OCTOBER 2014

IOR Newsletter

THE INSTITUTE OF OPERATIONAL RISK

Welcome to the latest edition of the Newsletter of the Institute of Operational Risk. This publication is designed to help keep members and non-members informed of developments within the industry and also within the IOR itself. If you would like further information about any of the issues raised in this newsletter, or have any suggestions about how we can improve the content or design, please do not hesitate to contact the Editorial team at the following address: info@ior-institute.co.uk

Message from the Chairman

Dr Simon Ashby,
FIOR,
IOR Chairman

A D-Day for Operational Risk?

This summer I visited Normandy with my wife and a group of friends from my local community. The motive for this was largely wine, food and good company; however we also took some time to visit the D-Day beaches, the 5th June 2014 being the 70th anniversary of the invasion – very important to me as my Grandpa had entered France through Gold Beach two days after the initial invasion.

As you can imagine visiting the beaches, as well as the cemeteries full of American, French, German, British and Commonwealth troops (plus many more nationalities) brings with it some very mixed emotions. However it also caused me to reflect on the nature and objectives of operational risk management.

Any military operation involves a complex mix of both strategic and operational objectives and is characterised by a high degree of uncertainty. The weather, for example, was a key factor in the D-Day landings; a storm caused the invasion to be delayed by a day and very nearly prevented it altogether. Plus a further violent storm on the 19th to 22nd June further hampered the invasion effort. There were also a range of people, process and systems related issues to consider (morale, coordinating a bewildering array of men and machinery, supply chains, communication, etc.)

In short, achieving the strategic objectives of this military operation required a significant amount of operational risk management. Strategic and operational risk management were blended to such a degree that they were impossible to separate. To ensure that this near impossible mission was accomplished the military commanders of the time not only anticipated a range of potential risks but also developed a capability in resilience that allowed their forces to respond to a wide range of unexpected events.

But here is my dilemma. The merits of such a strong blend between strategy and risk might well seem obvious to us. So why do modern financial and some non-financial organisations still persist in keeping their strategic management and operational risk management activities separate? Why don't board/senior managers pay more attention to operational risk management, given how essential it can be to strategic success and why don't operational risk managers get invited more often to support strategic decision making?

Perhaps it is because, since the 1940's, we have come to believe that operational risk management is a discipline that should only be concerned with preventing and or financing operational losses. By formalising our discipline we have inadvertently divorced it from more strategic concerns. I believe that we need to reconnect our discipline with strategic management, since as highlighted by the D-Day landings, the two go hand in hand. Operational risk managers must also be strategic managers and vice-versa. After all risk taking is a necessary part of achieving any strategic objective, whether military or not. No strategy can be achieved without balancing a range of operational concerns (related to people, processes, systems and external factors like regulation) within environments that can be characterised by a significant element of uncertainty. As operational risk managers we must remember that.

-- BREAKING NEWS --

Please note that the Annual General Meeting of the IOR will be held on 27th November 2014 at the offices of Daiwa Capital Markets Europe at 5 King William Street, London EC4N 7DA. Formal notification will be sent out in due course.

Contacting the IOR

Dedicated IOR telephone number

The IOR has a dedicated telephone line so that both members and non-members can speak to someone in person if they have, for example, any queries regarding membership, the application process, payment of annual fees or any other more general queries.

+44 (0)1920 443818

The number can also be found on the IOR website under the "Contact Us" section.

Call for Articles

Your Institute needs you!

This is primarily a members' newsletter and we would be delighted to receive articles or submissions from any member of the Institute. These submissions may be in the form of research, review, comment, conference coverage or any other risk related article.

Please send any articles for consideration to info@ior-institute.co.uk with the subject line of "IOR Newsletter".

Did You Know?

The IOR has a discussion group on LinkedIn. Since inception in 2010, the group has grown to over 3,500 members world-wide. It is a great opportunity to debate current operational risk stories and thinking. If you are not yet a member, we would urge you to join and, if you are already a member, please take advantage of the network this brings for you by adding new discussions and commenting on existing entries. Click on the following to take you to the website: Link

IOR Announcements

The Institute is proud to announce that Santander, the largest bank in the Eurozone and one of the largest in the world, has agreed to join us as a corporate member.

Banco Santander is a global, multinational bank which, in 2012, was named Best Bank in the World in the annual Euromoney ranking for the third time in recent years. Founded in 1857 in the Spanish town of Santander by 76 businessmen linked to regional economy and to the Spanish colonial trade with the Americas, the 155-year old Banco Santander climbed all the rungs in the financial ladder throughout the 20th century until in the 21st century it became a leading world bank, a reference in good management and competence in the sector, with a solid presence in ten countries in two continents, Europe and America, and businesses in more than forty markets.

Santander is currently the main financial group in Spain, its country of origin, and in Latin America, a continent where its main markets are Brazil, Mexico, Chile, and Argentina. It also holds a significant position in the United Kingdom, Germany, Portugal, Poland, and the north-east of the United States. In addition to these main markets, it also offers consumer finance services in Scandinavia, the Netherlands, Austria, Italy, and Belgium.

