ORM Best Practices

Kenneth Wainwright
Senior Audit Manager (ORM), EMEA
Citi
Agenda

1. A simple capability / maturity model
2. Compliance versus risk management
3. RCSA
4. Operational risk events
5. Scenario analysis
6. BEICFs
7. Conclusion
8. Audience Questions and Discussion
1. A Simple Capability / Maturity Model for ORM

Where are you?

<table>
<thead>
<tr>
<th>Reaction</th>
<th>Compliance</th>
<th>Anticipation</th>
<th>High Reliability</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Cost-driven</td>
<td>• Rules, regulations and policies driven</td>
<td>• Understanding of risk</td>
</tr>
<tr>
<td></td>
<td>• Afterthought</td>
<td>• Obstacle to profitability</td>
<td>• Linkage to strategy, appetite</td>
</tr>
<tr>
<td></td>
<td>• Pain reduction</td>
<td>• Bottom-up, box ticking</td>
<td>• Linkage between all elements of framework</td>
</tr>
</tbody>
</table>
<pre><code>        |                                | • Least must, pain avoidance | • Value-added |
        |                                | • Blame mitigation | • Preoccupation with failure |
        |                                | • Management by Satnav? | • Deference to expertise |
</code></pre>

Where do you want to be?
2. Compliance versus Risk Management – in Numbers

RMS Titanic Lifeboats

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>64:</td>
<td>The number of lifeboats the Titanic was capable of carrying (a total well over the ship’s maximum capacity of 3547 people)</td>
</tr>
<tr>
<td>48:</td>
<td>The number of lifeboats originally planned for Titanic by the chief designer Alexander Carlisle, 3 on each davit; The number was reduced to make the decks look less cluttered</td>
</tr>
<tr>
<td>20:</td>
<td>The number of lifeboats actually carried aboard</td>
</tr>
</tbody>
</table>

Remarkably, this was technically legal; the law at that time based the number of lifeboats required on the gross register tonnage of a ship, not her passenger capacity.
3a. RCSA

Do you know which operational risks create the greatest drag on performance?

- Lost in the rating?
- RCSA linkage to operational risk appetite: how much risk is too much risk?
- When does it start to matter? It’s not all about the money...
- End to end view?
- Cost of control vs loss experience of controlled process
- Quantification of expected and unexpected loss
- Linkage to scenario analysis
- Risk ranking and residual risk quantification
- Linkage to other risks (broad sense)

Customer retention, share price, fines, competitive positioning, efficiency, employee engagement...
3b. RCSA

Risks or Processes? How many risks?

Chart 1.1: 100 Risks in Financial Services
4. Operational Risk Events

Operational risk events are opportunities to improve structure, system and systems.

- Operational risk events are opportunities to improve structure, system and systems.
- Risk management becomes quality management which supports reputation and share price.
- E.g. Major bank payments issue(s) – customer compensation, share price impact, fine, reputation, clear up
5. Scenario Analysis

An underused tool

Why?
- Lack of data
- Lack of process understanding
- Lack of agreement of underlying risk drivers

Value:
- Understand key risk drivers, and risk profile
- Move focus away from just a capital number

Start thinking about stress testing.......
6. BEICFs

Key Learnings:

- can be used to update a capital figure to reflect changes in risk profile between formal capital calculations
- the most suitable of the four elements to OR capital aligned with residual risk profile.
- Internal and external loss data are an historical reflection, and scenarios are typically focussed only on extreme events.

Best Practices:

- Use as consideration in the scenario analysis process.
- Internal and external loss data considered for scenario assessments may lack relevance or currency. Consideration of BEICFs can assist the scenario assessors in making estimates that are more relevant to the current residual risk profile of the bank.

The Road Ahead:

- Internal BEFs can include the size volume of the business; the nature and complexity of the products or services offered, and of the processes and technology required to supply them; the skills and turnover levels of the staff; and the level of change and development within the business.
- External BEFs include factors such as the competitive, economic, regulatory, legal, geographic, political and natural environment.

7. Conclusion

Do nothing which is of no use
- Miyamoto Musashi

Quality over quantity
What’s the value?
Understand your risk drivers
Communicate your risk profile
Link your framework together
Link to strategy and risk appetite

Continually seek ways to improve
### 8. A Simple Capability / Maturity Model for ORM

#### Where are you?

<table>
<thead>
<tr>
<th>Reaction</th>
<th>Compliance</th>
<th>Anticipation</th>
<th>High Reliability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost-driven</td>
<td>Rules, regulations and policies driven</td>
<td>Understanding of risk</td>
<td>Preoccupation with success</td>
</tr>
<tr>
<td>Afterthought</td>
<td>Obstacle to profitability</td>
<td>Linkage to strategy, appetite</td>
<td>Continuous improvement</td>
</tr>
<tr>
<td>Pain reduction</td>
<td>Bottom-up, box ticking</td>
<td>Linkage between all elements of framework</td>
<td>Strategic advantage</td>
</tr>
<tr>
<td></td>
<td>Least must, pain avoidance</td>
<td>Value-added</td>
<td>Commitment to resilience</td>
</tr>
<tr>
<td></td>
<td>Blame mitigation</td>
<td>Preoccupation with failure</td>
<td>Deference to expertise</td>
</tr>
<tr>
<td></td>
<td>Management by Satnav?</td>
<td></td>
<td>Value-driven</td>
</tr>
</tbody>
</table>

#### Where do you want to be?