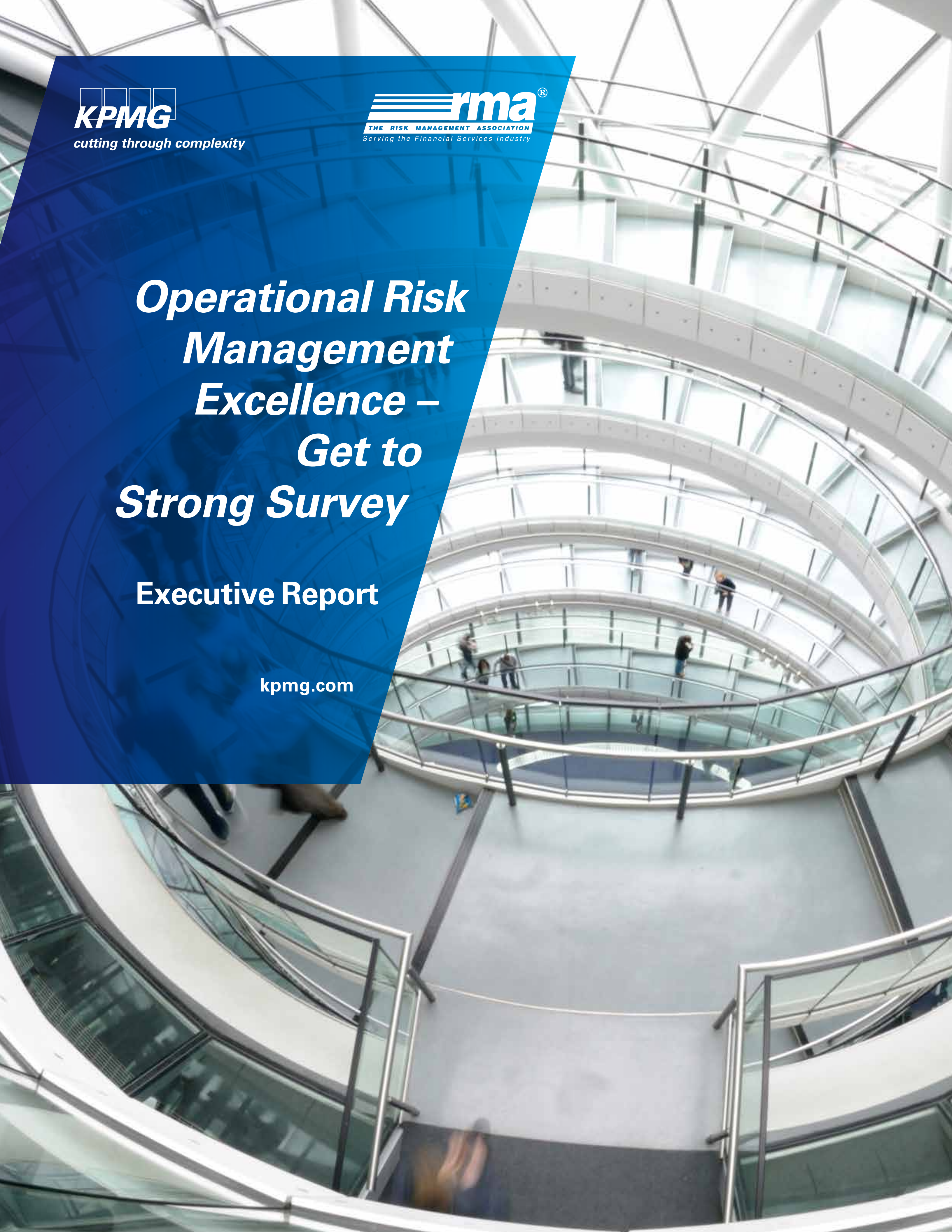

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Operational Risk Management Excellence – Get to Strong Survey

Executive Report

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STOP

Operational Risk Management Excellence – Get to Strong Survey Executive Report

KPMG LLP (KPMG) and the Risk Management Association (RMA) teamed to conduct the *Operational Risk Management Excellence – Get to Strong Survey* of leading financial institutions on the evolution of their operational risk frameworks in support of enhanced business value and alignment with heightened regulatory expectations for "strong" risk management. The following pages highlight key survey results and next steps in the evolution of the operational risk management discipline.

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Introduction

Operational risk has become an increasingly important area of focus for financial institutions and regulators in the wake of the financial crisis, as the industry has had to come to grips with wrongful disclosures, trading scandals, cyber threats, third party concerns, and operational disruptions such as that caused by Super Storm Sandy. These incidents, coupled with management's efforts to derive greater "risk intelligence" to enhance business strategy, performance, and risk management, along with heightened regulatory expectations for institutions to meet "strong" risk management criteria, have all contributed to this increased focus on operational risk.

Comptroller of the Currency Thomas Curry has voiced his views on the importance of operational risk on multiple occasions, starting with a speech that he delivered in May 2012, during which he remarked that operational risk is "gaining increasing prominence" and that "the risk of operational failure is embedded in every activity and product of an institution."[1] As a result, the Office of the Comptroller of the Currency (OCC) has placed operational risk "at the top of the list of safety and soundness issues for the institutions we supervise."[2]

Almost one year later, Comptroller Curry reiterated his concern, noting that seasoned OCC supervisors are seeing "operational risk eclipse credit risk as a safety and soundness concern."[3] During this period, large institutions have clearly been focused on getting to "strong" to meet these heightened regulatory expectations and have been working to demonstrate operational risk management (ORM) value across their firms. In addition, those banks applying Basel's Advanced Measurement Approach (AMA) are working to meet "use test" requirements and exit from parallel run.

Against this backdrop, KPMG LLP (KPMG) and the Risk Management Association (RMA) teamed to conduct the *Operational Risk Management Excellence – Get to Strong Survey* (the "Survey") in 2013. The objective was to give participants insights into leading industry ORM practices in support of enhanced business value, heightened regulatory expectations for "strong" risk management, and Basel AMA use test compliance in order to help gauge positioning against evolving industry practices, optimize their ORM frameworks, and enhance risk management.

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[1] http://www.occ.gov/news-issuances/speeches/2012/pub-speech-2012-77.pdf.

[2] Ibid.

[3] http://www.occ.gov/news-issuances/speeches/2013/pub-speech-2013-39.pdf.

Executive Summary

The results of the Survey reveal that AMA and non-AMA financial institutions continue to make important strides with respect to the following areas:

- Improved contribution of ORM to business/risk decision-making and strategic planning;
- Increased recognition of ORM contribution to business strategy and performance by the Board and other leaders;
- Improved standing of ORM with market, credit, and other risks;
- Broadened deployment of operational risk appetite at the enterprise, line of business, and other levels;
- Expanded use of standard risk taxonomies, assessment processes, and linkage to risk appetite;
- Improved processes to challenge, escalate, and communicate risks and issues; and
- Enhanced data quality for improved risk intelligence, decision-making, and reporting.

There is, however, still work to be done by financial institutions as they strive towards operational risk excellence and strong risk management, including:

- Further positioning the ORM framework so that it is fully aligned with firm strategy and that operational risk is considered when launching and implementing significant strategic change;
- Expanding efforts to deploy qualitative and quantitative measures of operational risk appetite across business lines, legal entities, processes, and other key areas;
- Broadening efforts to identify, assess, measure, and manage operational risk against defined risk appetite levels and thresholds;
- Strengthening ORM's value at the business line level and continuing to enhance business line ORM maturity;
- Reinforcing efforts to augment data governance, integrity, and aggregation for greater risk intelligence and actionable reporting; and
- Broadening effective challenge of 1st line of defense risk data (e.g., risk and control self-assessments (RCSAs), key risk indicators (KRIs), loss events, and mitigation plans) and calibrating that data for increased accuracy, value, and use.

Compliance with enhanced regulatory standards will likely pose considerable challenges to financial institutions. Risk management and business lines will require extensive efforts and increased coordination in order to ensure compliance and drive optimal value as they address regulatory imperatives such as the Volcker Rule, OCC and Federal Reserve Board rules and guidance establishing heightened standards, enhanced supervision and prudential standards, third party risk management guidance, Consumer Financial Protection Bureau requirements, and the Basel principles for effective risk data aggregation and risk reporting, among others.

Survey Methodology and Background

The fifty-one question web-based Survey, which was developed in collaboration with leading institutions, focused on the following key areas of operational risk excellence and heightened expectations for "strong" risk management:

- **Strategy and value**, including queries about ORM's alignment with strategy and the benefits and objectives derived from the institutions' enterprise ORM framework.
- **Stature, risk appetite, and governance**, including queries about the level of operational risk appetite deployment across the firms, the alignment of risk appetite with incentives, and ORM's standing with other risk types, such as market and credit risk.
- **Assessment, measurement, and management**, including queries about the institutions' efforts to identify, assess, measure, and manage risk, as well as define and deploy forward-looking indicators.
- **Data, analysis, and reporting**, including queries about the institutions' efforts to accurately and completely aggregate, analyze, and report ORM exposures.

The Survey consisted of multiple choice questions that gauged the evolution of ORM practices and deployment. In addition, respondents could then elaborate on their responses by providing qualitative inputs.

