Internal Loss Data Collection in a Global Banking Organisation

Operational Risk Policy & Support

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Contents

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I. Introduction - Defining the Site

Presentation Objectives

- **Explain how ABN AMRO started the process of operational loss data gathering**

- **What were the starting points, what were the considerations and what were the choices?**

- **What would we do the same, what would we do differently, what where the success factors?**

OpRisk Loss Mitigation

◆ **Where do we lose money?**

◆ **Where can we save money?**

 - High Frequency - Low Severity Events?

 - Low Frequency - High Severity Events?

 - Specific Risk Categories?

 - Do we recognise trends?

 - What does benchmark data show us?

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Loss data collection seems easy….

- ◆ **Define about thirty data fields**

- ◆ **Build an intranet based tool**

- ◆ **Roll it out world-wide**

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…. but reality is more complex

- Governance structure needed

- Existing initiatives

- Long wish lists from different parties involved

- Thirty data fields only partially recognised

- Cultural changes needed

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Starting point:

Wandering the data desert in search of a structure

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Facing reality….

- **Limited Central Resources**

  - 1.5 FTE on Corporate Centre Level

  - Working Group with BU ORM managers

- **Limited History in Tracking OpRisk Loss Data**

- **Uncertainty about Basel II**

- **No IT System Available**

- **Limited ORM Awareness**

- **No Local Resources for Loss Reporting**

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… and a long list of questions:

Who is responsible for inputting?

One CLD vs. Multiple LLDs?

Who is the owner of the data?

How to prevent double entries?   Boundary issues!

Granularity of event and cause categories (level 1,2,3,4?)

OpRisk Management vs. Basel

How to determine a threshold?

Event recognition vs. Effect recognition (CoA based)

Timing issues (when do you record a loss)?

One event vs. Multiple events (e.g 9/11 case)

Mapping to Regulatory LoB

What is a loss?

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II. Drafting the Blueprint

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Considerations

- **Inventory existing sources of loss data**

- **Inventory existing initiatives**

- **Resolve local vs corporate needs**

- **Define a "loss"**

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What did we find?

The Tower of Babel

Existing Sources of Loss Data (1)

◆ **Corporate Security Department**

◆ **Corporate Insurance Management**

- databases with more than 10 years of history

- focussed on <u>individual</u> criminal cases/insurance cases with

   related information (partly confidential)

- no possibility to do structured analysis on the database

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Existing Sources of Loss Data (2)

- ◆ **Legal Department**

  - Paper based files

  - Manual quarterly reports produced

  - No database system available to provide overview

  - It can take years before loss amount is definitive

- ◆ **Local retail banking databases**

  - Databases also maintain non-loss data (e.g. discounts)

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Existing Sources of Loss Data (3)

Ultimately, small fragmented databases existed:

- not mapped to the Framework for Operational Risk (FfOR)
- not consistent
- not aligned
- not adequately granular (details; # of data fields; ε values)
- workflow management requirements
- too much confidential information (e.g. names of suspects)
- documents needed to be attached

Thus, existing databases could not be readily used, but, they were a starting point to build upon.

Existing Initiatives

The **International Division** piloted a loss data gathering process in three locations

Observations:
- not aligned with the FfOR
- included indirect losses and near misses which made the process difficult to execute

Conclusions:
- adopt one framework world-wide
- keep it simple

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Results of our search:

Some structure existed, but it was jumbled.

