ORIC INTERNATIONAL

Powering risk intelligence

APRIL 2021

NEWSLETTER

AT A GLANCE...

LAUNCHING NEW OPERATIONAL RESILIENCE INITIATIVE

To support firms on their operational resilience journey, ORIC International are building an operational resilience benchmarking service, developed in partnership with Sicsic Advisory. As a first step, we are conducting a flash survey to establish preliminary industry benchmarks on the important business services firms have identified and the approaches they have used to identify these.

BACKGROUND

The Prudential Regulatory Authority (PRA)[1] and the Financial Conduct Authority (FCA)[2] published their final policy and supervisory statements for operational resilience on 29 March 2021.

By 31 March 2022 insurance firms, intermediaries (enhanced scope SMCR firms) and investment firms are required to have identified all their important business services, impact tolerances and completed sufficient mapping and testing to identify vulnerabilities. Following this deadline there will be a three-year transitional period to 31 March 2025 for firms to demonstrate that they can remain within their impact tolerances for important business services in severe but plausible scenarios.

Although the regulators have provided guidance on how these requirements should be implemented, it is up to individual firms to apply the rules and guidance in a way that is appropriate to their organisation.

We anticipate that firms will face significant regulatory challenge on the processes they have followed to determine what their important business services are and the impact tolerances they have set for each of these. ORIC International is uniquely positioned to help firms meet this challenge.

OUTLINE OF PROPOSED OPERATIONAL RESILIENCE BENCHMARKING SERVICE

The operational resilience of individual firms and the market as a whole will be enhanced through increased industry collaboration. The proposed service will leverage ORIC International's unique industry collaboration model which enables the secure and anoymised sharing of data, benchmarks and best practice across our network of member firms. This peer-to-peer network is the largest of its kind with over 40 leading (re)insurers and investment firms.

The service will:

- Provide an industry reference taxonomy and library of important business services.
- Overlay important business services with risk event and scenario data from ORIC International's network of member firms.
- Cover methodology and industry best practice.
- Enable the secure exchange of the important business services firms have identified, together with impact tolerance data, across the market.
- Provide a working group forum for firms to discuss current practices, share knowledge and lessons learned.

Firms will be able to compare and contrast their approach with industry peers which will help them to meet regulatory expectations.

FLASH SURVEY

We are conducting a flash survey to establish preliminary industry benchmarks on the important business services firms have identified and the approaches they have used to identify these. The flash survey results will be treated confidentially with responses being consolidated and presented on an anonymised basis. By participating in the flash survey you will receive a personalised operational resilience benchmark report. You will also be invited to attend the operational resilience working group to discuss the results. ORIC International will use the anonymised outputs of the flash survey support the development of the new service.

HOW TO PARTICIPATE

The flash survey is now open. Please contact caroline.coombe@oricinterational.com for further information or to confirm your participation. We are offering non-members the opportunity to participate in the flash survey without charge.

1. PRA Policy statement 2. FCA Policy statement

CAPITAL BENCHMARKS

Participants who took part in this year's study received a comprehensive 70-page report providing unparalleled insights and benchmarks for more than 130 aspects of the end:end capital modelling process. If your firm did not participate in the study this year, a summary report is available which details the top ten takeaways.

In addition to these reports, ORIC International will be providing participating firms with a dynamic reporting tool which means they can perform deeper dives on certain questions, we are also offering bespoke debrief sessions where we will take you through your firm's responses and compare and contrast these with the wider industry view.

The next internal model working group session is **3 June 2021**. These sessions which are chaired by Adrian Whitaker at Aviva provide a platform for firms to share industry best practice and approaches to operational risk modelling and will be used as a vehicle to provide greater context and insight on many of the takeaways identified in this year's report.

For further information contact Ciaran.

NEWSFLASH

5.28bn loss

Credit Suisse told investors the debt in its $7.3 billion finance fund was low risk because it was insured but the bank failed to ensure the policies would pay out.

Read more on page 4.