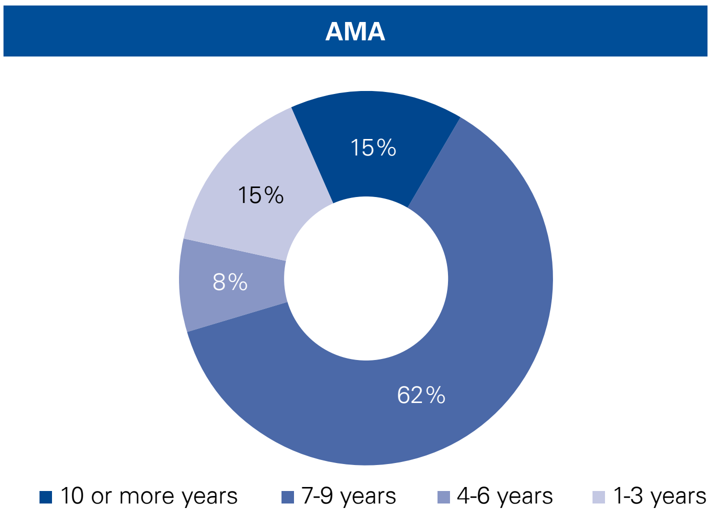
Survey participants were comprised of North American financial institutions (i.e., banks and investment companies), including global systemically important financial institutions (G-SIFIs) and Basel AMA banks, non-AMA large banks, and mid-size banks. Among the institutions surveyed, 57 percent were AMA mandatory or opt-in (AMA), 13 percent were planning to opt-in within two years, and 30 percent were not planning to opt in (non-AMA). Survey results provided insights into evolving industry practices and areas where AMA and non-AMA institutions diverge.

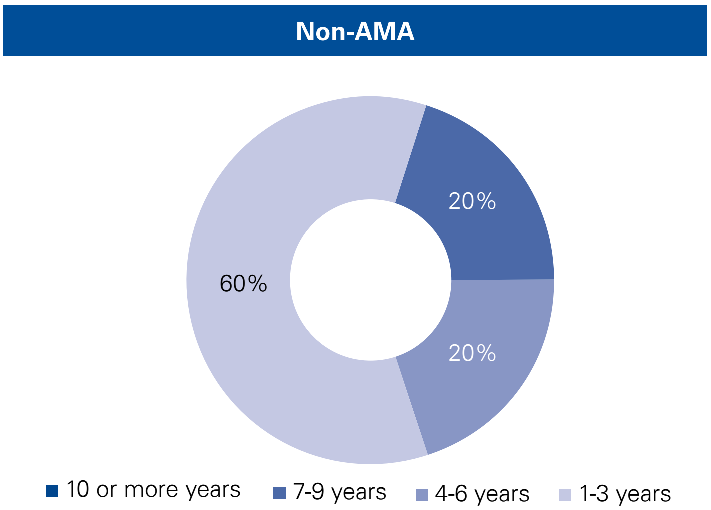
Sixty-two percent of the AMA respondents and 40 percent of the non-AMA respondents were commercial banks. The remaining respondents included investment banks, brokerages, investment management firms, and insurance companies. Among the institutions surveyed, 87 percent were headquartered in North America and 13 percent were headquartered in Europe.

Among the AMA respondents, 85 percent of the Enterprise ORM Heads report to the Chief Risk Officer, while the remaining ORM Heads report to either the Enterprise Risk Management (ERM) Officer or the Chief Executive Officer. Among non-AMA respondents, 80 percent of the Enterprise ORM Heads report to the Chief Risk Officer, while the remaining ORM Heads report to either the ERM Officer or the Chief Compliance Officer.

Among the AMA respondents, 77 percent have been deploying their firms' enterprise ORM framework for at least seven years. The majority of non-AMA respondents have deployed their frameworks within the past one to three years (please see Chart 1).

Chart 1
How long has your firm's enterprise ORM framework been deployed?

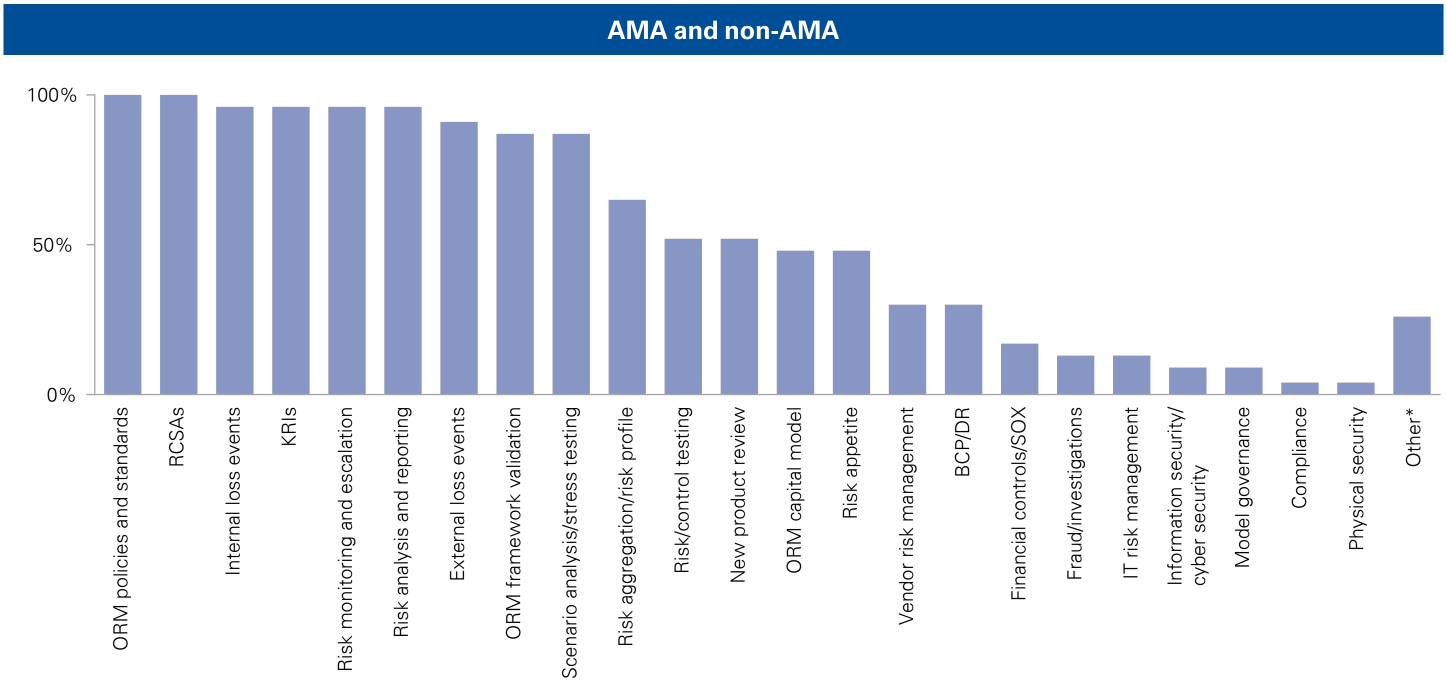




Operational Risk Management Processes and Functions

As noted in Chart 2 below, AMA and non-AMA respondents reported that the following processes and functions were directly under ORM management:

Chart 2
What processes and functions are directly under ORM management?



Multiple responses allowed

*For the "Other" category, respondents noted insurance, fiduciary risk, business process transition risk, concentration risk, operational risk economic capital allocation, reputational risk management, risk based incentive compensation, and SSAE 16 report reviews.

RESULTS COMPARISON

The responses of AMA and non-AMA participants were generally in line. The major differences were:

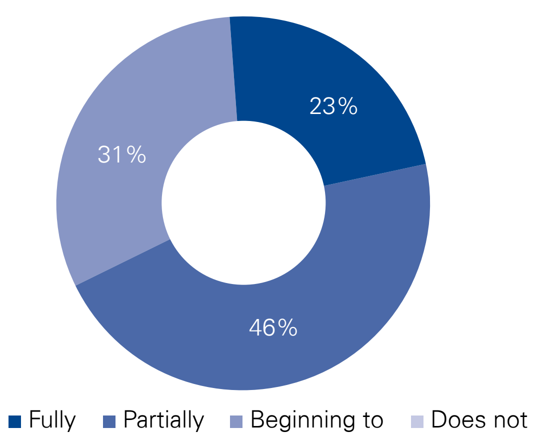
- Standards for operational risk and control testing – 69 percent of AMA respondents reported it was under ORM management versus 30 percent of non-AMA respondents.
- ORM capital modelling – 62 percent of AMA respondents reported it was under ORM management versus 30 percent of non-AMA respondents.
- Risk aggregation and risk profiling – 54 percent of AMA respondents reported it was under ORM management versus 80 percent of non-AMA respondents.
- Fraud and investigations – 23 percent of AMA respondents reported it was under ORM management versus no non-AMA respondents.

Strategy and Value

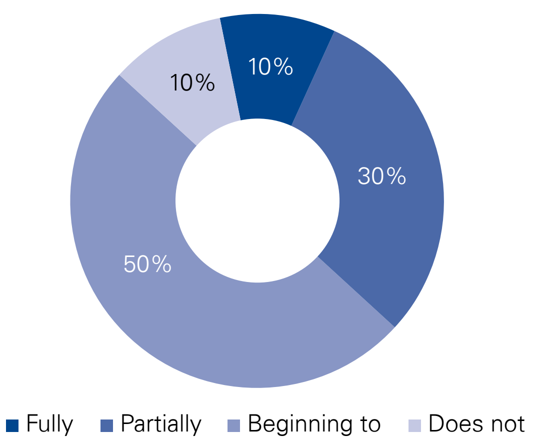
ORM alignment with strategy is critical to achieving sustainable value add, and to ensuring effective risk identification, assessment, and mitigation. However, reflecting the need for further positioning of the ORM framework, only 23 percent of AMA respondents stated their ORM framework fully aligns with their firms' strategy, and that risk is an integrated component in their strategic planning. While an additional 46 percent of AMA respondents noted partial ORM alignment with strategy, these results bring into question whether operational risk is considered in launching and implementing significant strategic change. The majority of non-AMA respondents are just beginning to align ORM with strategy (please see Chart 3).