Loss Database

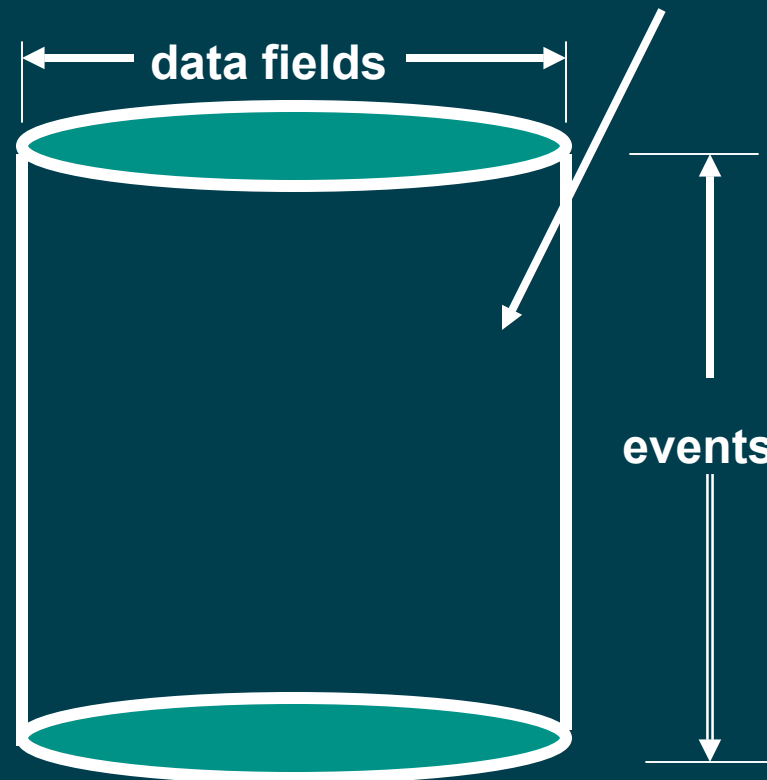- **Some BUs prefer a Local Database to fulfil local needs**

- **Therefore the "Core" Corporate Loss Database (CCLD) concept was introduced**

- **Local loss databases (LLD) allowed under the condition that:**

  - **All Core CLD data is maintained in the LLD**

  - **Minimum requirements are met (e.g. timeliness of reporting, mapping to Framework for OpRisk)**

