



Celebrate Your Victories

Summary

Over the past 64 months, GRAS has put out newsletters on all manner of (operational) risk management topics. This current newsletter will be the final one for now. Many of the newsletters have been critical — focusing on what is not working well, what needs improvement and where banks and regulators are looking the wrong way. And although the newsletters always provided suggestions for improvement and a way out of the maze, they may have lead some readers to believe that ORM is somehow ‘problem’ area. To correct for that, this 65th and final newsletter will highlight only success stories.

Dear reader,

This newsletter lists the success stories GRAS has witnessed regarding ORM. They have been collected from personal experiences gained over the last decade from a good dozen banks scattered across as many countries, chiefly from Greater Asia, with a sprinkling of Middle Eastern, European and South American banks. The successes are categorised by ORM topic to be re-read in case you feel despondent about the progress in your bank on any topic.

Governance Successes

- A. The establishment of ORM as a discipline has forced banks to clearly spell out the roles and responsibilities of the first and second line of defence in safeguarding the bank. Even a rudimentary policy statement (we have seen ORM policy statements of a single sentence and one ORM policy document of barely three pages text) draws attention to what would otherwise be a haphazard way of dealing with risk. Having a board approved ORM statement cum policy is no mean achievement for such a loosely defined discipline, and it should be counted as one of the successes of ORM that it exists at all.
- B. This clarity has been most successful for those banks that implement a Risk Appetite statement at the same time – preferably one which can be cascaded down into the business units since that operationalises the responsibilities. The most successful implementation was in a small bank (about 700 employees) where risk appetite was measured in terms of the number of deficiencies requiring resolution and the timeframe for that resolution. By the way, this bank manages to get by with a single ORM manager and excellent cooperation with both the other control functions and the first line.

Loss Data Collection Successes

- C. In one way or another, banks have always analysed losses. With the advent of ORM, however, this is now done more consistently and with greater transparency. ORM reporting often starts with a loss data paragraph which always receives great management attention. The best loss reports we very have seen were not just detailed and accurate but were also turned around within days and had an immediate effect on the business process within weeks. It remains the best attention grabber for struggling ORM departments and can be used to drive awareness like no other ORM tool.



Celebrate Your Victories

- D. Rigorous and comprehensive loss data analysis for all manner of OpRisk losses has only started properly with ORM. Before ORM, credit losses or market losses would usually be seen as one-off client or product aberrations, and generally not as a symptom for underlying (process) deficiencies. Now, the costs and the causes for such diverse losses as inability to access collateral, electrical power outages, breaches of fiduciary duty, failure to keep records, weaknesses in a reconciliation process or vandalism to an ATM are all analysed, reported and monitored as process / product deficiencies. The most rigorous reporting has been in a large bank in Asia where the monthly loss report often ran close to 40 pages, not because of the number of losses but because of the depth of the causal analysis. Four dedicated loss data analysts were responsible for this monthly feat.
- E. ORM routinely examines not only the bank's own losses, but also losses that were reported by other banks. The reports on the frauds in Barings Bank¹, Allied Irish Bank and Société Générale have been devoured by those working on control frameworks for dealing rooms. The best example we have seen consisted of workshops that were set up by working groups from a number of local savings banks who teamed up to draft better guidelines on how to tackle Money Laundering based on their pooled experiences.

Assessment Successes

- F. Risk assessments, whether in the form of questionnaires, checklists, workshops, brainstorm sessions or structured walkthroughs are among the most successful instruments of operational risk management. The most successes have been achieved by eschewing formalised 'systems-assisted' assessments with meaningless quantification and by allowing unrestricted input from many participants. An operational risk comes in many guises, and since different problems require different solutions, it is best to allow many types of assessment in the toolkit. That may be criticised as incoherent or inefficient, but we have seen too many cookie-cutter assessments which benefit no-one. On the plus side, we have seen experimental assessments that were very successful, perhaps because of the novelty effect². The lesson for ORM professionals is not to give up on developing assessment techniques, and to spend more time on doing assessments.
- G. A Middle Eastern bank we advised went through an assessment of a new product (not all that complex in itself) that took much longer than anticipated. By the time they had completed all risk assessments, it turned out the competition who had already marketed the product (possibly with less care) was suffering multi-million dollar losses and had to withdraw the product. Eventually, the bank saved a considerable amount by not launching the product at all. Risk management were suddenly no longer the spoilsports but the saviour of the business unit.

¹ This was in fact in many ways was the seminal moment for ORM. There are indications that the collapse of Barings in 1995 was one of the drivers for the inclusion of Operational Risk in the Basel II capital accord in 2001.