Chart 3
Does your ORM framework align process, people, policy, and infrastructure against strategy in your firm?

AMA



Non-AMA



RESPONDENT COMMENTS

When asked if their ORM framework aligns process, people, policy, and infrastructure against strategy in their firms, respondents stated:

- "This could be more transparent, but work has started."
- "We are not there yet with linking processes to our RCSA or ORM framework."
- "With the recent rollout of risk profiling, RCSAs, policy governance, and new product and initiative policies throughout the company, we are enhancing the alignment of these elements with strategic decisions."
- "Each of these elements is considered in assessing strategic plans, launching new businesses and products, or implementing significant change. Our strategic planning policy and new business and product policy are relatively new and processes around them are not yet embedded and practiced to their full strength."

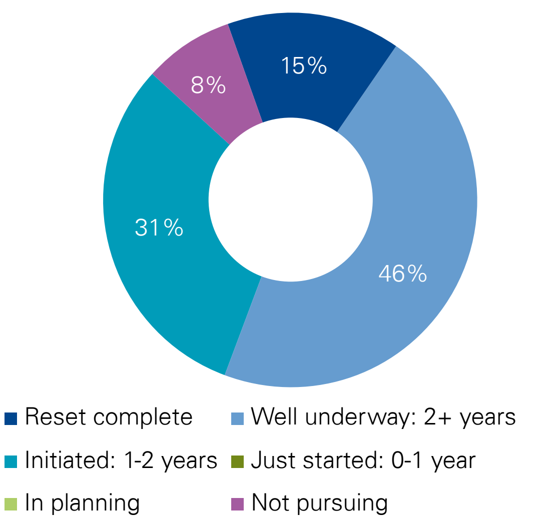
Resetting ORM for Enhanced Value

When asked if their firm had "reset" its ORM framework to drive greater strategic value for their business and to meet heightened regulatory expectations, 46 percent of AMA respondents reported their efforts were well underway, and only 15 percent reported they have completed efforts to strengthen their ORM frameworks. Among non-AMA respondents, 40 percent reported they have initiated their ORM reset only within the last one to two years. For both AMA and non-AMA respondents, the ability to meet heightened regulatory expectations for strong risk management was a driving factor in their ORM framework "reset." Both AMA and non-AMA respondents cited incorporating clear governance, standards, and thresholds as key priorities in their ORM "reset," while enabling technology strategy and performance management lagged behind as priorities (please see Chart 4).

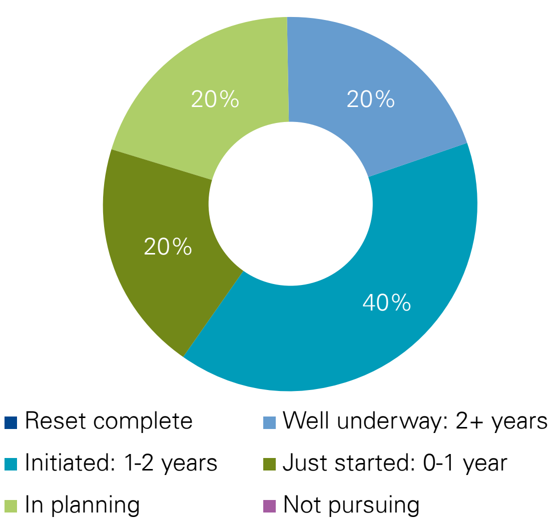
Chart 4

Has your firm "reset" its ORM framework to drive greater strategic value for the business and meet heightened regulatory expectations?

AMA



Non-AMA



RESPONDENT COMMENTS

When asked if their ORM reset supported requirements such as regulatory examinations, the AMA use test, and Dodd-Frank compliance, respondents stated:

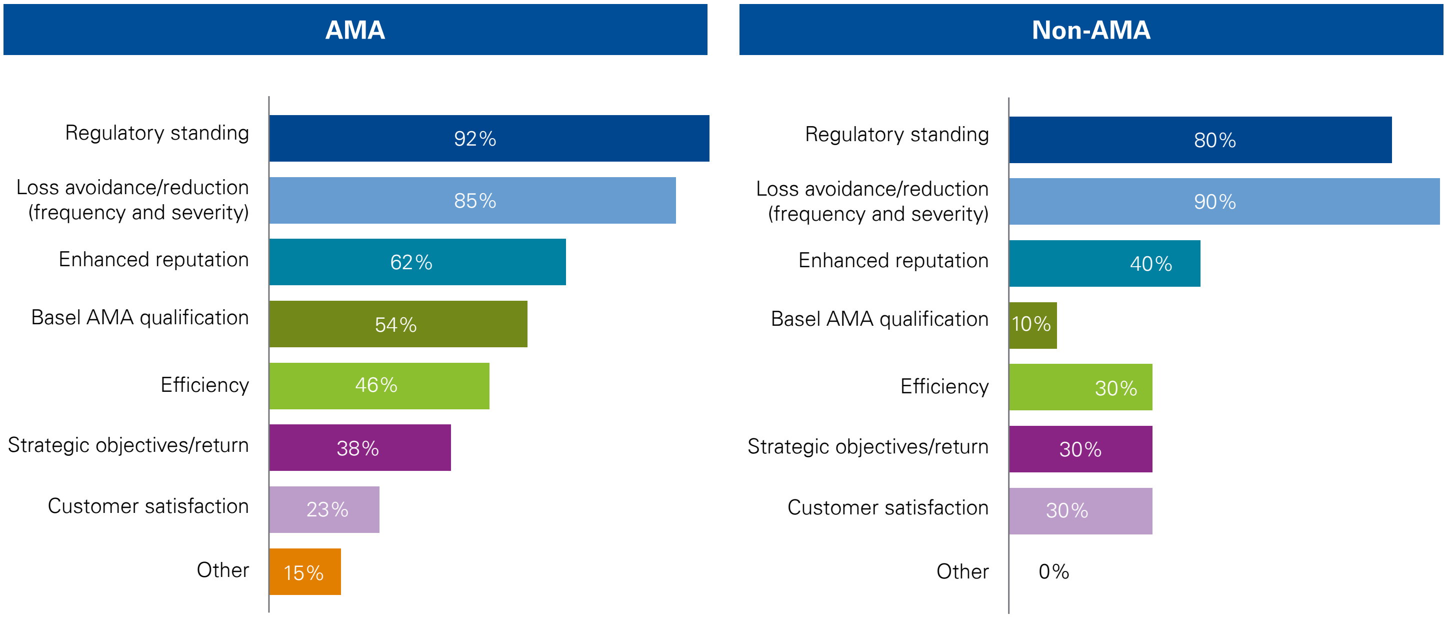
- "It supports the AMA use test and is being embedded in the business for management decision-making; embedding the ORM framework is the foundation for strong ERM and heightened OCC expectations."
- "It is not actually a reset, because the ORM framework continually evolves with the environment and our learning."
- "Our parent is applying for and expected to receive AMA accreditation."
- "The Basel AMA is a future consideration."
- "While we have several Dodd-Frank activities underway across the organization and we are utilizing appropriate program management and assessment techniques, we have not linked Dodd-Frank compliance specifically to the ORM framework."

Key Objectives & Benefits

Both AMA and non-AMA respondents cited enhanced internal control, risk mitigation, regulatory compliance, and information security as the most important objectives. The majority of AMA respondents also mentioned the importance of enhancing their firm's reputation and improving capital planning, while AMA and non-AMA respondents both cited vendor risk management and product/system implementations as additional top objectives.

When asked to describe the benefits they derived from their ORM frameworks, a reduction in the frequency and severity of losses was one of the top priorities cited the need for by both AMA and non-AMA respondents. Respondents also cited the need for increased role clarity across the three lines of defense and greater knowledge of top risks and control issues. It is interesting to note that achieving strategic objectives/return targets and improved customer satisfaction were not yet cited as broadly derived benefits. These benefits will likely increase across the industry as additional firms focus on strategy, value, and the Basel use-test results (please see Chart 5).

Chart 5
What benefits have you derived from your ORM framework?