For more details about the benefits of corporate membership please see the article opposite or email us at:

info@ior-institute.co.uk

Conduct Risk white paper

Conduct Risk – When Compliance Becomes a Game

As markets await a clearer agenda for change, everyone is busy considering their own approach to conduct risk. With fines in the tens of millions, some organizations are finding that it can be costly to ignore the significance of good conduct. Regulators are calling for a new culture of risk controls which go beyond mere financial reporting and impact directly on human behaviour.

Recent research into types of “creative compliance” has uncovered alarming lessons about what happens when democracy and commercial interests fall out of balance. The various categories of “compliance games” have led to regulators now promising to recalibrate what they deem acceptable, causing a number of organizations to be caught in the conduct spotlight.

New understanding is required, and both risk and compliance professionals must become willing to look beyond their own organizations for proof that their own behaviour is acceptable and keep conduct regulators satisfied.

A new whitepaper from Thomson Reuters explores the contrasting views of risk, the various categories of compliance games, and clarifies why many conduct risk controls have historically failed.

Please click here where you can register to download the paper.

CIR Risk Management Awards

Gala Dinner & Awards Ceremony

We would like to inform you of a Gala Dinner and Awards Ceremony that is taking place in London in November organised by CIR Magazine. The awards shortlist has recently been announced (view **here**).

Details of the black tie gala dinner and ceremony are as follows:

The Risk Management Awards Gala Dinner & Ceremony

Thursday 13th November 2014,

Millennium Hotel, Mayfair, London

Reaching their 5th year in 2014 the Risk Management Awards recognise those individuals, organisations and teams that have significantly added to the understanding and practice of risk management.

The awards are free to enter to all organisations worldwide, and are an opportunity for companies and organisations to gain recognition for their achievements, to network with fellow professionals and to celebrate your achievements in risk management.

To find out more and book your table visit:

www.cirmagazine.com/riskmanagementawards

Corporate Membership

The IOR is committed to the promotion of skills and standards associated with the profession of Operational Risk Management. It is an independent, not for profit, professional body designed to support its members through the provision of:

- Professional standards
- External events
- Research
- Sound practice guidance

By becoming a Corporate Member your organisation will directly support the work of the IOR. You will also receive a range of benefits for both your organisation as a whole and your operational risk and related professionals.

Corporate Membership Benefits

- Affiliation to the local chapter in which your Head Office is located, where available.
- Access to events across all IOR Chapters (including seminars, forums, conferences and social events).
- Many events at zero cost for nominated corporate representatives.
- Chargeable events at the discounted member rate (where available).
- Your logo, plus an acknowledgement on the IOR website to demonstrate your commitment to the Institute and the discipline of operational risk management.
- Access to the members only area and associated resources, including all Sound Practice Guidance Papers (for nominated corporate representatives).
- Regular IOR Newsletter.
- Automatic notification of official IOR events and IOR accredited events.
- Access to general meetings and voting rights for one senior official.

Obligations of Corporate Members

- Corporate members are asked to host one IOR event per year, to support the Local Chapter to which they are affiliated, where one is available.
- To ensure that nominated individuals abide by the Institute’s member code of conduct.
- To keep the IOR informed of any changes in the details of nominated corporate representatives.

For more information about joining as a Corporate Member, please visit the IOR website or email us on info@ior-institute.co.uk

England and Wales Chapter

The England and Wales Chapter's leadership team currently comprises Helen Pykhova, Ariane Chapelle, Denis Lyons and Andrew Sheen. The need to juggle work while arranging events and promoting the chapter is proving challenging for such a small team and we would welcome any members who would like to join us in making sure the Chapter actively promotes Operational Risk in England and Wales. The leadership team continues to look for opportunities to provide members with the chance to network, discuss issues impacting on our discipline and opportunities for learning and development.

So far this year we have held 7 events, with five taking place since the last newsletter. In April, in association with RiskBusiness International, the Institute organised a webinar on Risk Culture, led by Simon Ashby, the Chairman of the IOR with the help of Mike Finlay. The webinar focused on the nature, scope and importance of risk culture within operational risk management. In the same month HSBC hosted an event for the chapter on Effective KRIs lead by Ariane Chapelle. We are grateful to Duncan Wilson and Peter Ridding of HSBC for their contributions to this extremely interesting event.

Risk and Incentives were the topic for the June seminar. We were delighted to have four very interesting speakers address the subject from different perspectives. Jacqui Boyd and Natalie Duranton from the FCA summarised the findings of the thematic work completed by the FCA into financial incentives. In addition Jennifer Moodie from Santander provided a practitioner's perspective on how operational risk inputs into the development of culture and performance of the organization, and David Royston-Lee, chartered business psychologist, talked about the key requirement for engaging the hearts, heads and minds of the employees. We are very grateful to Santander for hosting this event.

