

IRM Operational Risk (OR) SIG MINUTES

Date:	27 November, 2008
Time:	17.30 – 19.00
Meeting location:	RBS offices Waterhouse Square, 138-142 Holborn, London

Attendees	
Mark Russell (RBS) Chair and Minutes	Jonty Birrell-Gray (West LB)
Anna Nicholl (BNY Mellon) Deputy Chair	Julian Philips (JP Risk)
Ian Fraser (IRM)	Anne Stenning (Environment Agency)
Fagan Shah (Prudential)	Loraine Love (HBOS)
James Macrae (Metronet Rail)	Peter Phillpot (NCBS)
Jeremy Philpott (LloydsTSB)	Patricia Brown (SMBCE)
James Cole (Cognitix 360)	Susan Young (Zurich)
Paul Saunders (RBS)	

No.	Notes
1	<p>Welcome and introduction</p> <p>In welcoming members to the meeting of the SIG, the Chairman noted that the theme of the meeting was 'OR Culture, basically a matter of training'.</p> <p>Although the 'short straw' this time seemed to be the case for this being true, there were two very well rounded arguments put across.</p>
2	<p>Agree minutes of previous meeting</p> <p>As the minutes from the meeting of 30 October had only been issued recently it was agreed to allow a week longer for any comments before taking them as approved.</p>
2	<p>Definition of Operational Risk</p> <p>After some further discussion, the following definition of Operational Risk was adopted by the group:</p> <p>Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.</p>
3	<p>Presentations on 'OR Culture, basically a matter of training'</p> <p>One SIG member gave a short presentation in support of the proposal, as the speaker against was unable to attend, three members offered arguments against the proposal. These talks set out theoretical positions to prompt debate and did not represent either personal or corporate opinions. The main points presented were as follows:</p> <p><u>In Favour of this being true</u></p> <ul style="list-style-type: none"> • This is essentially a debate around the power of nature versus the ability to nurture. • Key question – What do we mean by culture? – All organisations have cultural norms and training embeds these. • A genuine belief that the majority of people are decent individuals who understand that if they are being paid for a job then they do have some degree of responsibility to do that job properly – In essence training then takes over.

- The reality of life today is that people do have many demands upon their time, thus a natural prioritisation of effort towards the things which are perceived to be 'important' – training helps to reinforce what is a priority for an organisation.
- The only way to tell people very clearly what OR is, and why it matters within the organisation in which they work is to train them.
- The regulatory environment has changed; it is unreasonable to expect that people in organisations will understand the potential impact of such changes, unless someone clearly articulates what they are.
- In the case of banks, one of the most important changes has been the inclusion of a separate element of capital requirements, which has some direct linkage to the operational risk profile of the organisation. This enables a powerful argument to be formed in respect of training staff in OR management, with clear benefits.
- Operational Risk culture is inextricably tied up with training because training can ensure knowledge transfer - it can provide discipline, a common understanding and a common language in which to express and articulate OR within an organisation.

In summary training;

- Makes sure people understand the core elements of an OR management framework
- It helps to establish and ensure a common vocabulary is used across the organisation for OR matters
- This in turn means that people can communicate more effectively and consistently about risk and control issues.
- Avoid misunderstanding e.g. people know what the acceptable thresholds are for losses
- People are more likely to understand the mechanisms to assess risks, why it is important to learn lessons from things that have happened in the past, and consider whether things that have gone wrong elsewhere 'could happen here'.

Against this being true

- Again this is essentially a debate about the power of nature versus the ability to nurture.
- People will always default to nature regardless of the amount of training they receive – especially when placed under pressure either by their situation or by their own actions. Thus they need 'policing' more than 'training'.
- You only know what the real risk culture is when you see what people actually do when they can benefit from ignoring what they have been taught. Teaching has its place in explaining what the rules are: "If you do X, Y, or Z, you'll be thrown out".
- The tone for risk management is set from the top of the organisation, regardless of the amount of training in the ranks. The executive attitude to risk is embodied in the reality of 'carrots' and 'sticks', and these do infinitely more to set risk culture than training does.
- If a healthy risk culture is not cascaded from the top, there will be no more than cynical lip-service, or the dysfunctionality of inconsistent staff and executive cultures repeatedly embarrassing each other.
- The recent problems in financial services show how, regardless of training, the basic driver of reward within the bonus culture dominates over prudence and the duty of care.
- You need to be clear what culture you want. Is the aim to minimise risks or to seize opportunities? Push this point further and you have to ask whether it is naive to think that a consistent OR culture is an appropriate goal. Perhaps it is wiser to recognise the different needs of different functions: product design, sales, front office, back office, etc. and to pitch the intended OR culture appropriately.
- There are some people you just don't want to train: I want a trader to take risk without thinking about it, there should be a control freak looking over his shoulder.
- Few organisations have built OR frameworks that systematically and consistently reward business managers for good OR practices and so achieve full embeddedness in the business culture. Most depend on control frameworks run and managed by staff segregated and independent from the staff driving the direction of the business.

	<ul style="list-style-type: none"> • That said there is some acknowledgement that training has a role to play, albeit maximum benefit comes from targeted programmes rather than a blanket approach. There may be more benefit in focusing scarce training resource on 'middle' and 'back' offices rather than 'front office'. • Some research suggests that 1/3 of people are honest, 1/3 dishonest, the final 1/3 may behave dishonestly in some circumstances – the trick may be to weed the people who cannot be relied on out from sensitive functions; 'police' rather than 'train'.
	<p>There was then a wide-ranging debate on the pros and cons of the arguments offered. It was recognised that whilst training has a role to play, nature tends to be deeply engrained.</p> <p>Some points raised during the discussion were:</p> <ul style="list-style-type: none"> • Acknowledgement that there was a clear need for OR objectives to be set from the top, in terms of; <ul style="list-style-type: none"> • Board remits • Senior Management objectives • Business Strategies • Embedding OR objectives into the job descriptions of staff throughout a business and thus into their performance evaluations, is the most effective way of building OR awareness into the culture. • The need for escalation mechanisms to work well within an organisation (more so in large organisations), in order to embed an OR culture effectively.
	<ul style="list-style-type: none"> • OR competes for time with a lot of other 'control' functions in large firms (Health and Safety Officers, Regulatory (and Compliance) Officers, Human Resource staff, Other Risk Disciplines, etc..). As such it needs to have a clear modus operandi in order to get the time it deserves. Where it has been most effective it can realistically aspire to act as a facilitator or coordinator for other 'control' functions. • Re-emphasis that the effective use of the carrot and stick (reward for good behaviour and punish for bad) has the most effect on a business and its OR culture • Re-emphasis that understanding human behaviour (again especially under pressure) is a vital part of OR management. Most OR decisions are over shades of grey; people can only learn how to make these calls by interaction with others.
4	<p>Topic for December</p> <p>The SIG members agreed to consider topics for next month and contact Mark Russell with offers to speak. A meeting would be held on 18 December if there was sufficient demand and volunteer speakers.</p> <p>It was agreed that there would also be an ad-hoc meeting (potentially 11 December 2008) to consider Executive Reporting.</p>
5	<p>AOB</p> <p>Other IRM working Groups: it was noted that the Enterprise Risk Management SIG had recently completed some research on risk culture.</p>
6	<p>Next meeting</p> <p>This was to be scheduled for 18 December 2008, but in view of the timing (in respect of the holiday season) it was intended to confirm reasonable attendance before going ahead</p>