Multiple responses allowed

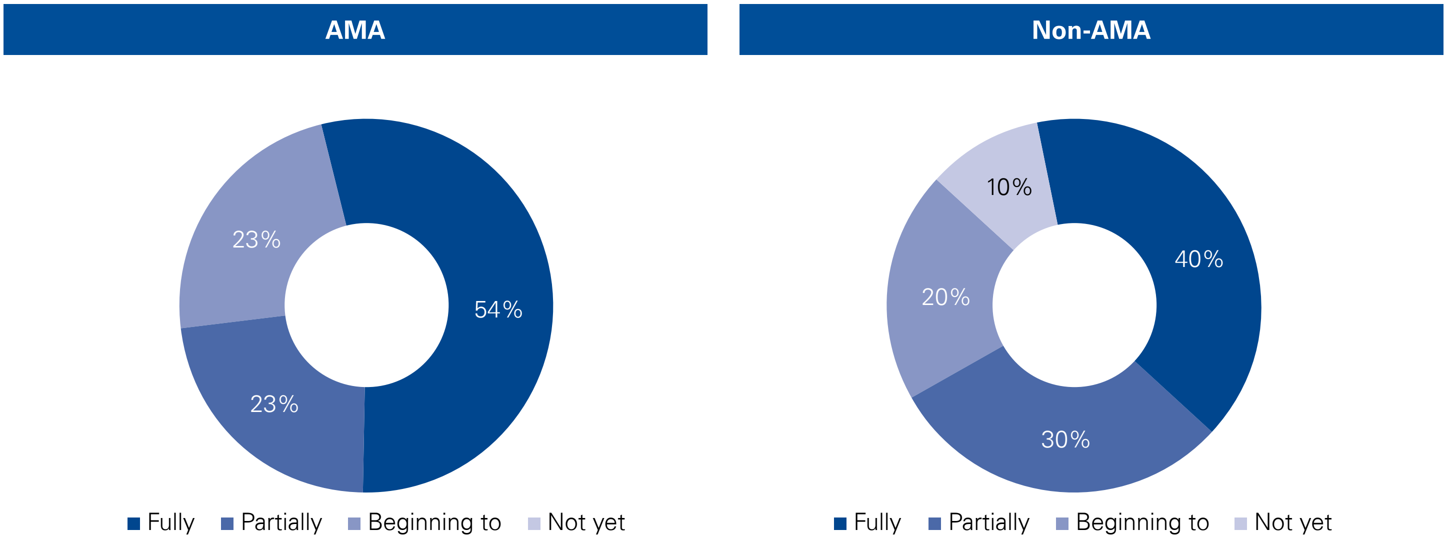
Stature, Risk Appetite, and Governance

ORM Maturity & Stature

A key question with respect to ORM maturity is whether operational risk has consistent stature with other risk types across all lines of business. Survey results indicate that, while ORM/operational risk stature continues to improve for AMA and non-AMA institutions, there is still work to be done. For instance, 54 percent of AMA and 40 percent of non-AMA institutions state that the Board and Executive Management have elevated the stature of ORM within their ERM framework (please see Chart 6).

Chart 6

Has the Board and Executive Management elevated the institutional stature of ORM to align with business strategy and heightened regulatory expectations?



RESPONDENT COMMENTS

When asked if their Boards and Executive Management elevated the institutional stature of ORM to align with business strategy and heightened regulatory expectations, respondents stated:

- "ORM reports are included in monthly Board packages. Our business strategy is influenced by our operational readiness."
- "The Board and Executive Management have approved a policy that provides full support to ORM and strategic risk considerations."
- "The value of risk management is high, while ORM within the risk family is still less understood when compared to credit and market risk. Regulatory attention is greatly increasing awareness and support for the ORM mandate, but there is still a learning curve and a compliance curve that must be addressed."

However, 31 percent of AMA institutions report that operational risk is just beginning to receive equal time and attention compared to credit and market risk, and 15 percent report that operational risk has yet to receive equal standing. Only 20 percent of non-AMA respondents indicate they are just beginning these efforts and 20 percent have yet to elevate operational risk commensurate with credit and market risk.

The maturity of ORM business ownership continues to evolve, as AMA and non-AMA institutions recognize there is important work ahead to strengthen business ownership and operational risk maturity consistently across all lines of business. Notably, only 15 percent of AMA respondents stated that business ownership and operational risk maturity is consistent across the business lines; 62 percent stated they have made partial efforts towards this goal; and 8 percent stated they were just beginning these efforts. With respect to non-AMA respondents, 50 percent stated they have made partial progress with these efforts, 40 percent are just beginning, and 10 percent have yet to start.

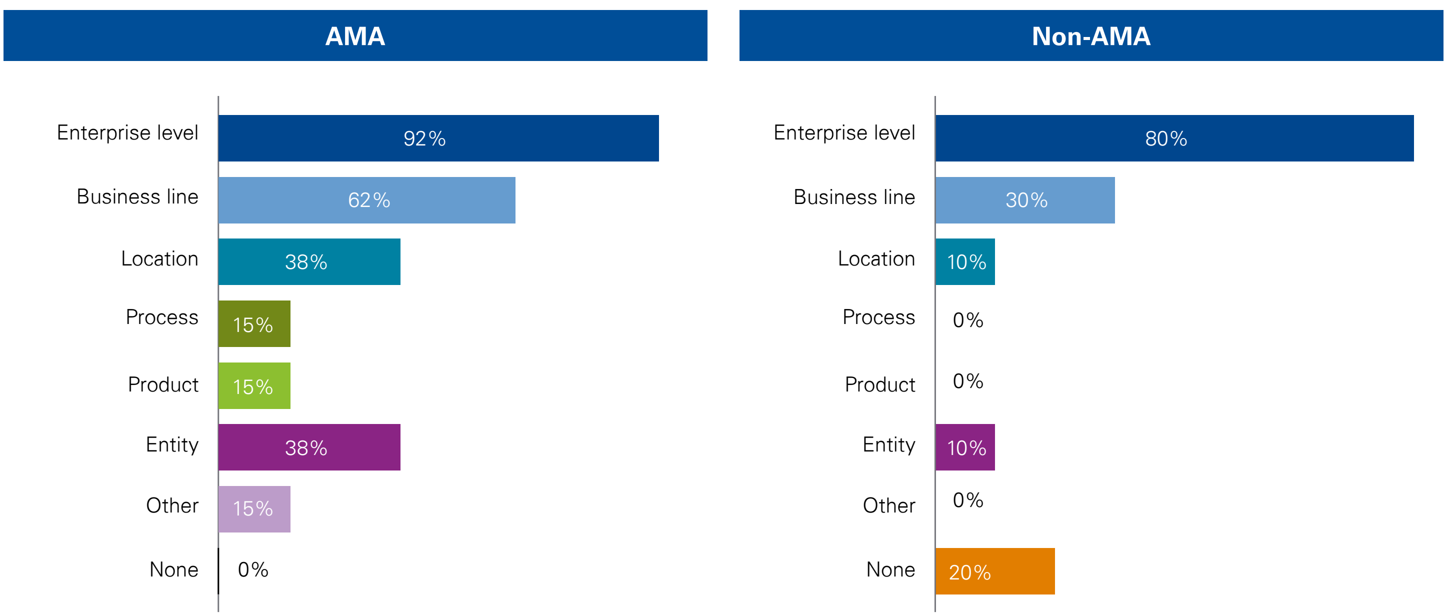
On a positive note, AMA respondents reported that the Board firmly recognizes ORM's value to the organization and its alignment with business strategy and performance. That recognition was also noted by Executive and line of business management. However, Executive Management's recognition of ORM was less strong than that of the Board, and recognition of ORM by the lines of business trailed that of Executive Management—an indicator that ORM use-test and value have yet to be fully embedded at the business line level.

It is encouraging to see that 85 percent of AMA respondents stated they have fully or partially integrated and embedded their ORM processes and systems into business activities across the enterprise. It was equally encouraging to note that 60 percent of non-AMA respondents stated they have also embedded their processes and systems, or are working to do so.

Risk Appetite & Governance

Effectively defining a firm's risk appetite (i.e., the aggregate level and type of risk the Board and management are willing to assume to achieve the bank's strategic objectives and business plan, consistent with applicable capital, liquidity, and other regulatory requirements), and then monitoring and managing that appetite is a key element for strong risk management. Survey results indicate that firms are working to define and manage their operational risk appetite, but additional work is needed to fully deploy both qualitative and quantitative measures of operational risk appetite across the enterprise. For example, almost all AMA and non-AMA institutions reported that they define operational risk appetite at the enterprise level (please see Chart 7).

Chart 7
Has the Board and Executive Management defined and cascaded operational risk appetite at the following levels?



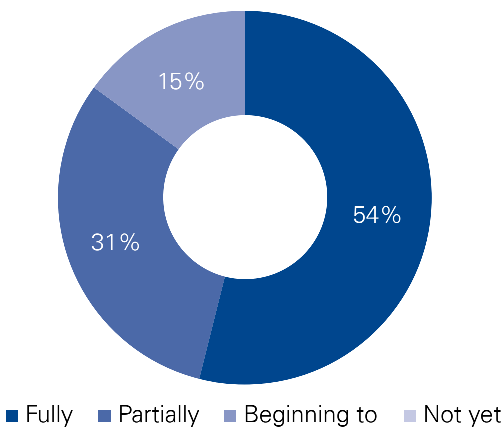
Multiple responses allowed

Results dropped significantly after that, with 38 percent of AMA and 70 percent of non-AMA respondents stating that they have yet to define and cascade their operational risk appetite to the business line level. Further, operational risk appetite definitions are just beginning at the location, process, product, and entity levels. However, several AMA respondents commented that, while operational risk appetite was not defined below the business line level, operational risk KRI thresholds and tolerances were in place across processes.

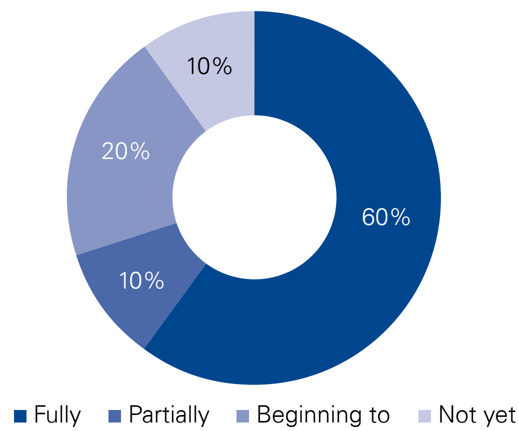
With respect to operational risk appetite monitoring and management, 54 percent of AMA and 60 percent of non-AMA respondents indicated that ORM is fully escalating issues that exceed their firm's operational risk appetite and several AMA respondents indicated that their escalation efforts need strengthening (please see Chart 8). Some respondents commented that this will likely happen as their firms' operational risk appetite is defined in more quantitative terms and as its application in the business areas matures.