England and Wales Chapter

Following the success of the insurance event last year, we were delighted to be able to continue the tradition of dedicating the day to addressing the issues pertinent to insurers. Oracle kindly sponsored the event while Willis hosted the seminar again this year. Speakers included: Jagdev Kenth, of Willis who gave a Regulatory Update; Adam Seager, Head of Risk, Torus International, presented on Emerging Risks - Looking forward to what is coming up behind you; Steve Strickland, Senior Police Lead, Economic Crime and Fraud Training Academy, City of London Police, talked about Profiling staff and managing the threat from insiders and professional enablers; Irina Kendix, Head of Internal Audit, Financial Risk, Aviva Operational Risk discussed the view from the 3rd Line; Caroline Coombe, CEO, ORIC, argued that its all about Data; Neal Foundly, Partner, Reputation Consultancy, presented a session on Corporate Reputation Risk – Measure, Manage and Mitigate; and last but not least Matthew Long, of Oracle discussed 'Bridging the gap between Operational Risk, Financial Crime and Regulatory Compliance'. This was a great event and very well received.

Our most recent event was a very successful workshop on the lessons learnt for Op Risk managers from the Global Financial Crisis and was generously sponsored by Mitsubishi UFJ Securities International, a member of MUFG. The workshop was presented by Michael Grimwade of Mitsubishi UFJ Securities International and discussed: why large Op Risks spiked during the Global Financial Crisis; Identifying and discussing key emerging threats; and discussed the lessons learnt for Op Risk Managers. Attendees faced the question of whether "Insanity is doing the same thing over and over again but expecting different results", definite food for thought.

Looking forward, during October we have scheduled a breakfast seminar on "Making Sense of Operational Risk Data". As Operational Risk Practitioners, we are collecting a lot of data from the activities being performed in managing the firm's operational risk. Of course there's Internal Loss/Event data, information gathered through the Risk and Control Self-Assessment (RCSA) process, Key Risk Indicators (KRIs), issues and actions and so on. The data needs to be accurate, timely, appropriately recorded and easily retrievable, and we also need the bit of magic glue that sticks it all together. How do we address various data challenges, including linking risks to events, to issues to KRIs? When we do manage to do it successfully, how can we make sense

England and Wales Chapter

of it in reporting to senior management? This breakfast session will provide participants with the opportunity to review and discuss Operational Risk Data challenges and solutions. We still have an opportunity for one more speaker for this event, if you are interested in sharing your experience in overcoming data challenges, we'll be delighted to hear from you.

In conclusion, if you would like to contact the chapter please e-mail Helen Pykhova at **epykhova@ior-institute.org**, or Andrew Sheen at **asheen@ior-institute.org.**

Managing Operational Risk – Moving towards AMA

Peter McCormack, Andrew Sheen, and Philip Umande have had an article accepted and published in the Journal of Risk Management in Financial Institutions with the title "Managing Operational Risk: Moving towards the Advanced Measurement Approach".

The article looks at the importance of modeling operational risk as a contributor to helping understand the forward-looking risk profile of the firm, the value of the AMA components (scenario analysis, internal loss data, external loss data, and business environment and internal control factors) in delivering improved operational risk management, and recommends an evolutionary approach to achieving AMA.

Article reference: *McCormack, P., Sheen, A., and Umande, P. (2014), Managing Operational Risk: Moving towards the Advanced Measurement Approach, Journal of Risk Management in Financial Institutions, Vol 7, Issue 3, p 239*-256.

Alarm National Autumn Forum 'Risk Tips, Tools & Tactics'

11th - 12th November 2014
Selsdon Park, South Croydon

To further support the learning and development of all professionals managing risk, the Alarm National Autumn Forum provides an opportunity to engage with like-minded professionals and share best practice in a relaxed environment. November's event will feature risk tips, tools and tactics that delegates will be able to apply back in the workplace, aiding the effective delivery of vital services to the public and our communities.

View the Autumn Forum Programme.

New Chapters in the Pipeline

Significant progress is being made towards establishing new IOR chapters in South Africa, Argentina, the United States, Denmark (which will also support all of Scandinavia) and in Saudi Arabia (which will initially support all of the Gulf Cooperation Council states).

All IOR members are invited to recommend friends, colleagues and acquaintances living in these regions to contact mfinlay@ior-institute.org for onward connection to the members active in setting up the relevant local chapters.

Mike Finlay
Vice-Chair, IOR Council

Hong Kong Chapter Update

Global Internet Finance is a hot discussion topic in the financial markets in light of the recent IPO of Alibaba in the United States whose money market fund business has achieved enormous success. On 18th July the Hong Kong Chapter hosted a workshop at the Hong Kong Polytechnic University to examine the development drivers of Global Internet Finance, learn from what's happened elsewhere in the world and understand the regulation and risk management in various products. Topics included Revolution of Internet Finance; Comparison between the development of Internet Finance globally and in China; Overview of risk management and regulation on Internet Finance from a global perspective; and Experience of Risk management relating to Internet Finance.