² We should also not rule out the likely *Hawthorne* effect. So called after the 1940s experiment where it turned out that any special attention given to factory workers lead to increased productivity. The explanation being that by making the experimental group feel special, they start to outperform their peers.



Celebrate Your Victories

Risk Indicator Successes

H. The real success of Risk Indicators would be measured by the number of prevented losses and their amounts, thanks to timely action. Those, unfortunately, are make-belief numbers. The KRIs that we have had most success with, in terms of actions taken which presumably reduced risk and hence prevented losses, were invariably part of the normal business process. They were also typically transaction oriented and were measured frequently, i.e., daily. Here is the top five:

- The daily total sum in suspense accounts and the delta from the day before;
- The number of outstanding projects for the next 12 months measured in man days;
- The daily number of intrusion (malware / hacking attacks / DOS etc) attempts;
- The daily peak utilisation level for selected hardware / network statistics;
- The number and the amount of margin calls in dispute.

Capital Modelling Successes

I. Banks that have been successful in capital modelling are those that have taken a lot of liberties with the AMA prescriptions. For one bank in Asia, we developed a KPI-based AMA for internal use that combines the loss history of business units with a factor derived from identified risks, deficiencies and outstanding actions. What may surprise some readers is that in the model, identified risks and deficiencies marginally *lower* the capital requirement. This seems counterintuitive. However, each identified deficiency without a corresponding action substantially *increases* capital requirements, and overdue outstanding actions increase the capital requirements dramatically.

J. The best result for capital modelling was a bank where an AMA-like capital calculation and Risk Appetite were closely combined. Both were couched in the same terms and both were easily cascaded down to the BUs. This makes sense because that is where the risks, deficiencies and actions reside in the first place. Also, a capital charge alone does not command the same level of board attention as risk appetite. In certain business units the capital thus derived deviated considerably from TSA. To keep the aggregated sum within a 10% deviation from TSA, a top of the house correction will need to be applied once the regulator allows AMA. The success story, however, is that this bank is to all intents and purposes applying AMA and making the business OpRisk charge risk sensitive.

Integration Successes

K. There has been much idle talk about Integrated Risk Management, Enterprise Risk Management, Integrated Control and Risk *Governance* Frameworks etc., chiefly by consultants and conference organisers. The success of integration rests on the realisation that ORM has little to gain from integration. Although Credit Risk, Market Risk, Liquidity risk etc and Operational Risk share the *risk* epithet, they are nowhere near the same species. OpRisk is unique in that it has no specific object of study, is not restricted in scope to any specific part of the bank, is not entered into for reasons of profit and is managed through qualitative and



Celebrate Your Victories

behavioural measures rather than quantitative measures or via models. Integrated approaches have been most successful where various control-like functions (such as Compliance, Business Continuity management, Internal control, Anti Money Laundering, IT security etc.) were made to share a single risk/control/deficiency/action repository. In other words, where the ORM function has found a place close to the other control functions rather than in joint approaches with Credit or Market risk functions.

- L. In one bank, the internal Audit function and the ORM function report to the senior management/board using exactly the same reporting template. That is rare to find, but it makes perfect sense. It goes a long way to avoiding confusion in the bank over outstanding issues and action prioritisation.

Conclusion: The Ten Key Success Factors in implementing ORM

So what is the general lesson learned from these successes? Maybe that ORM is still an emerging discipline, seeking its proper place among the other risk and control functions and the realisation that ORM does have a contribution to make.

In one bank we found a small folding card in every meeting room. It listed ten *Do's & Don'ts in Meetings*. Half the audience would see the side with the five *Do's*, the other half would see the five *Don'ts*. The admonitions themselves are common sense really. They are, however, very useful because despite their triviality: people simply need to be reminded of home truths. And the fact is that ORM is mostly common sense. Following the same set of admonitions we found at the meeting table for the ORM activities will do more than any expert, IT system, consultant or funding to make it a success. Here is that list as it applies to the ORM practice:

MAKE SURE NOBODY ...	MAKE SURE EVERYBODY...
... corrupts the process	... sticks to timelines
... uses aggressive language	... contributes
... puts anyone on the spot	... respects all contributions
... dominates the discussion	... stays on topic
... challenges people instead of ideas	... praises more

Final words

Dear Reader,

at 65, the newsletters have reached retirement age. There are plenty of issues that require further work, but it is time to find new ways to explore those. I would like to thank all of you who have taken the time to send in a reaction and I look forward to further correspondence with each of you.

Best wishes,

Marc Leipoldt