FIVE TIPS TO IMPROVE THE QUALITY OF YOUR SCENARIOS

1. CONSIDER LINKING SCENARIOS TO A SINGLE RISK EVENT

Having scenarios with multiple storylines (i.e. risk events) can lead to confusion in scenario workshops when considering the risk driver(s), calculating the magnitude of the loss, and linking the mitigating controls. If you have identified multiple risk events, consider developing separate scenarios for individual risk category.

2. UNDERSTAND YOUR RISK DRIVERS

Define and document the risk driver(s) (i.e. root causes) that can influence the risk event. This information will help the subject matter experts in the scenario workshops evaluate the magnitude of the loss as the likelihood and impact of changes to risk drivers. For example, when calculating the loss for a scenario related to unit pricing errors on an investment platform, if the main risk driver is the number of customers on the platform, has the frequency or severity of the scenario changed following Covid-19 if the number of customers has doubled?

3. WHEN EXPRESSING LIKELIHOOD, UNDERSTAND THE DIFFERENCES BETWEEN PROBABILITY AND FREQUENCY

When When determining the 'likelihood' of the risk in a workshop setting, the facilitator should appreciate that it can be articulated by participants as a probability or a frequency. Although these risk terms are interchangeable, there is a difference in definition. In a scenario workshop, you need to be clear on whether you are asking participants for a probability or a frequency of a risk. It is essential to differentiate between the two as this will impact the data collected, how you document expert judgement, and how you calibrate the risk. If you use a risk matrix within the workshop and the likelihood is defined as high, medium and low, you should articulate this for both probability and frequency to help participants.

The probability of a risk is an expression of confidence that a one-time event may or may not happen. The probability, by definition, is required when you have limited data or track record and is often expressed as a percentage or equivalent. For example, a risk manager may ask in the workshop, 'What is the probability of a material outsourcer failing over the term of a contract?' The SME may say we have no track record for this, and therefore, my expression of confidence is less than 10% which is a low likelihood. The frequency of the risk is the measurement of the number of occurrences expected over a specific period for a repeated event. Frequency, by definition, is required where data is available to support. For example, the risk manager may ask in the workshop, 'How many times will the payment process fail over a 12-month period?' The SME may have a track record (i.e. recorded risk events), and say 5 in a year; hence the frequency will be 5, which is may mean a medium likelihood.

4. IMPROVE THE COMPLETENESS, ACCURACY AND CONSISTENCY OF THE CALCULATED LOSSES FOR YOUR SCENARIOS

- Completeness & consistency: you may want to use a pre-defined template that records both direct and indirect impacts. Recording indirect impacts are also significant as they help capture all management actions related to the scenario. For example, a risk scenario may have captured the direct customer impacts. However, indirectly the risk may have material reputational implications which will require a management communication plan to shareholders and the market.
- Accuracy: use a pre-defined rate card for calculating direct costs such as internal staff costs and consultant fees for all scenarios. Costs (e.g. fines) can also be calculated as a percentage of your firm's turnover or net operating profit. ORIC members have access to an impact calculator, they can also use ORIC risk events and scenario data to benchmark their calculated loss estimates.

5. LINK YOUR SCENARIOS TO YOUR INTERNAL BUSINESS PROCESSES

Mapping each scenario in your universe to your internal business/entity processes can help you:

1) Identify gaps in your scenario universe at a solo or group level, e.g. the risk of intra-group outsourcing is missed by participants when thinking about third party failure at a solo level only.
2) Understand the interconnectivity of processes, risks and controls linked to a scenario and how they may change over time, e.g. if an internal process becomes outsourced, how will that impact the associated risks, controls and scenarios?
3) Determine which scenarios require a connection to your critical business services. These scenarios are essential to identify as they will be linked to impact tolerances related to customer harm and require additional management actions to safeguard operational resilience plans.

BREACH OF INVESTMENT MANDATE

The investment firm forum met on 20 April 2021 to discuss 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.

Willis Towers Watson (W.T.W) presented on how this risk is dynamically changing when looking at the ecosystem of risks faced by investment firms.

