ORIC INTERNATIONAL

Powering risk intelligence

NEWSLETTER

MARCH 2021

AT A GLANCE...

2021 CAPITAL BENCHMARKS REPORT LAUNCHED

We are delighted to announce that both the full and summary reports of our 2021 capital benchmarks are now available. The full report is only available to participants who completed this year's annual capital benchmarking study, whilst the summary report is available upon request.

CAPITAL BENCHMARKS – FULL REPORT

- Available to all participants of the 2021 capital benchmarks
- Access to 130 questions with detailed analysis and commentary
- Access to detailed capital metrics following report release
- Access to dynamic benchmark reporting for select questions
- Bespoke data cuts and analysis available upon request
- Discuss focus areas in more detail at upcoming Internal Model Working Group sessions*

CAPITAL BENCHMARKS – SUMMARY REPORT

- Available to all non-participants of the 2021 capital benchmarks
- Access to 11 takeaways from this year's report (including 34 selected questions)
- Discuss focus areas in more detail at upcoming Internal Model Working Group sessions*

*In addition, all participants may take advantage of a firm specific debrief which involves a deep dive into your firm's responses and how these compare to the rest of the industry and your specific peer group.

We would also like to welcome all members to join us at the next Internal Model Working Group which is set to take place on **Thursday 3 June** (14.00 – 15.00 BST). The group will discuss some of the key findings from this year's report and share best practice approaches. If you would like to be involved in these discussions, or would like to propose a specific agenda item, please contact Ciaran Hosty as soon as possible.

SCENARIOS – UNDERSTAND THIRD-PARTY RISK AND CAPITAL ALLOCATION; INSIGHTS USING THE ORIC SCENARIO ASSESSMENT DATA

The scenario assessment data service is proving popular with members. It helps them understand how financial service firms continue to enhance scenarios and how their peer groups deal with risk assessments within board documents such as ORSA and ICAAPs. With the 2020 cycle being in full flow, let's see what some of the output shows us in answering questions around third-party risk.

What are the third-party risk scenario storylines used by firms?
Firms are now playing several storylines together, which is encouraging, as it shows the importance of this risk type. The main scenario storylines are:

1. Third-party step in – storylines include taking over outsourced processes for a short period of time to maintain regulatory status.
2. Service contract/SLA dispute – this storyline is similar to ORIC Benchmark scenario: S00034 Supplier service failure/SLA breach.
3. Total third-party failure – this storyline is identical to ORIC Benchmark scenario: S00035 Partnership failure.

At solo level, where are third-party scenarios being included?
We note that insurance groups will set up service companies to manage third-party material outsourced arrangements. It is encouraging to see that, at solo level, this is where third-party scenarios are also applied and modelled. This change in risk measurement is crucial, as correctly showing service companies' risk profiles will improve capital allocation between solo and group entities and indirectly benefit the dynamic relationship between shareholder and policyholders.

Looking through a resilience lens, a financially stronger shareholder service company will be more capable of providing the necessary services agreed with policyholders, thus safeguarding good customer outcomes for all parties involved in the agreement.

At group level, are we seeing any trends related to third-party scenarios?
During the last financial crisis in 2007–08, we noted several examples of holding companies in financial service groups that suffered financial distress requiring recapitalising.

Financial service firms are now including third-party risk scenarios at group level for intra-group outsourcing. This scenario allocation approach at a holding company level is very encouraging. It complements current regulatory rules on outsourcing, requiring firms to apply the same rigour to external outsourcing arrangements as they do to internal outsourcing arrangements.

Using our operational resilience lenses, we conclude that a group correctly reflecting the holding companies' risk profile will improve capital allocation and also the shareholders' and policyholders' dynamic, as well as safeguarding good customer outcomes.

How are the scenario diversification benefits applied to third-party scenarios?
Depending on the taxonomy used by the financial service firm in constructing its correlation approach, a third-party risk can either be an operational or credit risk.

With the local and international regulators not specifying a preference within rules or guidance, a small number of firms include third-party supplier failure within credit risk and benefit from a different level of diversification. Do they gain a competitive advantage?

Why do financial consolidators seemingly hold less capital for third-party scenarios?
Looking at the business model of financial consolidators, they rely heavily on specialist third-party outsourcing. Surprisingly, they seem to hold lower amounts of capital for third-party risk scenarios than other traditional financial service firms.

