

IRM Operational Risk SIG MINUTES

Date:	28 th August, 2008
Time:	17.30 – 19.00
Meeting location:	RBS offices Waterhouse Square, 138-142 Holborn, London

Attendees	
Mark Russell (RBS) Chair and Minutes	Major Jonathan Crook (MOD)
Anna Nicholl (BNY Mellon) Deputy Chair	Jonty Birrell-Gray (West LB)
Andrew Lilley (RBS)	Julian Philips (JP Risk)
Edward Sankey	Liz Burn (AIB)
Elena Munt (RBS Insurance)	Lorraine Love (HBOS)
Ian Goode (MEGA International)	Maria Puddu
James Macrae (Metronet Rail)	Patricia Brown (SMBCE)
Jeremy Philpott (LloydsTSB)	Susan Young (Zurich)
Jeremy Tilney-Bassett (Airbus)	

No.	Notes
1	<p>Welcome and introduction</p> <p>In welcoming members to the third meeting of the SIG, the Chairman noted that the theme of the meeting was ‘ownership by the business’ as against ‘ownership by the OR function’.</p> <p>Although the short straw this time seemed to be the case for ownership by the OR function, we would have to see the strength of the arguments.</p>
2	<p>Agree minutes of previous meeting</p> <p>The minutes from the meeting of 31st July were agreed without changes.</p>
3	<p>Presentations on ‘ownership by the business’ as against ‘ownership by the OR function’</p> <p>Two SIG members each gave a ten minute presentation on the ownership of OR, one presentation in favour of ownership by the business, one against. These talks set out theoretical positions to prompt debate and did not represent either personal or corporate opinions.</p> <p>The main points presented were as follows:</p> <p><u>In Favour of Ownership by the Business</u></p> <ul style="list-style-type: none"> • Ownership of risk management rests with the business and ownership of the process rests with the risk management function, which should “assist the Board in setting policy and structure an organisational framework to coordinate functional activities and develop the risk response; prepare reports for the Board and stakeholders”. • Risk managers are not there to do the risk management; they are not responsible for managing the risk as that rests firmly with the managers of the functional areas. • For the financial services industry, Basel 2 defines operational risk as... “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.”. All businesses have risk from... “inadequate or

failed internal processes, people and systems or from external events, including legal risk.” but not all businesses have a separate dedicated resource to manage OR. There is no dedicated resource, but the risks are still there.

- OR management must be embedded in the hearts and minds of people at the coal face.
- In the speaker’s firm, 5 years ago there was little or no OR management, just an annual review of risks and some trouble-shooting. There was then a move to quarterly reviews of the total risk profile, risk reporting including control failures and loss events; broken processes that needed fixing. First they got endorsement from top management and then they cascaded this, making people see risk management as a way of fixing problems, rather than throwing the book at people. In doing all this we had to overcome the misconception that the ORM function was there to manage risk.
- In the 3 lines of defence model, ORM is the 2nd line.

Against Ownership by the Business

- The edge that a dedicated risk management team has is that it is committed to risk management. If you give ownership to the business, there is just not the same level of understanding.
- How will you ever succeed in carrying out an effective risk assessment without specialist leadership; if you leave the onus with the business some areas will do it, others won’t. People in the business have their day job, and that has to take priority.
- Consistency comes about from having a risk management team who can keep subjectivity out of it.
- My firm organises ORM around a small central team who run core activities and have a dotted line into each of the ORM teams located in major business programmes. This sometimes works well, sometimes not so well. Without this central team there would be no long term training, no policy, and no advice to the Board. Without this team the central issues would get dropped. In the past we tried to do without it but there was too much divergence in the divisions.
- Ownership of what? Of managing risks, or of coordinating effort? It is the organisation as a whole that owns this. Ownership is passion and empowerment. Ownership depends on the risk; the business owns business risk. OR ownership splits into ownership of the OR process risk, which is the risk of poor execution, and ownership of the overall risk portfolio.
- Without a sense of accountability you get a shrugging of shoulders and “Oh, well, it was their risk”; the OR function must have a sense of accountability. There must be shared ownership, and shared accountability, between the business and the OR function; a partnership, a shared passion for the quality of the output.

There was then a wide-ranging debate on the pros and cons of the arguments offered. It was recognised that...

Some points raised during the discussion were:

- You can tell who the de-facto owner is by seeing who gets kicked first when something goes wrong.
- We have seen organisations that react against the de-centralisation of risk management down into the business; suddenly being accountable, the business can see the prospect of the finger pointing at them and they react by escalating everything upwards. Whoever is the owner, they must be empowered.
- Sometimes the ORM team is seen as a specialist function coming in to tell line management how to do a part of their job.
- Responsibility for managing the risks, over months and over years, must sit high up in an organisation. The owner must have the resources and the influence. On-going ownership must be at a high level; the detailed management can be at a working level, but responsibility lies at the top.

	<ul style="list-style-type: none"> • So what's a person to do? The central ORM unit should have a lot of responsibility for the management of those risks; this can be the only way of making it happen in the long run. • OR always existed, but it was brushed under the carpet; the existence of an ORM function enables consistency. • The OR function can be accountable if it is given the option to disagree and decide what to bring to the OR Committee; they need to ask whether the firm should accept the risk. • ORM is quite a new profession, born out of corporate governance. The top of the organisation is accountable for RM and must be able to explain to institutional investors, so the executive should decide who owns the risk. • Is the ORM function just a parasite on the business? Specialist functions (HR, Finance, ORM) arise out of scale and complexity, but do they add any value? • In one organisation there was a sea change when OR was put into the objectives of executives and impacted their bonuses. This was based on metrics like the number of audit issues, and worked as a points system. The downside was that areas with a bad risk culture started to cover things up. • In financial services, the Risk Officer and the business manager both get kicked. The short life-expectancy of CROs shows that there is some ownership. • In some organisations, the risk committee became a way of avoiding responsibility; they were ditched, and replaced by the requirement that major issues (transactions, etc.) are each signed off by three individuals. • Re the Soc. Gen. event, you can have an organisation with great controls, exception reports, and so on, but if the staff are not educated to understand the fundamentals, things are allowed to go on that just don't add up. It's vital to understand who the risk owner is so that we can make sure that they understand their responsibility. The risk owners must be truly empowered and they must have the appetite for their role. • Risk appetite must be defined at the top of the tree; the actual management of risk can be delegated. • Another member then observed that risk appetites really don't exist in a tangible form, in reality they change every half hour. The appetite for un-crystallised risk is much higher than the appetite for crystallised risk.
4	<p>Topic for August</p> <p>The SIG members agreed to consider topics for next month and contact Mark Russell with offers to speak.</p>
6	<p>Next meeting</p> <p>25th September 2008, 17.30 – 19.00, RBS offices Waterhouse Square, 138-142 Holborn, London.</p>