

IRM Operational Risk SIG MINUTES

Date:	30 th October, 2008
Time:	17.30 – 19.00
Meeting location:	RBS offices Waterhouse Square, 138-142 Holborn, London

Attendees	
Mark Russell (RBS) Chair and Minutes	Julian Philips (JP Risk)
Amrita Reddy (AAA Risk Management)	Lorraine Love (HBOS)
Andrew Lilley (RBS)	Maria Puddu
Anna Nicholl (BNY Mellon)	Patricia Brown (SMBCE)
Ben Rendell (Deloitte)	Ross McGee (Whittington Capital Management)
Paul Grey (Co-Op Bank)	Sarah Job (BDO)
Elena Munt (RBS Insurance)	Scott Kerr (Lovells)
Ian Beale	Susan Young
Ian Fraser (IRM)	Tony Forbes (RBS Insurance)
Ian Goode (MEGA International)	
James Macrae (Metronet Rail)	

No.	Notes
1	<p>Welcome and introduction</p> <p>In welcoming members to the fifth meeting of the SIG, the Chairman noted that we had achieved the highest level of attendance to date, and that there was a healthy mix of new and old members.</p> <p>The theme of the meeting was “<i>Top-Down</i>” versus “<i>Bottom-Up</i>”.</p> <p>With this topic, it seemed that good arguments could be put forward on both sides, although the obvious answer might well be ‘both’.</p>
2	<p>Agree minutes of previous meeting</p> <p>The minutes from the meeting of 25th September were agreed without changes.</p>
3	<p>Definition of Operational Risk</p> <p>We held an initial discussion towards agreeing a definition of operational risk; the aim being to have a clear statement of the scope of the Special Interest Group so that potential members understand what our focus is.</p>

We started with the FSA Handbook definition:

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

The conversation covered a wide range of points including:

- Failure in daily operations
- Upside risk and preventing downside risk
- Looking at the business from more angles
- Making things work to meet reasonable expectations
- Managing the downside better.

Ian Fraser (IRM) kindly provided a set of possible definitions to stimulate discussion and we agreed that members would email their preferred definition to the Chairman over the following week. He would then bring the winning definition to the next meeting.

3

Presentations on “Top-Down” versus “Bottom-up” risk identification and assessment

Two SIG members each gave a ten minute presentation, one in favour of identifying and assessing risk “*Top-Down*” and the other on approaching this “*Bottom-Up*”. 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:

In Favour of identifying and assessing risk Top-Down

- What is vital is to have a clear view of the risks faced by the organisation at the top level; to identify and present the trends in risk in a way that can prompt executive action, and give focus to more junior staff.
- In reality, all executives worth the name are keenly aware of what their key operational risks are; the problem is that they do not always take time to communicate this vision to management layers below them. The top-down identification and documentation of risks is the only way of kick-starting effective ORM because it is the top-down vision that gives context and challenge to risk identification and assessment at lower levels of the hierarchy.
- Oversight and challenge is most crucial at the portfolio level; to achieve this you need a view that can be absorbed by senior managers who have very limited time, who need an immediate view of what the most important risks are so that they can engage directly in appropriate action.
- The executive needs to see at a glance why a particular risk is significant: be this financial impact, control deficiency, project outcomes, etc.
- There must then be strong links down the paths of delegated authority so that

appropriate decisions can be taken to terminate, transfer, or accept the risk.

In Favour of identifying and assessing risk Bottom-Up

- The bottom-up approach of granular risk identification and assessment brings rigorous and holistic method to managing risk from all sources.
- The Top-Down, strategic view can be too aspirational; the main flow of risk assessment must be bottom-up, the Top-Down view acts as a check and a focus.
- The full set of business processes must be covered by risk assessment over time; this carries a consistent culture of risk awareness across a firm.
- Risk management should be a feature of all roles, all employees should have a reference to risk management in their job descriptions. Risks cannot be reliably assessed unless this starts at a granular level.

- Comprehensive bottom-up assessment is the only way to stop management circumventing controls.
- Key advantages of a bottom-up approach are:
 - It creates a strong link between management judgement and capital
 - It is data driven and so less subjective
 - It is more compatible with other risk disciplines (e.g. credit and market risk)
 - What get measured gets managed.

General debate

- Top-Down and Bottom-Up cannot be mutually exclusive. Executives must have the courage to take big risks, but managers below them must call out the risks, and present them through management information, to strike the right balance.
- In a business start-up situation, risk assessment will begin bottom-up; as practices become more mature and executive sponsorship emerges, top-down assessment will start.
- Five years ago the typical approach was bottom-up; but it was like trying to push a huge stone up a hill. When there started to be executive sponsorship, everyone started to realise that it should be integrated into 'business as usual'.
- You need to work in both directions; but it is a tough challenge as to how you can get enough of the bottom-up detail into a punchy board paper. A typical approach is to have a risk register feeding some form of dashboard; this is obviously easier to achieve with a standard risk catalogue. You can present 'top ten risks', tied into risk owners and control owners. The bottom-up process might leave you with 400 or more risks; the challenge is how to boil them down to the top 10 for the Board. We need to bridge between the two views. It is very hard to bring together a unified view for a global business that spans very different cultures and wide differences of

	<p>scale. But the harder this is, the more useful it will be.</p> <ul style="list-style-type: none"> • Do Top-Down and Bottom-Up represent two different languages? One is based on appetite and a broad understanding of themes, the other granular and specific. • It is vital to communicate upwards so that the big inherent or residual risks are either formally accepted or action is taken to reduce them; to do either you need an appropriate level of authority. • One organisation had waited two and a half years to secure the funds for its Operational Risk system; blocked by the F.D.; in some businesses there is strong cultural resistance to this. • We have to meet in the middle because the Top-Down view must be challenged by data; the key points emerging from the detail needed to be lifted up to enrich the top layer. To some extent this boils down to transparency of communication. • A lot of challenge is needed to arrive at a robust view. For example, IT staff would estimate the cost of losing a data cartridge at £80; but if the cartridge holds customer data, it could cost us a regulatory fine of £4.5 million.
<p>6</p>	<p>AOB</p> <p>Post-Xmas SIG meal 27th January: please contact Jeremy Philpott to reserve a place. Possible locations were discussed and the Bleeding Heart, near Smithfield, was suggested.</p>
<p>7</p>	<p>Next meeting</p> <p>27th November 2008, 17.30 – 19.00, RBS offices Waterhouse Square, 138-142 Holborn, London.</p>