Key takeaways from the presentation and panel discussion include:

- By definition the breach of mandate category includes claims for when these limits were not adhered to by the investment firm. Funds or individual investors will often have prescribed limits for exposures to specific asset classes, geographies, industry sectors, etc.
- W.T.W.'s claims database shows the most significant loss was $250m, the average loss was £11m, and the median average loss was $400k.
- For investment firms, recessions and the stock market falls have historically caused a significant increase in claims notifications.
- Post-COVID-19, a concern for investment firms should be that a recession following a significant stock market fall could herald the return of the breach of mandate events.
- Regular review of risk management controls is required. Undertake regular inspections with a focus on high-risk areas looking at materiality and proportionality.
- Preventative action is better than holding excessive capital. Risk managers needed to resist or challenge the significant capital holdings or risk appetite buffers.
- Providing training around senior managers responsibilities for mandate breaches (i.e. SMCR) and the prudent person principle) for insurance firms would be useful.
- Insurance should be the last line of defence, but cover for this risk is essential for an insurance purchase decision. Also, firms must understand the pitfalls – insurance is a reactive financial instrument, and the legal process of a claim is complex and may take several years to resolve.

At our next investment firm forum in June we will cover model risk, invitations will be issued shortly. If you wish to join us please contact shahine.sivakumar@oricinternational.com or lauren.kissick@oricinternational.com.

LOSS REPORTING FOCUS GROUP

The loss reporting focus group met on Thursday 15 April to discuss project risk and the extent to which it should be captured within firms operational risk event reporting.

Phil Smith (Quilter), Matthew Wilmot (Flood Re) and Fay Westray (PPF) spoke about their firm's approaches to identifying and reporting project risk boundary events and the associated challenges. Interestingly, the group discussions that followed highlighted that there was no clear or consistent approach to capturing project risk boundary events. ORIC has seen evidence of this in its data-sets from previous reporting periods.

Therefore, the next step for the group is to prepare paper for the wider membership that will consult on how project risk boundary events should be captured and reported to ORIC.

If you'd like to know more about this workstream or if you'd like to be involved in the consultation work, please contact Ciaran.

NEW PRUDENTIAL REGIME FOR INVESTMENT FIRMS

The prudential regime working group met on 19 May to share approaches to framework development and benchmarking for investment firms implementing the FCA Investment Prudential Firms Regime. IFPR is a new prudential regime for UK firms authorised under the Markets in Financial Instruments Directive (MiFID).

The next level of consultation from the UK FCA has been released.-CP21/7- A new UK prudential regime for MiFID investment firms. With consultation expected to close on 28May.

This consultation paper is an essential read for risk professionals as it covers:

- Risk management & governance
- The ICARA and SERP structure and the taxonomy expectations
- Own funds requirements
- Regulatory reporting
- Remuneration

This rulebook will represent a significant change for investment firms, and it's critical that firms adequately prepare for the incoming regime.

How we are helping our members meet this challenge
This working group will continue to focus on more technical aspects of the rules and future risk taxonomy changes. Our strategic technical partner is Brian Thornhill (Director of Deloitte LLP), will help interpret the finer details of the guidance and rules.

TOP FIVE PUBLIC NEWSFLASHES

APRIL 2021

The largest potential loss of £5.28bn is one of 167 insurance and investment management losses to have occurred this month, with a combined loss value of over £27bn.