Architecture of Loss Databases
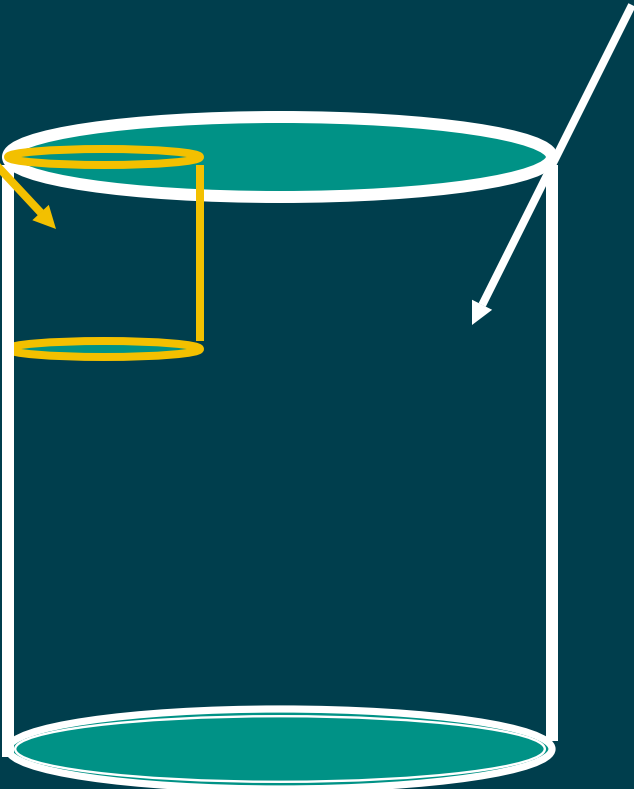
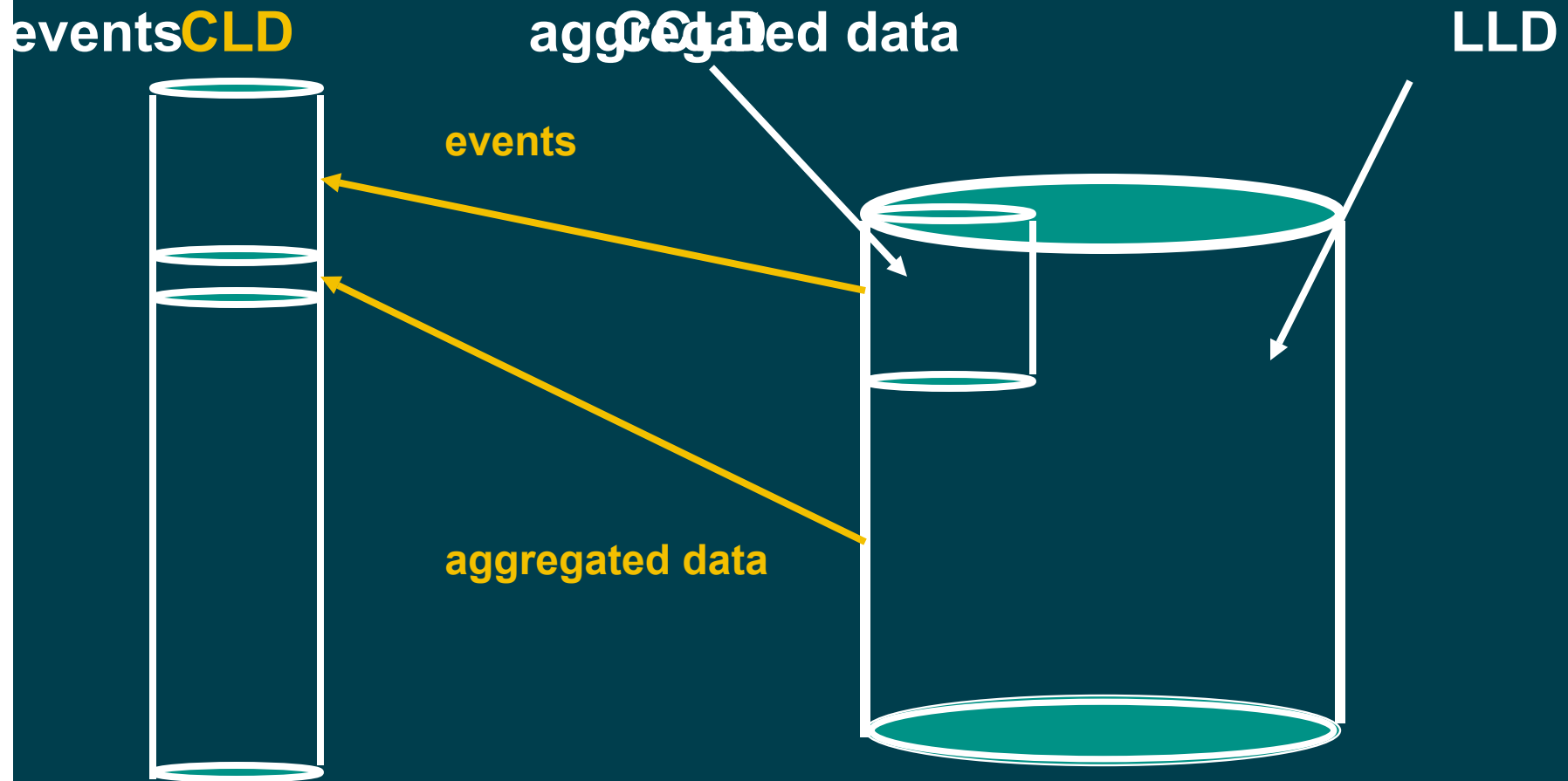events   **aggregated data**   **LLD**

data fields

events

events   CCLD aggregated data   LLD

Architecture of Loss Databases

events**CLD**   agg**CCLD**ed data   **LLD**

events

aggregated data

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The most fundamental question: "What is the loss?"

+ ε **10,000,000**   **fraud**

- ε 6,000,000   recovered

+ ε   400,000   cost for recovery

- ε 3,000,000   insurance claim

- ε   ?   insurance premium

+ ε   100,000   internal investigation/resolution cost

+/- ε   ???

What is the loss???

What is the loss?

- ε **10,000,000 ???**

- ε **1,400,000 ???** ———→ **debatable!**

- ε **1,300,000 ???**

Not Debatable:

All this information is relevant for analysing OpRisk and/or establishing OpRisk mitigation programs and therefore should be stored in a Corporate Loss Database.