A closer look at the scenario assessment data shows that consolidators use more sophisticated risk mitigation to manage third-party risks. For example, they use products such as letters of credit as a risk mitigation method, especially for businesses that outsource critical business operations.

Another risk mitigation strategy is to use indemnities and warranties from contracts related to acquisitions and third-party suppliers, primarily when cashflows are accessible within one year.

For more information on how your firm can benefit from using scenario assessment data, or to confirm your participation in our Scenario Assessment Working Group, please contact Shahine Sivakumar or Chris Watson.

EMERGING RISK

At our member forum on 10 March, we discussed how the emerging risk landscape was evolving.

Cyber security

More and more cyber security risk events are being reported by firms (as also highlighted in our COVID-19 deep dive launch event). An increase in malware and penetration attempts, as well as increase in 'clone' criminal websites, are of concern, especially due to the potential of highly confidential databases being at risk which, if accessed by malicious parties, can have an adverse impact on customers, clients and employees.

Post-pandemic risk

Company risk profile through the economic recovery could be adversely impacted if the pace and shape of the recovery is not as expected. For example, a long recovery, further lockdowns and long-term unemployment can affect company margins and possible strategic plans with changes in personal financial circumstances due to pandemic.

ESG

Effective management of sustainability issues such as climate change, exploitation in supply chains, corporate governance, etc. are now a competitive advantage. The transition risk associated with integrating and developing ESG models should be closely monitored to avoid any unintended consequence.

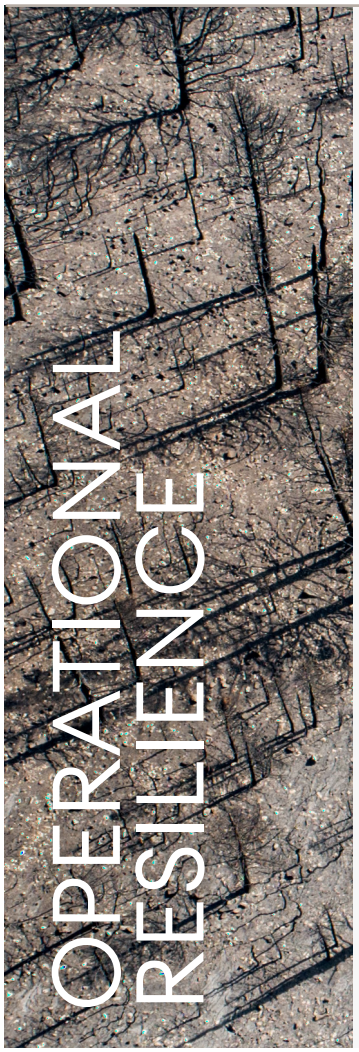
INSIGHTS FROM OUR COVID-19 DEEP DIVE EVENT

On Tuesday 16 March, ORIC International, with support from Risk Dynamics, a McKinsey company, shared the findings from our COVID-19 deep dive study. The study explored the risk impact of COVID-19 on the economic environment, capital and mitigation strategies, operational risk, and future modelling considerations.

Four key themes emerged from the study:

- **The impact on profitability has been limited**
  Most firms in the study anticipated a lasting impact of the pandemic on the economy. However, the impact on firms' profitability is expected to be short-term in nature.
- **Capital levels have been sufficient**
  Study participants did not identify any material impact on stand-alone capital requirements and, therefore, there have been no plans for fundamental changes to capital models.
- **Cyber and tech risks have increased**
  Firms have reported an increase in information security risks (including cyber security risk), technology risk and third-party/supplier risk. These may be of concern for liabilities but present an opportunity for new product types.
- **Responses focus on short-term mitigation**
  Most firms are using management overlays and additional stress testing to assess and manage risks arising from the pandemic. There may be a need to build resilience in anticipation of impacts that will be felt later.

The full report will be released shortly. Please contact Ciaran Hosty for more information on this workstream and to request copies of the presentation materials.



EMPLOYEE WELLBEING INDUSTRY CALL

We were joined by Tera Allas and Daniel Mikkelsen from McKinsey & Company, and Charles Garthwaite from M&G plc, on our operational resilience industry call on employee wellbeing on 24 March. They shared some great perspectives on this topic.

Why the wellbeing perspective matters, now more than ever
In April 2020, COVID-19-related restrictions had resulted in a material reduction in life satisfaction in European countries. The biggest drivers of life satisfaction alongside mental and physical health, is job satisfaction, which depends on interpersonal relationships at work and how interesting the job is.