Hong Kong Chapter Update (cont'd)

More than 40 industry peers and students attended the workshop. In addition, industry experts were invited to provide training on Research, Problem Solving, Presentation Skills and Article Writing.

The Hong Kong Chapter are currently working on another project relating to trading room malpractices and market abuse. This small group will examine trading room malpractices by reference to both local Hong Kong incidents and others overseas and will put forward recommendations to prevent and detect such incidents. Through these events, we aim to put forward recommendations on current market events, bring new ideas for the financial markets and risk management and promote the development of finance risk management. The Hong Kong Chapter has worked closely with the Hong Kong Institute of Bankers and Thomson Reuters on events where there is mutual interest. Several members have contributed their thoughts in commenting on some current market events in the local press which has enhanced the visibility of IOR.

The Chapter has generated continued increased recognition in the city and is highly regarded by the regulators and general practitioners.

Dominic Wu
Head of Hong Kong Chapter

THE INSTITUTE OF OPERATIONAL RISK

Promoting and Developing the Discipline of Operational Risk Management

Dutch Chapter Update

On Thursday, 2nd October 2014 the Dutch chapter held a major event at the Achmea Conference Center in Zeist. The event began with presentations and discussions followed by a 'borrel'. During this event the focus was on two main topics – Marco Vet, Director Group Risk Management at Achmea discussed the recent work done by the CRO Forum entitled Operational Risk Management and Measurement. The CRO Forum is a global network of CROs and Marco has been the chairman of this network for the past two years. He outlined the forum and discussed the recommendations they have developed. This was followed by a presentation by Claudia Zapp and Hans Bikker (Supervisors) of De Nederlandsche Bank (DNB) entitled 'Supervisory expectations of managing operational risk at banks that use the standardized approach'. DNB recently conducted an examination at a number of medium-sized banks focusing on the implementation of the Basel principles for the sound management of operational risk. In their presentation DNB identify areas of operational risk management that require particular attention by banks.

We were delighted that Achmea and DNB agreed to share their insights at our IOR event and we invite all ORM professionals to participate in our local chapter activities.

For more information please email me at: adowdalls@ior-institute.org

Alex Dowdalls
Head of Dutch Chapter

Scottish Chapter Update

On Friday 7th November, the Scottish Chapter of the IOR will host their 4th Annual Operational Risk Conference in conjunction with Glasgow Caledonian University.

This year's key note speaker will be David Ferbrache OBE, a Special Adviser on Cyber Security. David was Head of Cyber and Space for the Ministry of Defence, leading a £90m programme to transform the way the MoD approaches cyber security. There will also be a topical presentation that will provide a 'behind the scenes' insight into some of the security measures deployed at the 2014 Commonwealth Games, held earlier this year in Glasgow.

In addition to the above, a range of professional subject matter experts will be joining the conference to present throughout the day and other topics will include:

- Information Security
- Anti-Money Laundering
- IOR Sound Practice Guidance
- Business Continuity

The cost of the event will be £50 for IOR and CIBS members and £150 for non-members, although non-members can receive a £30 discount by booking before 10th October.

To secure your place at this year's event please click on the following link

Global webinar

On 24th September the IOR held a global webinar in association with Thomson Reuters Accelus. The topic was "Key Risk Indicators: Debating their Value, Understanding their Potential'.

For most risk management programs, both operational risk and enterprise risk, key risk indicators ('KRIs') are accepted as part of the standard tool bag of metrics. However, risk managers today question whether KRIs deliver the value they were originally supposed to. In short – can KRIs really be predictive?

During the webinar (which had over 370 participants) three expert panellists (Dr Simon Ashby, IOR Chairman and Associate Professor, Plymouth Business School; Mike Finlay, IOR Vice-Chair and CEO RiskBusiness; and Dr Philippa Girling, Managing Vice President, Head of Commercial Business Risk Office at Capital One) discussed what KRIs have delivered, and failed to deliver, for organisations – and why. They also explored the future of KRIs – how organisations should be using these metrics to drive the kind of understanding of risk that provides business value to senior management and the board, as well as executives directly in the business.

The agenda was as follows:

- Why KRI programs seem to have failed to deliver what they promised;
- Whether KRIs could ever be predictive or will they only provide a measure of the past and the present;
- If derived KRIs are more risk sensitive than source-value metrics;
- Where should the focus be: top-down or bottom-up;
- Should there be a complete set of KRIs which everyone must monitor;
- How KRIs can reflect risk appetite.

'Tech spot'

The IOR LinkedIn discussion group goes from strength to strength - now with a global membership of over 3,500 members. Take advantage of this vast and ever-growing network by posting your own discussion or joining in an existing discussion.

Given the importance of the global reach and appeal in the IOR, the global IOR chapters have now been added 'front and centre' to the home page of the IOR website, also to promote the development of further new chapters.