Chart 8
Does ORM consistently escalate issues that are outside the firm's risk appetite/thresholds?

AMA



Non-AMA



RESPONDENT COMMENTS

When asked if ORM consistently escalated issues that are outside the firm's risk appetite/thresholds, respondents noted:

- "Since our risk appetites are still somewhat qualitative, this will develop further in the future as additional quantitative measures are identified."
- "We have policies and processes in place for escalation and reporting; compliance with these is good but not at 100 percent."
- "The de minimis risk appetite is well known by the business so we do not typically have issues outside of that tolerance."
- "ORM escalates KRIs that surpass our tolerance levels, as well as any high-risk rated outstanding issues. These issues are highlighted and discussed at operational risk committee meetings."

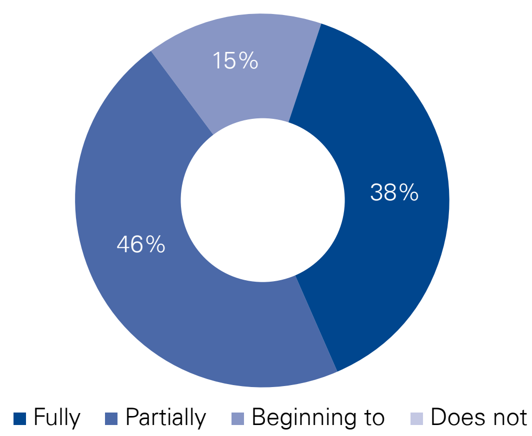
AMA respondents reported incentive structures that align risk taking with their institutions' operational risk appetite and strategic objectives are in place for Executive Management, and risk management and business line management are following suit. Non-AMA respondents report that additional work is needed in this area, as almost 35 percent indicated that they were just beginning to align or have not yet aligned incentives with operational risk appetite.

Integrated Risk & Performance

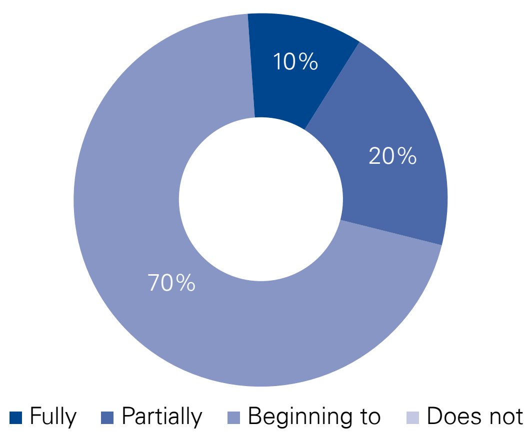
Integrated risk and performance management is an increasing priority for many institutions. In a positive industry trend, 38 percent of AMA respondents stated their ORM framework fully enables integrated risk and performance management, including regular metric reporting via dashboards, while an additional 46 percent stated they are progressing towards these goals. The majority of non-AMA institutions are at the beginning stages of these efforts (please see Chart 9).

Chart 9
Does your ORM framework enable integrated risk and performance management in your firm?

AMA



Non-AMA



May not equal 100% due to rounding

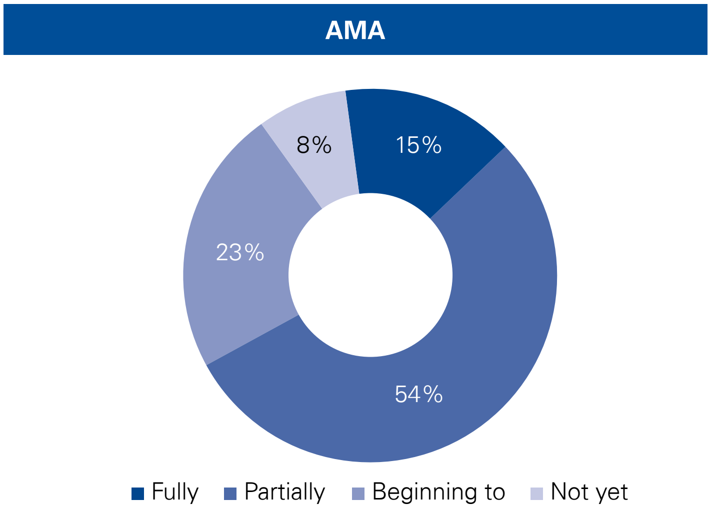
RESPONDENT COMMENTS

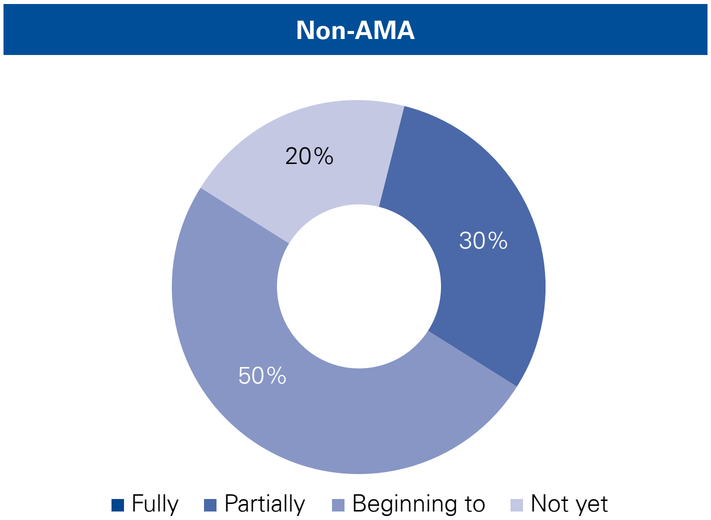
When asked if their ORM framework enabled integrated risk and performance management in their firm, respondents noted:

- "We recently formed a risk oversight and alignment group in order to facilitate an integrated approach. We are also working on establishing a risk assessment system platform in order to enable the capturing, monitoring, and reporting of risks derived from assessments performed by various risk groups, including ORM, audit, compliance, SOX, fraud, etc. Our goal is a coordinated approach to risk management."
- "Initiatives are underway to more fully integrate ORM with other risk pillar functions in order to identify gaps and areas of overlap."
- "Our ORM framework includes a cycle of ongoing risk and control assessments to drive businesses to integrate a risk focus into their ongoing management practices. Our dashboard reporting integrates risk and performance metrics to enable a broad understanding of the risk environment. Risk is also an integrated element of strategic planning. However, these practices are still being embedded in our businesses and implementation is not yet strong."
- "We have started the process and have linked risk and performance to the top executives of the institution and we are working on driving it further into the organization."

The majority of AMA and non-AMA respondents stated that ORM was fully integrated into their firm's ERM framework. However, quantifiable measures of risk appetite that span and link operational risk taking, business performance, and compensation have yet to be fully deployed (please see Chart 10).

Chart 10
Are your risk appetite thresholds empirically observable and do they span and link operational risk taking, business performance, and compensation?





RESPONDENT COMMENTS

When asked if their risk appetite thresholds were empirically observable and if they span and link operational risk taking, business performance, and compensation, respondents noted:

- "We need to more fully develop the linkage to economic capital."
- "We still need to link compensation."
- "We track various KRIs and key performance indicators (KPIs) with respect to established thresholds. Most of these have been established within the last year and managers are still learning from and adjusting them based on trends."
- "While our thresholds are observable, they are not all quantifiable, so judgment is involved. However, there is a link at the most senior level between risk, performance, and compensation."

Assessment, Measurement, and Management

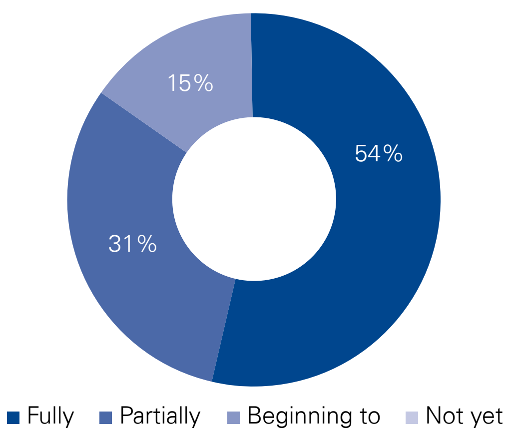
Risk Assessment

The ability to effectively identify, assess, measure, and manage risk is vital for operational risk excellence and strong risk management. Survey results show that operational risk assessment efforts continue to evolve and strengthen, including efforts to define and deploy forward-looking indicators.

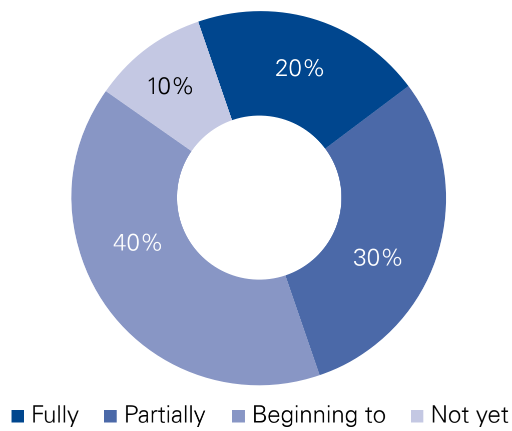
Over 50 percent of AMA and 20 percent of non-AMA respondents tie risk assessment identification, escalation, and management to their operational risk appetite, while others are working towards these efforts (please see Chart 11).