Work relationships are key
It is found that people's main driver for strong interpersonal relationships at work is their relationship with the management. When people feel heard and are looked after by the management, the level of job satisfaction is higher. Employees are also more likely to go the extra mile when they are happier with their relationship with the management. High job satisfaction is also strongly linked to company performance, including shareholder value.

> *An interesting fact highlighted during the forum was that employees in sectors where they have more autonomy are, on average, happier with their lives.*

What managers and leaders can do to make a difference
Psychological safety and satisfaction lead to a happier and more satisfied workforce. This can be achieved by creating an atmosphere of collaboration through positivity, empathy and gratitude.
In companies where the management shared their personal experience with mental health, the work environment was more transparent, with a higher degree of trust between employees and management.

Our next operational resilience industry call is on **30 June**. If you would like to attend this event, please contact the team or email enquiries@oricinternational.com.

TOP FIVE PUBLIC NEWSFLASHES

MARCH 2021

This month, we've analysed some of the top losses in March from our public newsflash service. The largest potential loss of £7.1bn is one of 163 insurance and investment management losses to have occurred this month, with a combined loss value of over £21bn.

No.	Risk event summary	Amount (GBP)	Business line	L1 risk category
1	**An Italian judge sentenced four executives of former cooperative bank Popolare di Vicenza to jail for market manipulation and obstruction of regulators following the 2017 collapse of the Veneto-based lender.** Popolare di Vicenza bankruptcy wiped out 6.5 billion euros in savings in Italy's industrial north-east, where many of the lender's 120,000 small shareholders were local business owners. Following shareholder complaints, prosecutors in Vicenza since 2015 had been looking into the allegations against the bank's executives for fraudulently inflating the prices of shares and misleading investors about the financial solidity of the group.	**1.19bn**	Corporate services	Clients, products and business practices
2	**A director of Envy Asset Management (EAM) and Envy Global Trading (EGT) – two firms being probed for alleged fraud related to nickel trading – was charged with cheating and fraud. At least $1 billion is believed to have been invested in the companies for the purported sale and purchase of nickel. It is one of the largest financial fraud cases in Singapore.**	**537m**	Asset management	Internal fraud
3	**Over 65,000 bank employees from over 6,000 branches of public sector banks across Telangana, India, participated on the first day of the two-day bank strike against the privatisation of government banks and 'retrograde' banking reforms.** As a result of the two-day strike, clearances of around Rs 50-75 lakh of cheques/instruments worth about 20,000 – 30,000 crore in the State were impacted. Meanwhile, withdrawal of cash at bank branches and ATMs, loan approvals and deposits were also affected, bank unions said. Under the aegis of the United Forum of Bank Unions (UFBU), multiple bank associations in the State participated in the strike.	**297m**	Corporate services	Business disruption and system failures
4	**A man from Vcitoria who allegedly hoodwinked two major Korean investment houses into investing $395 million in fake NDIS-related property deals has been charged with fraud.** The charges relate to finance that was allegedly fraudulently obtained between April and July 2019 when the man was employed at a Melbourne-based property company, LBA Capital. The case made headlines in Korea, given the money invested by both groups was on behalf of Korean pension funds, which hold the superannuation entitlements for workers in the country.	**219m**	Asset management	External fraud
5	**A billionaire hedge fund manager has paid US$105m to New York, the biggest fine of its kind in the State, after being accused of dodging tax liability in 2017 on hundreds of millions of dollars in deferred investment fees.** Thomas Sandell and his activist firm, Sandell Asset Management Corp, failed to pay state and city taxes on US$450m in management and performance fees from a decade's worth of work in New York City, New York attorney general Letitia James said in a statement. A whistleblower who exposed the allegations will get a US$22m cut of the settlement.	**76m**	Asset management	Clients, products and business practices

RUN FOR CANCER

CHRIS WATSON, SENIOR MANAGER AT ORIC INTERNATIONAL

In need of a challenge to help me best utilise my free time during the latest lockdown measures, I decided to train and participate in the 2021 Cancer Research UK London Winter Run. Having completed a few 10km runs previously, the distance wasn't a worry – so my challenge was to beat the one-hour mark. Having completed the necessary training, I was optimistic of beating my previous best and dipping under the magical hour. Unfortunately, when the day arrived, I was greeted with snow, icy winds and not a ski in sight for me to use – my trainers would have to do! I completed the run in just over an hour (1:08) and, through sponsorship, raised £265 for Cancer Research UK. To date, the event has raised £950k for cancer research, but more is still needed to help prevent and find a cure for this disease.