If readers would like to add a contribution to a future 'Tech Spot' article (perhaps on how you are using technology in operational risk management) or have ideas about how we can further improve the IOR website and associated member services, please do not hesitate to contact us at: info@ior-institute.co.uk

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Operational Risk – The People Factor

David Crook,
Specialist Risk Consultant,
Cameron Kennedy

Of the four cornerstones of Operational Risk – People, Process/Procedures, System and Environment – arguably the most important is the People dimension. Having the right people in the right place is absolutely essential for the success of any organisation. The right people, suitably trained and qualified either by experience or professional qualification (or more likely, both) are also the foundation of an effective and relevant Operational Risk culture and process.

Obvious really – or is it?

As an Operational Risk professional and now specialist recruiter of the same I am constantly surprised at how often the hiring manager has little involvement with the selection process prior to interview. Many times the submission of a suitable candidate does not get beyond the HR department or the recruitment team – usually because the candidate does not appear to have the obvious requirements as determined by the all-powerful job specification.

> "The right people, suitably trained and qualified either by experience or professional qualification (or more likely, both) are the foundation of an effective and relevant operational risk culture and process."

I would consider this to be a potential risk as it may mean that a candidate who may not appear to be an obvious fit will fall by the wayside, never to be seen again. A good example of this is when a candidate is moving across business areas – from asset management to private banking being a case in point.

The Operational Risk skills will be present but the background may not be – just how essential is this? I have seen many candidates arbitrarily dismissed out of hand for this reason alone. The solution to this is an easy one in theory, less so in practice – the recruiter should be able and encouraged to deal with the hiring manager directly in order to get that all-important cultural outlook and 'feel' for what exactly is required and how relevant the background should be.

A recent example of the value of this direct approach occurred whilst recruiting an Operational Risk Analyst for a well-known investment bank. The client had engaged with a number of agencies (using the HR route) and had received a number of CVs that were completely unsuitable for a variety of reasons. After having approached and met with the hiring manager I was able to gain a better insight to what the client was trying to achieve with the team (there had been recent organisational restructure) and was able to provide a variety of CVs for review that would not ordinarily have gotten past the come from a variety of other backgrounds. The hiring manager knew and could see the value of the skills on offer – in effect 'reading between the lines' of the CV - and so was happy to meet with them for interview. These particular candidates would not have even made it to the hiring manager as they would have fallen at the first hurdle – the HR and recruitment team – as the CVs were at first glance too far removed from the job description.

The value of contact between the hiring manager and the recruiter is a tangible benefit as relying solely on the contents of a job description to find suitable candidates is not always successful. Establishing a dialogue – particularly if the recruiter has practical industry experience of the role itself – is an important part of the recruitment process and from an Operational Risk perspective will reduce the risk of valuable time and money being wasted during the hiring cycle.

Certainly one must sympathise with a hiring manager being bombarded by unsolicited telephone calls and emails – even LinkedIn messages – from overzealous recruitment professionals eager to make that elusive placement. It is little wonder then that many hiring managers are happy (and relieved) to defer to their HR and recruitment team to act as a filter but, this is at the risk of missing out on a candidate that could be a 'hidden gem'.

The ideal scenario would be for the recruiter to work with both the HR and recruitment team in concert with the hiring manager. This will ensure that the technical aspects of the role – usually taken from the job description - will be addressed together with the less obvious cultural and background suitability.

It should be emphasised though that whilst maintaining a healthy dialogue directly between the recruiter and the hiring manager is invariably mutually beneficial, it is unfortunately sadly open to abuse and as a recruiter I am mindful of the need to temper continual contact calls to the hiring manager with the requirement of the client to actually be doing their job! Fortunately some HR and recruitment teams have a degree of flexibility in this respect and as long as they are involved in any communications are happy to allow such contact – obviously a degree of common sense needs to be applied as to the frequency of any such communication and the timing of any such contact is everything.

Operational Risk and Recruitment at Cameron Kennedy

Using a former industry professional to source candidates for your organisation has numerous tangible advantages – all of which will serve to mitigate the risk of having less than suitable candidates coming in for interview.

Operational Risk – The People Factor

It also means that they are better able to engage directly with the business and are able to 'talk the talk' to a degree unachievable when using a more generalist recruitment solution.

Finally, and this is particularly true in the case of Cameron Kennedy, the head of the Operational Risk recruitment team has many years of practical industry experience to call upon, as well as the direct involvement with the discipline itself.

The Operational Risk team at Cameron Kennedy is well-established in the marketplace. Headed by a qualified former Operational Risk professional and with a dedicated resourcing unit the team has enjoyed much success across the whole spectrum of financial services, together with commerce and industry.

Cameron Kennedy's ability to deliver candidates for 'Head of' board level roles down to junior analysts - both on a contract and permanent basis - has proven to be an effective and valuable addition to many Operational Risk departments across the industry.

With the market and regulatory emphasise currently being placed upon how a company conducts its business, more than ever finding the best possible personnel represents a critical investment in terms of both time and money.