Chart 11
Do your ORM assessment processes (i.e., RCSA, KRIs, loss data, scenario analysis) tie to defined risk appetite/ thresholds for effective identification, escalation, and management of risk?

AMA



Non-AMA



With respect to forward-looking indicators, 15 percent of AMA respondents felt their ORM assessment processes fully serve as forward-looking indicators of current and emerging risk. Another 62 percent of AMA respondents stated they have made partial progress towards this goal and 23 percent were just beginning. As one would expect, results were less favorable for non-AMA respondents. Efforts to develop forward-looking indicators and enhance their predictability are vital as firms work to strengthen their capabilities to identify and manage operational risk. For AMA respondents, 23 percent of AMA respondents (versus 30 percent of non-AMA respondents) stated their ORM processes currently promote efficient risk taking and mitigation. Another 77 percent of AMA respondents (versus 50 percent of non-AMA) stated they are working towards, or just beginning, these efforts. Respondents stated efforts towards more efficient and effective risk taking and mitigation is evolving as business lines mature, risk appetite is further deployed, and risk acceptance and/or mitigation alternatives are evaluated.

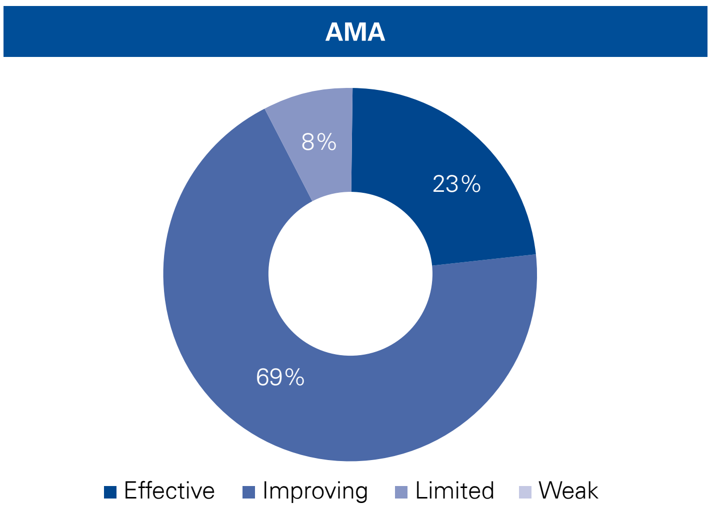
Roles and Responsibilities

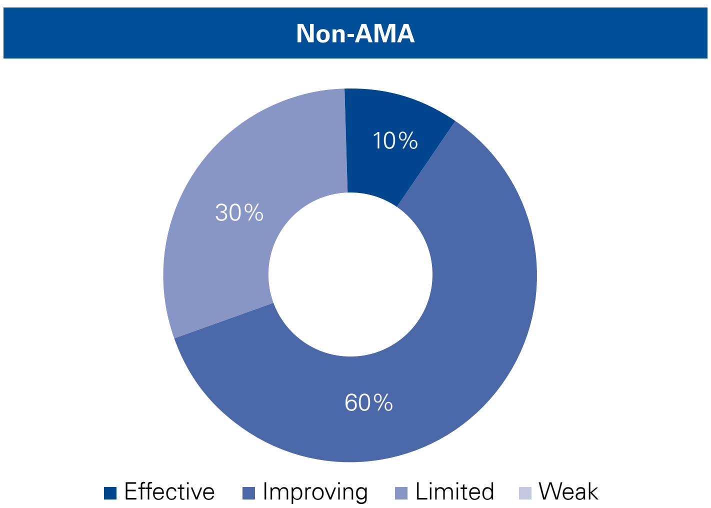
Consistent with the need to strengthen operational risk governance, over 50 percent of AMA respondents stated the need to further clarify roles and responsibilities across the 1st and 2nd lines of defense, including those impacting risk assessment in support functions, such as Finance, Human Resources, and Technology. For non-AMA respondents, 40 percent stated they are just beginning efforts to clarify roles and responsibilities—efforts critical for effective risk identification, assessment, measurement, and management.

Communication

A large majority of both AMA and non-AMA respondents indicated that communication between their 1st and 2nd lines of defense on emerging operational risks and changes to the internal and external environment is an area that needs strengthening. For instance, only 23 percent of AMA respondents felt communication was effective, and nearly 70 percent stated they were working to enhance communication. Respondents noted that several governance structures were in place to support communication, including committees, working groups, and structured meetings. Still, other respondents indicated that evidence of effective communication is difficult to provide and the tools and techniques to identify forward-looking and emerging risks are still in development. For non-AMA respondents, 30 percent stated their communication efforts were limited (please see Chart 12).

Chart 12
How effective is communication between the 1st and 2nd lines on emerging operational risks and on changes to the internal and external environment?





RESPONDENT COMMENTS

When asked about the effectiveness of the communication between the 1st and 2nd lines on emerging operational risks and changes to the internal and external environment, respondents stated:

- "Our 1st and 2nd lines collaborate to identify emerging risks and to assess and respond to significant changes in the internal and external environment. To be called effective, we need to embed more practices around follow-up and evidence of outcomes."
- "We discuss emerging risks in committees and as a part of the risk and control assessment process."
- "This is an area where we are looking to improve. With our initial roll out of RCSA, the focus has been more on current risks and we want to add a more forward looking approach."
- "The working relationships differ by business line."

Risk Taxonomies

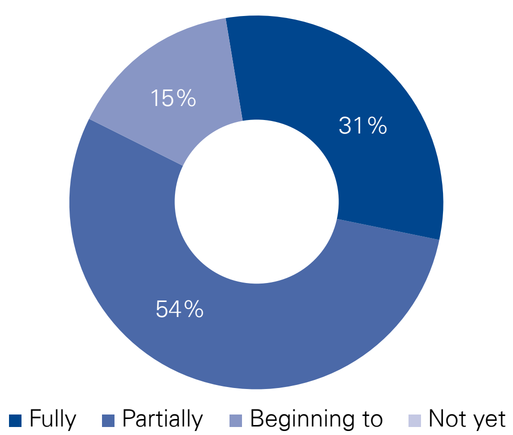
Almost 40 percent of AMA and non-AMA respondents stated they are beginning to establish, or have partially established, consistent ORM definitions and taxonomies across 1st and 2nd lines of defense. One respondent stated consistent definitions and taxonomies was the "corner stone" of their efforts to build effective ORM and ERM frameworks.

Risk Assessment Convergence

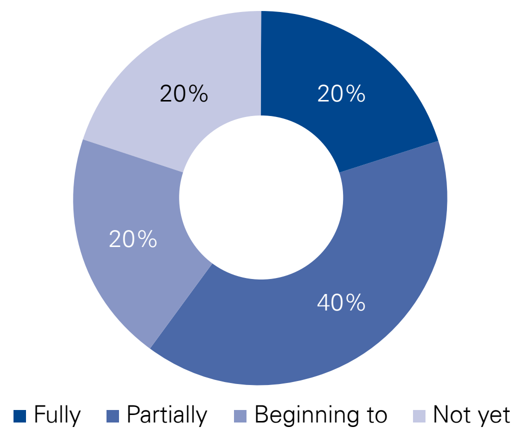
Reflecting the need for further risk assessment convergence in the industry, only 31 percent of AMA and 20 percent of non-AMA respondents stated they have established a consistent RCSA approach for multiple risk assessment types (i.e., ORM, compliance, business continuity planning, vendor, and information technology security). For AMA respondents, another 54 percent have partially established a consistent RCSA approach while 15 percent are just beginning these efforts. In the non-AMA category, 40 percent of respondents have partially established a consistent RCSA approach while 20 percent are just beginning these efforts and another 20 percent have not yet started (please see Chart 13). As these efforts progress firms can expect enhanced risk management effectiveness, integration, and efficiency.

Chart 13
Does your firm have a consistent RCSA process and approach across multiple risk assessment types (i.e., ORM, Compliance, BCP, Vendor, and IT Security)?

AMA



Non-AMA

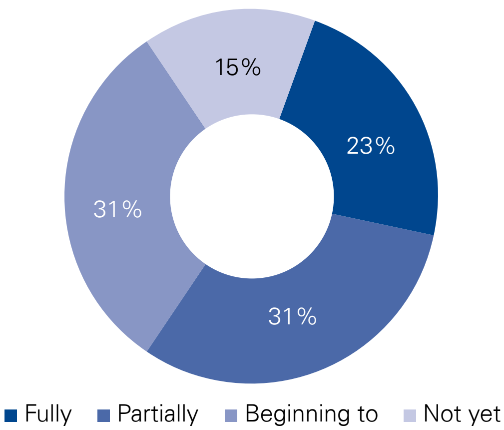


Back Testing & Calibration

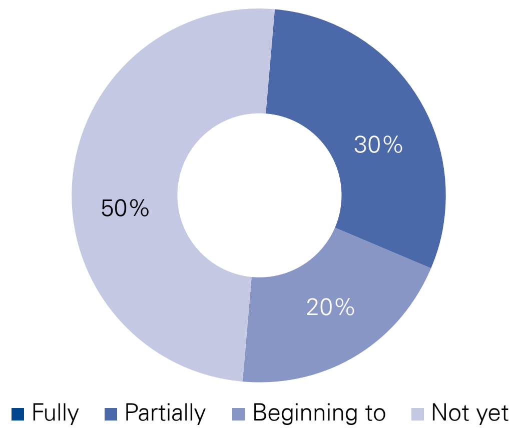
Just over 20 percent of AMA respondents are fully conducting back testing to confirm the accuracy and consistency of 1st line of defense operational risk assessments. Another 30 percent are well underway. However, 15 percent of AMA respondents have yet to begin and none of the non-AMA respondents are fully applying back testing (please see Chart 14). This is an important area of focus, as the value derived from using ORM data for risk intelligence and decision-making requires confidence and accuracy in the data.