If you would like to sign up for the Cancer Research UK London Summer Run, on 5 September, click the following link: https://londonsummerrun.co.uk/

DATA CYCLE Q1 2021: HOW TO FLAG COVID-19-RELATED RISK EVENTS

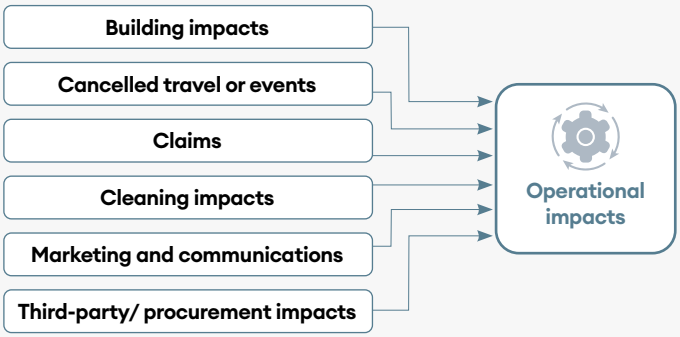
MAR 31

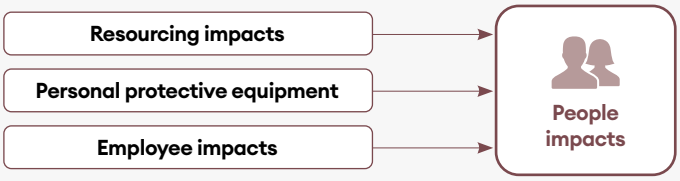
The data cycle for Q1 2021 will be opening on 31 March.

If COVID-19 has indirectly influenced the risk event, members should detail this within the risk or causal descriptions, to help ORIC International and fellow members identify this as an attributing factor.

ORIC International have added a COVID-19 data tag that allows members to search for all COVID-19-related risk events on the system via the 'Locate Loss Events' module on ORIS.

Members should consider the following impacts (divided into two categories) when submitting COVID-19-related risk events to ORIC International.





For full guidance, please visit the submission guide published in July 2020, or contact a member of the team.

APR 20

INVESTMENT FIRM FORUM Q2 2021

CAPITAL BENCHMARKS AND THE RISK BREACH OF INVESTMENT MANDATES

Our next meeting of the Investment Firm Forum, chaired by David Harper (ERM Director of Fidelity), is planned for the 20 April (3pm – 4pm) and will cover the following topics:

1) Capital benchmarks for Investment firms

After the success of the ORIC International capital benchmarks launch event at the end of February, this meeting is now an opportunity to delve deeper into the data specifically for investment firms. Ciaran Hosty will cover insights relating to the changes in the risk profile and critical scenarios used in modelling, the specific levels of diversification benefits used, and differences in modelling methodologies.

2) Breach of investment mandate

This continues to be a significant risk for investment firms, both from day-to-day management and when determining the appropriate level of operational risk capital. We have a presentation from industry commentators on how this risk has dynamically changed over the last ten years in relation to market volatility. This analysis includes the risk drivers, the major types of risk events seen by firms and potential mitigation of the risk using insurance products.

Invitations will be sent out soon; but if you wish to join the investment firm forum or have questions about topics covered, please contact jay.mistry@oricinternational.com or ciaran.hosty@oricinternational.com.

KEY CONTACTS

CAROLINE COOMBE
CEO
caroline.coombe@oricinternational.com
d: +44 (0)203 917 1730

CHRIS WATSON
Senior Manager
chris.watson@oricinternational.com
d: 44 (0)203 917 1735

CIARAN HOSTY
Senior Operational Risk Analyst
ciaran.hosty@oricinternational.com
d: +44 (0)203 917 1733

SHAHINE SIVAKUMAR
Senior Operational Risk Analyst
shahine.sivakumar@oricinternational.com
d: +44 (0)203 917 1732

PRAPTI MODI
Operational Risk Analyst
prapti.modi@oricinternational.com
d: +44 (0)203 917 1737

LAUREN KISSICK
Executive Assistant
lauren.kissick@oricinternational.com
d: +44 (0)203 917 1738

UPCOMING DATES

15 April
Loss reporting focus group

20 April
Investment firm forum

ORIC INTERNATIONAL