With an extensive database of candidates gathered over some fifteen years and with the use of a broad variety of sourcing techniques including social media, referrals and, invariably, head-hunting Cameron Kennedy are well placed to be able to source high caliber candidates at all levels speedily and efficiently.

As the Head of the Operational Risk team at Cameron Kennedy I would be delighted to discuss any recruitment needs you may have in this key area and so look forward to working with you. My email address is davidcr@cameronkennedy.com and my direct number is 0207 337 0023 or you can contact me via LinkedIn. Alternatively, you can visit the Cameron Kennedy website at www.cameronkennedy.com

David Crook is a Specialist Risk Consultant at Cameron Kennedy

IOR Sound Practice Guidance – Event !!

Hold the date: the Sound Practice Guidance (SPG) committee will hold an event in London on 20th November 2014. This will be an opportunity to revisit the activities of the committee over the past 12 months and to highlight the current projects and plans. In terms of activities, we edited a Sound Practice Guidance on Risk Culture (November 2013), a guidance on Scenario Analysis (December 2013) and an update of the RCSA guidance (May 2014). Activities will pick up this quarter with two guidance papers planned to be issued by the end of the year: Conduct (new guidance) and Key Risk Indicators (updated guidance).

The London Chapter SPG event on 20th November will review some of the key findings of these papers and collect votes for the topics to come. Topics in the pipeline are: Governance, Reputation, Internal Loss Data and many more are also under consideration.

We also need writers: please let us know if you are interested in contributing, we would love to hear from you. SPG papers are written anonymously, or more precisely, collectively, and the copyrights are owned by the IOR. They are peer reviewed by two members and edited by the SPG Committee. Please direct any questions, comments and offers to contribute to Ariane Chapelle, achapelle@ior-institute.org.

IOR 10th Anniversary Dinner






Managing People Risk Through Corporate Culture
- how firms can encourage the right behaviour

Alan Dunk
Member of IOR Council

George Orwell's classic novel, Nineteen Eighty-Four, portrayed a fictional totalitarian surveillance society ('Big Brother') with a simple mass surveillance system consisting of human operatives, informants, and two-way 'telescreens' in people's homes. This oppressive rule was justified in the name of the greater good but it ultimately led to rebellion.

So is a culture where 'Big Brother is watching you' the best way of coercing staff into toeing the line, encouraging them to adhere to corporate policies and procedures and ultimately act ethically at all times and in the best interests of the firm, or does this just lead to complaints of a lack of privacy, mistrust and disharmony in the workplace? As ever, the answer probably lies somewhere in between.

As we are all too well aware, the days of self-policing with the financial services industry have long since disappeared and both regulators and law-makers expect firms to provide adequate and appropriate systems and controls:

> *"A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime."*
>
> *[Financial Conduct Authority Handbook, SYSC 3.2.6 R]*

So how can firms ensure that they adhere to the FCA's requirements whilst, at the same time, avoid the pitfalls of a Big Brother-type society? The challenge facing us is to create an environment where bad behaviour is not only discouraged, but difficult to perpetrate (or at least not worth the risk), and easy to detect at the earliest opportunity. There must also be penalties severe enough to provide a credible deterrent but without creating a straightjacket that stifles creativity or flair.

But what exactly are we trying to protect against? Well, the answers are many and varied. Clearly, as we are obliged to ensure that we adhere to financial regulations, we are trying to protect our firms from a substantial fine or, possibly worse, censure by the regulator for non-adherence to their rules as well as the possibility of suffering a serious P&L impact from a major operational risk incident. However, we are also seeking to protect the people we do business with as well as our staff.

So what effective systems and controls might firms put in place to ensure adherence to the FCA's rules? Probably the most effective controls are those that are embedded into the organisation's structure, such as a clear segregation of duties between trading and settlement functions; the separation of purchasing from payment; keeping accounting and book-keeping separate from other business activities; ensuring that Compliance is independent from all business activities that need to comply; the maintenance of a strong and independent Risk function; and ultimately having a third line of defence with Internal Audit providing independent assurance over all other business activities.

However, other more tangible systems and controls can be equally as effective, such as the monitoring of outgoing emails and Bloomberg messages to personal email accounts which contain attachments; log monitoring, network forensics and vulnerability testing – all essential tools to help protect firms from data leakage, fraud and misuse of systems. There are other controls that, perhaps, we all take for granted such as the recording of telephone lines; the requirement for staff to take 10 consecutive days' leave every year; appropriate approval authorities for payments or requisitions; and the governance around the implementation of major projects.

Appropriate supervision of the activities of staff (not just front office personnel) remains a key control but there are other 'harder' controls, such as the setting and monitoring of trading limits, oversight over adherence to trading desk 'mandates', and the monitoring and investigation of trade cancellations and corrections and off-market priced trades. There should also be, of course, deterrents for bad behaviour such as firm's disciplinary processes which may ultimately result in summary dismissal.

