

IRM Operational Risk SIG MINUTES

Date:	29th January, 2009
Time:	17.30 – 19.00
Meeting location:	RBS offices Waterhouse Square, 138-142 Holborn, London

Attendees	
Mark Russell (RBS) Chair and Minutes	Tony Forbes (RBS Insurance)
Ian Fraser (IRM)	Susan Young (formerly Zurich now Antires)
Jack Theobald	James Cole (Cognitics 360)
Peter Philpot (National Counties B/Soc)	Maria Puddu
Fagan Shah (Prudential)	Paul Saunders (formerly RBS now DCG)
Andrew Lilley (RBS)	

No.	Notes
1	<p>Welcome and introduction</p> <p>In welcoming members, the Chairman noted that continued pressure in the Financial Services industry was taking a toll on the membership of the SIG; there had been a number of recent withdrawals due to redundancy. That said, a hard core of between 10 and 20 members attend each meeting, and this is encouraging as the group approaches its anniversary.</p> <p>The Chairman posed a challenge in the wake of recent market events, asking ‘How visible have Operational Risk (OR) functions been, when recent large incidents occurred?’ Should the OR function put its hand up and claim these major loss events as representing Operational Risk failings or should it lie low and point the finger at Credit or Market risk? Perhaps this is a ‘no win’, challenge: put your hand up, and be fired, or keep it down and be seen as marginal to the real issues. Being seen as central is the only hope of credibility for Operational Risk Management, but this is an uncomfortable space for Heads of Operational Risk.</p> <p>These thought were carried into the evening’s debate.</p> <p>The Theme for the evening was ‘<i>Operational Risk will always be disengaged from Business Management</i>’, arguments for and against being put by members.</p>
2	<p>Agree minutes of previous meeting</p> <p>The minutes from the meeting of 27 November were agreed with one change (the addition of the group’s adopted Basel 2 definition of OR).</p>
3	<p>Presentations for and against ‘Operational risk will always be disengaged from business management’</p> <p>Two SIG members each gave a five minute presentation, the first being the ‘cup half full’ argument against the motion, the second being the ‘cup half empty’ argument supporting it. 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>Against – ‘Operational Risk always being disengaged from business management’</u></p> <p>The first speaker challenged Members to think about their professional motivation. In so far as we have a passion for what we do we must believe that OR management will eventually be so fully engaged that it earns an undisputed seat at the ‘top table’.</p>

OR management faces two key challenges: there is an urgent need to agree a consistent tool set across the profession, and to share a clear understanding of how we add value.

There is a credibility issue, as expressed in a recent KPMG survey on risk in Financial Services in general, but we also face fantastic opportunities.

In order to increase Operational Risk Management engagement we need to focus on the changes in regulation, capital requirements and the commercial environment, all of which work in our favour. Again in Financial Services, BASEL II (and to some degree the current market turmoil) probably make it easier to achieve business engagement than it has been for years.

Senior OR people need to have gravitas and the professional skills to communicate effectively at the highest level – the mix of technical experience and advanced communication skills is a rare combination, but not impossible to find.

The potential for a ‘big event’ causing a company to collapse is now a more plausible than before, with reduced capital and tighter liquidity meaning that firms can’t absorb the impact of very large events as easily as in the past.

As a discipline we need to have a clear message (a story to tell) across company and industry boundaries to take advantage of the opportunity before us – groups like the IRM OR SIG have a role to play in this.

We have the opportunity to stake a claim to the centre stage and OR management leaders with the positive attitude needed to sell the potential contribution of OR management to business managers are best placed to inspire the take up these tools.

In favour of – ‘Operational risk always being disengaged from business management’

This argument was split into two parts, acknowledging the different situation in better run firms and in those with significant room for improvement. In the later, the OR function is tolerated in good times, but without any willingness or expectation that it should fulfil a real role in the business.

It is this attitude that brings the real challenge, where practices and frameworks can be superfluous to real activity. In essence OR management practice in these firms is ‘window dressing’.

Is the notion that Operational Risk as a function can become fully entwined in a business’s fabric realistic? There are some cultures (sales driven) where this may be both unrealistic and inappropriate, where the culture of OR awareness may actually undermine success. Trying to engage may be like trying to mix water and oil.

A badly run OR function may not only be squandered costs but may also become a business impediment. It is arguably more enlightened to recognise and nurture the different risk cultures ‘front to back’ within a firm in a way that achieves the best results and provides OR support tailored to the styles and needs of each of these cultures.

Independence (of the Operational Risk function) is also a virtue, enabling it to provide constructive challenge, but the strength of independence needs to be balanced by business acumen and pragmatism.

There was then a wide ranging discussion, the main points made were as follows:

- The group debated the challenges 1st / 2nd line roles (and principles) and how these had sometimes blurred during the evolution of the OR function
- This is a ‘hearts and minds’ exercise with the OR function sometimes positioning itself as a ‘friendly policeman’
- There are some benefits in being seen to be interested in managing ‘upside’ risks (lost opportunity cost) in addition to ‘downside’ risks (losses from threats) – essentially this can get OR Manager more engaged with the business (by speaking their language) and becoming an enabler, albeit with one eye on where the threats may emerge from.
- This re-emphasised the need for the OR Manager to develop commercial acumen and use this in applying the framework and toolset.

	<ul style="list-style-type: none"> • It was claimed that the collateral impact of OR, such as: loss of clients, loss of business, attrition (staff or customer) and reputation damage can be better managed by focussing on the 'upside'. • Ultimately by placing Operational Risk in a more 'positive' space (in terms of opportunity management) the business is likely to be more willing to accept it as a partner and subsequently see the benefit in heeding the 'negatives'.
4	<p>Topics and Speakers</p> <p>The Chairman asked for fresh topics and speakers for 2009, to make meeting planning less 'hand to mouth'.</p> <p>The topic for the next meeting was agreed as '<i>Operational Risk Management should turn into Enterprise Risk Management in order to survive</i>'. Two members volunteered to speak.</p> <p>It was agreed that the subject of risk assessment (and the various forms it takes could be used to stimulate a number of lively debates during the year, given that this was such a hot topic, particularly in the Financial Services industry. Example given were;</p> <ul style="list-style-type: none"> • Time based versus business change based • 1st versus 2nd line responsibility • Inherent risk versus residual risk. <p>The Chairman asked for e-mails ahead of the next meeting suggesting suitable motions and volunteering to speak.</p> <p>Thinking about the question pondered at the start of the evening, a further motion was suggested for a subsequent meeting in respect of 'The current Economic (and Market) conditions are a threat to OR management functions'.</p>
5	<p>Other IRM News and Events of Interest</p> <p>Ian Fraser, brought the following to the SIG's attention:</p> <ul style="list-style-type: none"> • The IRM is currently seeing a 50% reduction in recruitment advertisements, being a sign of the times • Any member wishing to place an article in the Institutes magazine were encouraged to do so, Mark Russell suggested a summary of this SIG's activities (with points of interest) could be produced for the March edition <p>The 'annual lecture' and 'essay competition' both detailed on the IRM's website</p>
6	<p>AOB</p> <p>The Chairman asked attendees to consider whether the current meeting booking (last Thursday of each month) was still the best going forward. This will be discussed during our February meeting.</p>
7	<p>Next meeting</p> <p>26 February 2009, 17.30 – 19.00, RBS offices Waterhouse Square, 138-142 Holborn, London.</p>