot in the business *and* lean towards the audit world at the same time, which leads to a wobbly balancing act. This newsletter takes a quick look at the time spent on various activities by ORM departments and investigates who they spend their time with.

Dear reader,
The three lines of defence model is the accepted standard for bank governance. The first line goes after the business, the second line sets the limits and the third line provides assurance as to the others' capabilities and methods. The second line typically has a mandate to develop policies and standards, to set limits, and to do business reviews regarding adherence to and efficiency of the daily practice. That is how it is on paper, and for financial risks such as Credit, Market and Liquidity risk, that is also largely how it really works. ORM, however, is a different animal.

Survey
To get an idea of what ORM really does, GRAS conducted a brief survey among ORM managers consisting of two questions: A) *How does your ORM team spend its time?* and B) *Who does your ORM team spend its time with?* The results are telling.

Question A) How does the ORM team spend its time?
The question (for which the answer categories were given) was put to 22 ORM managers worldwide, 21 of whom responded.



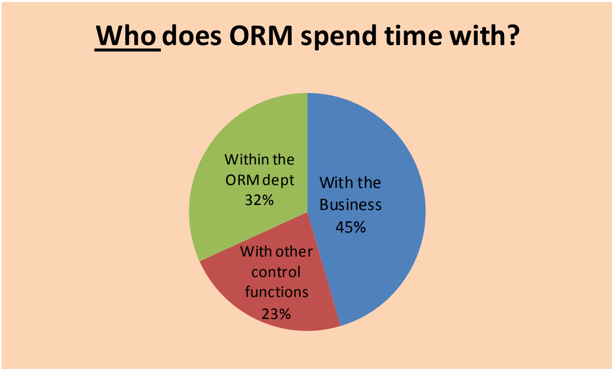
On the face of it, the ORM teams appear to be quite outgoing. Doing assessments, following up on issues, ad hoc investigations and technical support together make up 67% of the time, which is respectable for a unit that is typically viewed as churning out reports and attending committees. Indeed, only 33% of the time is devoted to report making and other internal administrative tasks.

The non-administrative activities that take up most time is the follow up on issues (average 22%) which ranged from less than 5% to more than 30%. That seems a very wide range. But if we add *Doing Assessments* and *Following up issues*, we get 40% on average with a range of 30-55%. Still a wide range, but much smaller. Perhaps some banks only count loss event follow up as follow up of issues. Ad hoc investigations were very interesting. Two sets of numbers appeared, one cluster of 4 responses hovering just over 0% and one cluster of 17 responses averaging 18%. Clearly, not all ORM departments are expected to perform such ad-hoc tasks.

A Three Ring Circus

Question B) Who does the ORM team spend time with?

For this question, three options were given: Time spent ■ within the department ■ with the first line or ■ with other control functions.



On average, the ORM department spends around 45% of its time with the business – assessing processes, evaluating events, or discussing product and process change (the range was 30 to 60%). A lesser amount of time is spent with other control functions, 23% on average. This includes Audit, which is a close cousin to many ORM departments.

These percentages were reversed in only one bank, where the time spent with the business amounted to a mere 30% and time spent with the other control functions reached 35%. In all cases, is clear that ORM is spending considerable time with the business and with other control functions.

Being in three places at once

In terms of governance, the ORM function forms part of an independent second line, but the survey shows that the ORM function has very close working relations with both the first line and third line. Spending time with them is even more important for ORM than for other risk functions for three reasons.

a. ORM is not in a position to hand down general dictates and guidelines to the business such as limits on counterparties, industries, instruments, tenors etc. Nor do they develop models that are rigorously tested and must be used by the business. Rather, ORM looks at the processes of each business to plug any control gaps. These control gaps are by no means limited to risks that are taken knowingly and on purpose, such as taking a position or granting a loan. Those types of risks lend themselves to models and limits. Risks that are not taken knowingly are not susceptible to that type of control.
b. The ORM department relies to a great extent on the relation it has with the business to both identify and remedy deficiencies. That relationship requires frequent contact and cannot be done remotely via email or phone calls. It requires actual presence on the scene.
c. A close cooperation with Audit (and other control functions) is necessary to ensure that the total control efforts show neither gaps nor overlaps. That requires frequent alignment.

Conclusion

ORM managers must be masters at balancing. They need to spend time at lot of time with the first line to keep a finger on the pulse and yet not become best mates. They must be aligned with the third line and yet respect the difference between Risk and Audit. They must be joined at the hip to other second line control functions and yet not become redundant. ORM is therefore a balancing act three times over.