The above examples are obviously not an exhaustive list. However, the proper functioning of all these systems and controls can help firms encourage the right behaviour and discourage bad behaviour.

Significant challenges remain, however. In response to the 'cultural' issues the banking crisis has highlighted, the UK regulator's remuneration code is an example of the changes envisaged under Basel III that requires financial institutions to demonstrate that their compensation arrangements promote sound and effective risk management and take account of all current and, crucially, future risks.

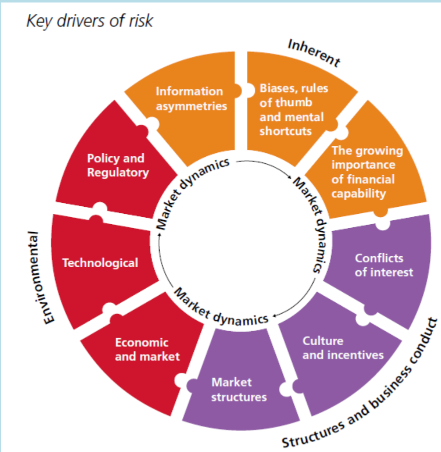
> "It would seem that the role of Human Resources and Risk Management as strategic business partners has never been more important"

The June 2013 EU Directive reinforced these requirements noting, in addition, that firm's remuneration policies should be "aligned with the risk appetite, values and long-term interests of the credit institution or investment firm." The Directive also requires firms to examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings. It would seem that the role of Human Resources and Risk Management as strategic business partners has never been more important.

A recent study by the London School of Economics discovered that, since 2008, the top banks have had to pay out a total of around £150bn in fines and other costs relating to inappropriate practices. For example, in the UK these related to such issues as the manipulation of LIBOR and the mis-selling of payment protection insurance. For resolving their disputes over home loans and foreclosures in the US, the Bank of America's costs alone were over £30bn with a further £24bn set aside as provisions – a total of around £54bn (or roughly the same as Bulgaria's GDP). The study by the LSE was published before the most recent fine of $8.9bn (£5.2bn) levied on BNP Paribas for violating sanctions rules against Iran, Sudan and Cuba. No wonder conduct risk is becoming an increasing concern for the senior management of banks, regulators and shareholders.

The relevance of the FCA's risk outlook for operational risk in Investment Banks

On 31st March, the UK Financial Conduct Authority ('FCA') published its annual Risk Outlook paper. FCA expects firms to read it and assess the relevance to their business models and strategies. The paper highlighted three risk drivers:



Relevance to Operational Risk

Whilst most of the FCA's concerns relate to retail banking and customers it does raise some specific concerns about investment banking.

The FCA has identified that investment bank incomes are declining and that banks may adopt new strategies to boost return on equity e.g.:

- New revenue streams, which may result in selling inappropriate products or using undue incentives;
- Cost-cutting, which may increase risks for businesses with low levels of investment and expertise;
- Insufficient spending on existing technology, which could weaken operational resilience and market integrity.

The FCA is also concerned about the threat of cyber-attacks and states that over the next year one of its areas of focus will be the resilience of both legacy systems and cyber-attacks and the visibility of these technology risks to firms' Boards.

Post-LIBOR fixing, the FCA will also, not surprisingly, look at how firms reduce the risks of traders manipulating processes and remain consistent with the FCA's expectations of market conduct.

Additionally, and with no sense of irony whatsoever, the FCA is also rightly concerned that regulatory actions have in the past actually created new issues due to:

- Poor coordination of regulatory approaches and the volume and pace of post-crisis reform in the UK and internationally which both increase complexity and raise the risk of unintended consequences; and
- Perimeter activity: The growth of activity outside of the regulatory perimeter and the increasing interconnectedness of regulated and non-regulated activities.

The FCA also sets out some of their expectations for Operational Risk Management i.e. they expect firms to:

- Have defined a Board approved Operational Risk Appetite statement;
- Provide Senior Management with an holistic, on-going view of the Op Risk profile vs. appetite;
- Have a culture supportive of the management of Operational Risk;
- Assess Operational Risks associated with their strategy, activities, products and services; and
- Encourage the timely and effective challenge of key decisions.

A mis-marking case study

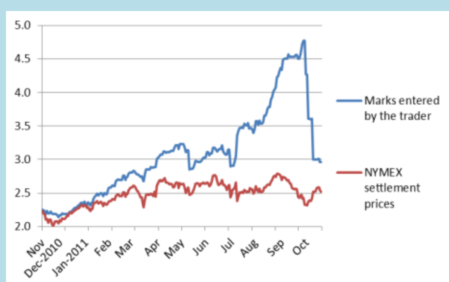
In September 2013 the CFTC filed an injunction against a trader alleging that between November 2010 and October 2011 he falsely inflated the value of his NYMEX ethanol futures position to disguise trading losses on his other positions. The amount of his mis-marking varied depending on his losses on other positions, see the chart opposite.