Chart 14
Do you conduct back testing to confirm the 1st line of defense is accurately and consistently assessing operational risk?

AMA



Non-AMA



Stress Testing

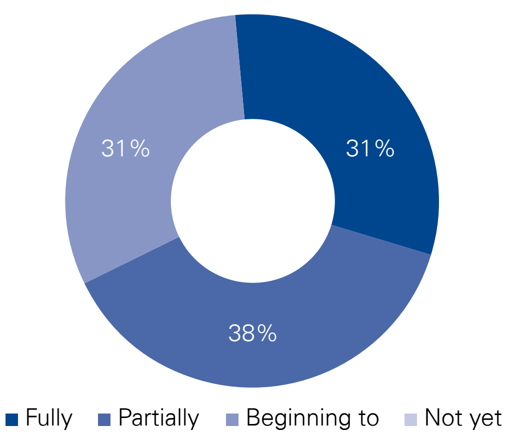
Over 60 percent of AMA respondents reported they stress test ORM capital against economic cycles, downturns, and tail events via their Comprehensive Capital Analysis and Review (CCAR) and/or other activities. However, 70 percent of non-AMA respondents either do not maintain ORM capital or have yet to stress test their ORM capital.

Challenge

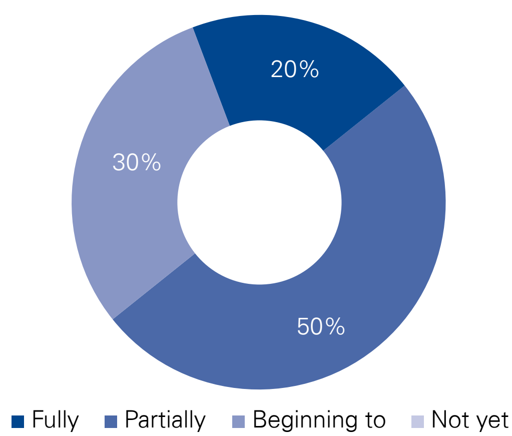
Effective "challenge" of the 1st line of defense continues to advance in the industry among AMA and non-AMA institutions, particularly with respect to RCSA tools and new product initiatives. Nevertheless, Survey results show there is still much to be done in this area, as 31 percent of AMA respondents (versus 30 percent of non-AMA respondents) stated that they are just beginning to provide effective challenge to 1st line assessment, monitoring, mitigation, reporting, planning, and strategic/tactical decision-making (please see Chart 15).

Chart 15
Does ORM provide effective "challenge" to 1st line assessment, monitoring, mitigation, reporting, planning, and strategic/tactical decision-making?

AMA



Non-AMA



RESPONDENT COMMENTS

When asked if their ORM provided effective "challenge" to 1st line assessment, monitoring, mitigation, reporting, planning, and strategic/tactical decision-making, respondents stated:

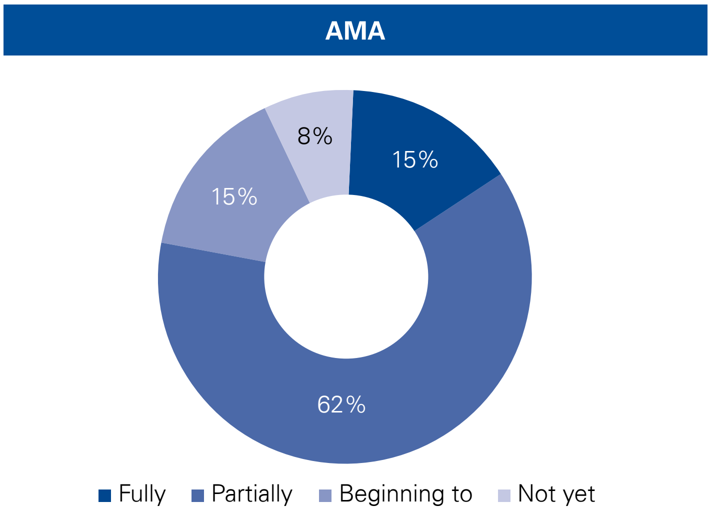
- "Our ORM 2nd line of defense is strong and we are building the ORM 1st line."
- "A lot of challenge occurs, but we are not yet fully capable of providing evidence of challenge and driving its consistency."
- "For RCSAs and new product assessments that have been completed to date, ORM has challenged control effectiveness ratings, particularly where inherent risks are higher."
- "Effective challenge is fully in place for assessment and monitoring. Planning and strategic/tactical challenge is still aspirational."
- "The presence of ORM is increasing with respect to strategic initiatives."

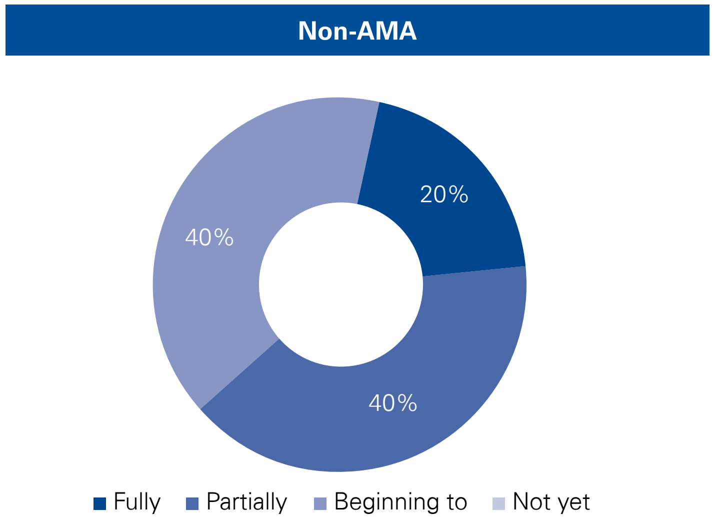
Towards the goal of effective challenge, Survey results did show that 31 percent of AMA respondents fully leverage their ORM framework to challenge business model options and returns, including the assumptions, risks, and controls embedded in their new products, mergers, acquisitions, and divestitures. However, it was surprising to find that another 31 percent of AMA respondents have not yet, or are just beginning, to apply effective challenge in these areas. With respect to non-AMA respondents, it was encouraging to see that 50 percent are at least partially leveraging their ORM frameworks to enhance challenge and to foster better risk management.

Risk Intelligence

Accurate risk information provides the "intelligence" firms need to make informed, risk-based decisions in day-to-day activities and strategic planning. As noted elsewhere, while many respondents are making important strides to enhance the quality of their operational risk intelligence, there is still much work ahead. For instance, only 15 percent of AMA and 20 percent of non-AMA respondents state they have fully calibrated their ORM assessment processes to create reliable, actionable risk intelligence for decision-making. For AMA respondents, 62 percent (versus 40 percent of non-AMA respondents) stated they are working to calibrate their processes and 15 percent (versus 40 percent of non-AMA) are just beginning these efforts (please see Chart 16).

Chart 16
Do your ORM assessment processes calibrate against each other to create reliable, actionable risk intelligence for decision-making?





It was also interesting to note that, while robust risk intelligence is still being developed, 69 percent of AMA and 50 percent of non-AMA respondents stated that their operational risk intelligence is at least partially influencing management behavior. Further, both AMA and non-AMA respondents stated business lines are maturing in both their ownership of risk and in business line use of "risk intelligence." As a result, 60 percent of AMA respondents and 40 percent of non-AMA respondents stated they were at least partially applying "risk intelligence" in business line decision-making.

Metrics Reporting via ORM Dashboards

With respect to operational risk metrics and reporting (covered further in the next section), 85 percent of AMA respondents (versus 20 percent of non-AMA respondents) stated their reporting includes ORM dashboards to alert Executive Management and the Board of changing risk conditions and to support decision-making. However, they also noted that enhancements to their KRIs, taxonomies, and links to capital are needed.

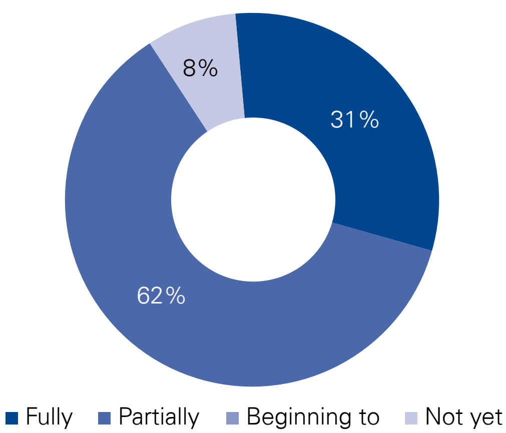
Early Identification & Escalation

Over 60 percent of AMA respondents stated their operational risk KRIs include triggers for early warning notification and management of risk. However, 20 percent of AMA and 50 percent of non-AMA respondents are just beginning to, or have not yet begun to, apply triggers. On a positive note, almost 100 percent of AMA respondents felt they have effective processes to escalate operational risk events (versus 80 percent for non-AMA respondents)—an important learning from the financial crisis.