No.	Risk event summary	Amount (GBP)	Business line	L1 risk category
1	**Credit Suisse told investors the debt in its $7.3 billion finance fund was low risk because it was insured but the bank failed to ensure the policies would pay out.** When Japan's Tokio Marine, the company insuring the debt, declined to renew its coverage with Greensill Capital last month, Credit Suisse was forced to liquidate the fund and said this may have a material impact on its results and reputation. The bank's shares have fallen by almost a quarter in the past month as it deals with the fallout from Greensill and the impact of losses at its prime brokerage division caused by the stricken U.S. fund Archegos. The debt Credit Suisse bought was issued by Greensill and backed by loans the supply chain finance firm made to companies. To manage its risk, Greensill took out credit insurance with a subsidiary of Insurance Australia Group (IAG). Tokio Marine took on the policies in 2019 when it bought the unit. Supply chain finance is a form of financing in which suppliers can receive early payment of their invoices.	**5.28bn**	Asset management	Clients, products and business practices
2	**The Central Bank was aware of, but failed to act on a German ponzi property scheme that had its "nerve centre" in Ireland. The company involved collapsed last year with 1,800 Irish victims facing losses of up to €108 million.** Sinn Féin finance spokesman Pearse Doherty made the claim as he highlighted a fraud investigation by German authorities into a company called Dolphin Trust and its director Charles Smethurst. The firm was renamed as the German Property Group and owed about €3 billion to some 20,000 investors around the world when it collapsed.	**2.59bn**	Asset management	Internal fraud
3	**The liquidation of a hedge fund run by manager Infinity Q Capital Management LLC could impact some asset owners because of potential losses from the same mispricing suffered in the firm's mutual fund, said investment consultants who asked not to be named.** The New York-based manager has already liquidated a mutual fund tainted by mispricing of swaps by the firm's CIO but has not publicly disclosed the planned liquidation of its $760 million hedge fund, Infinity Q Volatility Alpha Fund, which the consultants said was also subject to inaccurate valuations. The consultants said they've received liquidation notices on behalf of institutional clients invested in the hedge fund.	**547m**	Asset management	Internal fraud
4	**German financier Florian Homm was convicted by a Swiss court of breach of trust and multiple forgery of documents in a fraud case that had led to millions of dollars in losses for investors.** The former hedge fund manager was convicted in absentia and sentenced to 36 months in jail, of which half was suspended, the court said. Authorities had accused Homm of orchestrating a market manipulation scheme to artificially improve the performance of his funds, a fraud that led to at least $170 million in losses for investors.	**133m**	Asset management	Clients, products and business practices
5	**Moscow's Preobrazhensky District Court sentenced ex-president of now insolvent MAST-Bank Yury Pirogov to 8.5 years in penal colony for embezzling over 5.6 billion rubles ($73.5 million at the current exchange rate).** The court also convicted the former vice-president of the bank Elena Zhuravleva and ex-head of the loan department Natalya Zhelobayeva as part of the case. Zhuravleva was given 6.5 years in jail, while Zhelobayeva received 5 years and 10 months behind bars. However, the latter was released from serving the sentence due to its actual completion. Investigators believe that in 2013-2015 Pirogov and his accomplices stole funds by giving out non-performing credits to companies under their control and then transferred money further to other organizations.	**53m**	Corporate services	Internal fraud

ORIC EVENTS CALENDAR

JUNE	EVENT	TOPIC
09 June	Investment firm forum	Model risk
14 June	Internal model working group	Deep dive into 2021 results and diversification benefits
15 June	Member forum	ESG

JULY	EVENT	TOPIC
14 July	Scenarios working group	Structured scenarios and feed on the 2021 exercise
21 July	Q2 operational resilience industry call	Important business services
TBC	Leaders forum	TBC
TBC	JP Morgan corporate challenge	TBC

SEPT	EVENT	TOPIC
07 Sept	Investment firm working group	Regulatory update & Risk and Governance taxonomy
08 Sept	Q3 Operational resilience industry call	Third party risk
15 Sept	Q3 Member forum & AGM	Operational resilience
TBC	US Forum	TBC

OCT	EVENT	TOPIC
06 Oct	Investment firm forum	ESG
13 Oct	Internal model working group	2022 Capital benchmarks study

NOV	EVENT	TOPIC
10 Nov	Emerging risk launch event	Diversity
17 Nov	Investment firm working group	Regulatory update & Risk and governance taxonomy

DEC	EVENT	TOPIC
02 Dec	Q4 Member forum	Risk apetite
07 Dec	Q4 Operational resilience industry call	TBC
08 Dec	Investment firm forum	Compliance

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