The mis-marking was only discovered about a year after it started, when on 18th October 2011 the trader exceeded an internal trade limit on cattle futures, and the next day his line manager instructed him to unwind all of his positions, which he did, apart from his mis-marked NYMEX ethanol futures. He was consequently terminated on 21st October when the firm discovered $42.4million of hidden trading losses.

Reviewing the CFTC trade data highlights a number of potential Red flags, including:

- The 100% mis-mark at September 2011 month-end;
- The 5% of days when the trader's marks moved in the opposite direction to the market;
- No change in the trader's marks for up to 5 straight days; and
- The 25% movement in his marks following the expiry of the Aug-11 ethanol futures contract.

Comparison of marks entered by the trader vs. settlement prices for NYMEX futures



It is currently unclear why this mis-marking was not identified by any of these standard controls i.e.:

- Daily review of P&L conducted by the Desk Head; or
- Daily margin reconciliation to NYMEX conducted by Operations; or
- P&L attribution undertaken by Product Control; or
- Independent Price Verification (IPV) also conducted periodically by Product Control.

By way of comparison the key control weaknesses that allowed the largest ($2.65bn) recent intentional mis-marking loss, suffered by Credit Suisse in February 2008, included:

- Undue reliance was placed on the technical ability and revenue contribution of the traders, who were highly influential in down-playing price variances and influencing price testing methodology;
- Failures to respond concerns about price testing variances, first identified in September 2007; and
- A lack of effective supervision over price verification processes.

At Credit Suisse, these weaknesses were exacerbated by a complex booking structure that was overly reliant on large spreadsheets, inhibiting effective supervision, risk management and control.

IOR Special General Meeting and 10th Anniversary Dinner

On 4th June, the IOR held a Special General Meeting at Minster Exchange, Mincing Lane, London in order for members to vote on the following resolution:

- To consider and approve the proposed new Articles of Association, supporting members handbook and governance policy and that they be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association.

A good turnout at the SGM, encouraged no doubt by the prospect of the refreshments that followed, ensured that the meeting was quorate and the resolution was duly approved.

2014 marked the 10th Anniversary of the Institute and in order to celebrate the occasion, an awards dinner was held immediately following the SGM which was attended by approximately 100 members and guests.

As a component of its celebrations, the Institute presented three awards to the industry, using the opportunity to highlight the growing maturity of the discipline of operational risk. The awards were the first ever presented by the IOR to individuals and organisations in recognition of achievements in the field of operational risk.

The first award was for the “OpRisk Manager of Note” which was presented to Michael Sicsic, Group Operational Risk

L to R: Caspar Berry (guest speaker), Michael Sicsic, Simon Ashby, Danielle Finlay (RiskBusiness), Mike Finlay

Director for Aviva plc and Chair of ORIC International. Olaniyi Olalemi, Head of Operational Risk at Enterprise Bank in Nigeria was runner-up. The award was in recognition of an individual who has demonstrably improved or extended the practice and discipline of operational risk management within their firm over the last 3 years.

The second award was for the “Contribution to the Discipline of Operational Risk”, in recognition of an individual or organization whose work has led to improvements in, or extensions of, industry practice over the last 3 years. This award went to Michael Grimwade, Executive Director and Head of Operational Risk at Mitsubishi UFJ Securities for his contribution to the industry in the area of scenarios. ORIC International, the world’s leading provider of operational risk loss data for the insurance industry and Edima Ben Ekpo, Group Head of Operational Risk Management at United Bank for Africa were joint runners-up.

L to R: Caspar Berry, Michael Grimwade, Caroline Coombe (ORIC Int’l), Simon Ashby

The final award was for the “Outstanding Contribution to the Institute” which was presented to Michael Faber, the longest serving Director of Council of the IOR, a former Vice-Chair of Council and previous member of the IOR’s Executive Committee.

IOR Chair, Dr. Simon Ashby said:

“The standard of entries for the awards was very high. In such a competitive category, I am delighted that Michael Sicsic won the award the Operational Risk Manager of Note. This reflects the excellent work that he is doing to push the boundaries of operational risk management, both within Aviva and as Chair of ORIC International. I would also like to take this opportunity to congratulate all the short-listed nominees for the 3 awards and especially the other 2 worthy winners: Michael Grimwade and Michael Faber. I would also like to thank our sponsors for supporting this important event. Thomson Reuters Accelus for sponsoring the champagne reception, RSA Archer Risk Management, the dinner and wine and The Risk Universe for sponsoring the awards.”

L to R: Michael Faber and Mike Finlay

The awards were announced by Mike Finlay, Vice-Chair of the Council of Directors of the IOR and Chair of the IOR Awards Committee. He said that the ability to make these awards reflected the growing maturity of the operational risk discipline.

“The Awards Committee were overwhelmed by the sheer volume of high quality nominations and were pleasantly challenged to identify the very best to put forward as finalists. We believe that our finalists and the eventual winners represent current state-of-the-industry practices in operational risk, setting the bar for other practitioners and organisations to emulate and achieve.”