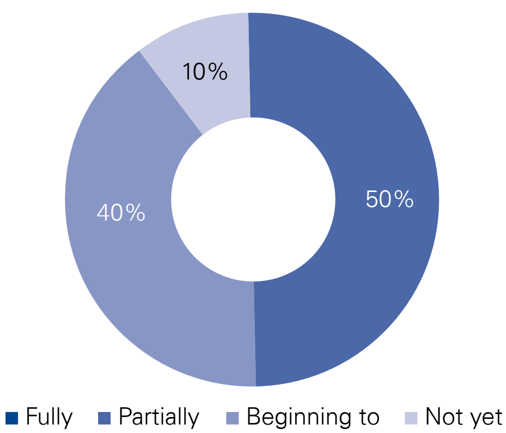
Almost 60 percent of AMA and non-AMA respondents stated they incorporate, or were well underway to incorporating, operational risk appetite and risk intelligence into their new business/product decisions to reflect process capacities and threats. Additionally, over 90 percent of AMA firms stated they have deployed scenario analysis to support capital planning, business decision-making, and process/system enhancement (versus 50 percent for non-AMA respondents). However, "near miss" analysis has yet to be broadly deployed by several AMA and non-AMA respondents—a potentially significant area of risk intelligence yet to be developed (please see Chart 17).

Chart 17
Do you incorporate "near miss" and scenario analysis to support capital planning, business decision-making, and process/system enhancement?

AMA



Non-AMA



May not equal 100% due to rounding

RESPONDENT COMMENTS

When asked about their ORM assessment processes, AMA respondents noted the following about their near miss and scenario analyses:

- "Our scenario analysis program produces part of our input to our AMA model (as a benchmark model against our internal loss model). Our formal standardized near miss assessment process is just being rolled out."
- "We have just implemented an operational risk scenario analysis program which will allow us to stress our operational risk environment, supplement our loss data with information relative to high impact/low frequency events, and more proactively enhance operational controls and processes."

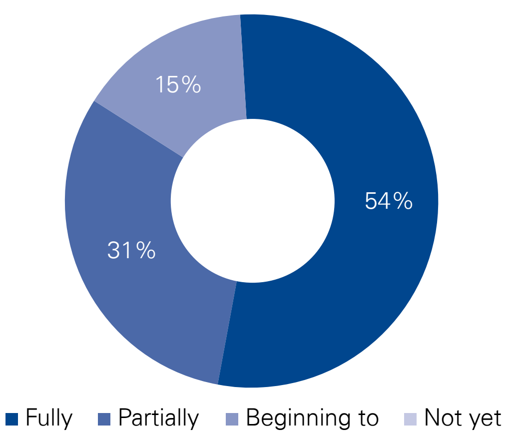
Data, Analysis, and Reporting

ORM Data, Analysis & Reporting

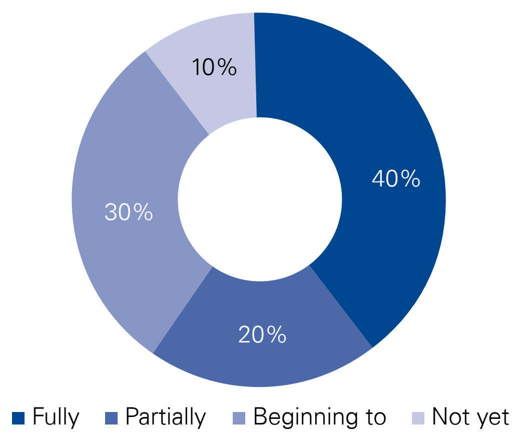
The ability to completely and accurately aggregate, analyze, and report ORM exposures is an essential capability of strong risk management and a requirement for global systemically important banks (G-SIBs), as noted in the Basel Committee on Bank Supervision's (BCBS) January 2013 publication entitled *Principles for effective risk data aggregation and risk reporting*. Data related issues are becoming increasingly important to AMA and non-AMA institutions as the regulatory community continues to stress the importance of sound risk data governance, aggregation, integration, and reporting. The Survey reveals that the industry is continuing to make advancements with respect to data quality. For example, 85 percent of AMA and 60 percent of non AMA respondents stated that their ORM data is fully, or partially, supported by effective governance, standards, and data stewards. Only 15 percent of AMA and 40 percent of non-AMA respondents stated they are beginning to, or have yet to, deploy effective data governance and standards (please see Chart 18).

Chart 18
Is your ORM data supported by clear governance, standards, and data stewards?

AMA



Non-AMA

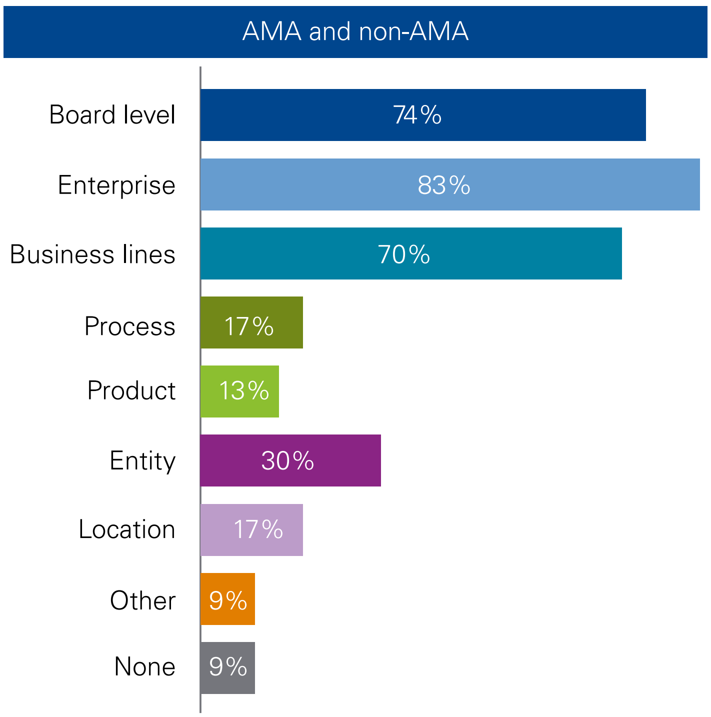


Further, 85 percent of AMA and 60 percent of non-AMA respondents state they validate, or partially validate, the accuracy and completeness of their ORM data through formal quality assurance (QA) processes. One respondent stated that, while some elements of their institution's QA process are quite new and are being refined, there is a comprehensive program in place that includes validation and monitoring of data quality. Another respondent noted that their validation efforts primarily leverage loss data and that they are working to develop additional validation approaches.

Almost 85 percent of AMA respondents and 50 percent of non-AMA respondents stated that their ORM dashboards were at least partially supported by integrated data and metrics. However, several respondents indicated that fully "robust" data quality is still on the horizon and management factors data accuracy and integrity into its decision-making and planning for this reason.

With respect to reporting, both AMA and non-AMA respondents noted that, while they have comprehensive ORM reporting at the Board, Executive, and business line levels, they need to enhance their reporting across other areas, such as process, product, location, and legal entity (please see Chart 19). The importance of producing complete, timely, accurate, and clear risk reporting across all material group entities was also echoed in the BCBS publication on effective risk data aggregation and risk reporting, and has received increased attention from regulators.

Chart 19
Do you have comprehensive reporting of operational risk and its impact on business strategy, performance, risk appetite and capital at the following levels?



Multiple responses allowed

RESPONDENT COMMENTS

Respondents revealed the following about the depth of their reporting levels:

- "We have a Board level report, but further enhancements need to be made. We are also focusing on entity, process, and business line reporting."
- "Reporting exists to cover all of these aspects, but we can improve reporting by consolidating it into one coherent picture from risk through to capital."
- "Operational risk reporting is developmental. RCSA aggregation allows for various reporting levels. Detailed reporting is at the division and department levels. High-level reporting is made to ORM and Board Risk Committees."
- "The correlation to business strategy and performance is not explicitly tied."

The Road Ahead

ORM plays an essential role in the strategic success of all financial institutions, and Survey results reveal that important strides continue to be made by both AMA and non-AMA institutions. ORM is improving its standing with other types of risk and its contribution to business/risk decision-making and strategic planning. Going forward, banks and other financial institutions need to expand efforts to deploy qualitative and quantitative measures of risk appetite across business lines, legal entities, processes, and other key areas. Firms need to broaden efforts to identify, assess, measure, and manage operational risk against defined risk appetite levels and thresholds. They also need to provide effective challenge to 1st line risk information and enhance data governance, integrity, and aggregation for greater risk intelligence and actionable reporting.

As financial institutions move forward, they are also likely to face considerable challenges in meeting competitive business pressures and in complying with the new heightened regulatory standards. Regulatory imperatives such as the Volcker Rule, OCC and Federal Reserve Board rules and supervisory guidance establishing heightened risk governance standards, new third party risk management guidance, Consumer Financial Protection Bureau compliance requirements, and the Basel principles for effective risk data aggregation and risk reporting all require expanded efforts by risk management and business lines to strengthen ORM.

The *KPMG/RMA Operational Risk Management Excellence – Get to Strong Survey* results are encouraging, as they confirm the industry is continuing efforts to further evolve ORM to provide enhanced business value and meet heightened regulatory expectations. Nonetheless, it is clear that there is still room for ORM to grow in order to truly become the "third leg of the enterprise risk management stool" along with credit and market risk.

KPMG and the RMA are appreciative of the respondents' support of this Survey and look forward to the further evolution of the ORM discipline.

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