Solution: Report All Loss Details

Loss Amount	Loss Details
Gross Direct Loss	• Reported Loss • Amount claimed by third parties
Recovered amount (-/-)	• Amount recovered (trading / from third parties) • Amount paid by CIM (Internal insurance company) • Amount received from external insurance companies
Incident Costs (+/+)	• Investigation costs • Legal costs • Other costs
Net Total Loss	• Direct Loss amount -/- Recovered +/+ Incident costs

Interesting possible result:

An operational risk <u>gain</u> could be reported!

Outcomes

- **Philosophy for Migration Path to be developed**

- **Definition of Loss Event needed**

- **Reporting Rules to be defined**

- **Governance Structure required**

- **A simple Corporate Loss Database needed to begin**

Building towards the next phase of development

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Needed to define a new structure:

Something quick, portable, and easy to use.

III. Beginning Construction

A proper foundation was crucial...

… to ensure the structure was built to last!

Philosophy for Migration Path

- ◆ **Define starting points that are indisputable**

  (e.g. full alignment with Basel II)

- ◆ **Make clear what is Corporate and what is Local**

- ◆ **Only ask for data that you are "entitled" to ask for**

- ◆ **Start simple, grow to increased sophistication**

AAB Definition of a Loss Event

An operational loss event is an incident caused by:

- **illegal/unauthorised activities or unintentional mistakes made by internal/external personnel;**

- **a failure/shortcoming in internal processes / systems / control measures; or**

- **external disasters**

that has lead to a P&L effect according to GAAP

Reporting Rules (1)

Mandatory:

◆ **Report losses with a gross loss above ε 5,000**

- **Loss Data Consortia $ 25,000**

- **QIS ε 1,000 - 10,000 (retail - wholesale)**

- **ABN AMRO's choice ε 5,000**

◆ **Fulfil centrally defined data requirements, based on:**

- **Basel requirements**

- **ORM needs**

- **Business management needs**

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Reporting Rules (2)

Optional:

- **Losses below ε 5,000**

- **Near Misses**

  (potential events prevented from happening)

- **Indirect Losses**

  (loss effects not recognised in the P&L per GAAP)

Governance (1)

Corporate Centre (ORP&S) responsible for:

- Defining high level policies and procedures

- Providing functional and technical system support

- Maintaining user administration

- Checking high level consistency

- Reporting to Senior Management

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Governance (2)

Local ORM responsible for:

- Implementing locally

- Authorising users

- Checking correctness and completeness

- Developing local procedures

- Reporting to local management

Governance (3)

The business is responsible for:

- Recognising events

- Inputting and maintenance of data

- Achieving correctness and completeness

Corporate Loss Database (CLD)

- Logon
- Incident
  - Insert
  - Update
  - Delete
  - View
- Users
- Password
- Help
- Feedback

Discovery date	12 ▼ Nov ▼ 2002 ▼	Discovered by :	Olaf Streutker
Start date	12 ▼ Nov ▼ 2002 ▼	End date	12 ▼ Nov ▼ 2002 ▼
Near Miss :	⦿ Yes ○ No	Suspect Known :	○ Yes ⦿ No
Reputational damage :	○ Yes ⦿ No	Internal :	○ Yes ⦿ No

Loss Details :

Loss details
Gross Loss
-/- Recovered
+ Incident Costs
= Net Loss

Currency	EUR ▼	
Gross Direct Loss	50,000.00	Reported Loss
		Amount claimed by third parties
Recovered Amount	45,000.00	Amount recovered(trading / from third parties)
		Amount paid by CIM(Internal insurance company)
		Amount received from external insurance companies
Incident Cost		Investigation costs
		Legal costs
		Other costs
Net Total Cost :	5,000.00	Net Total Cost

[Update] [Print]

Corporate Center - Operational Risk Policy & Support - Lotus Notes Address: CLD Support Team

IV. Expanding the Plan

Current Structure

- **Network includes 500 users world-wide**

- **Eight local Co-ordinators world-wide**

- **Reporting line to Group ORM Committee (Managing Board level committee)**

- **Corporate Operational Risk Policy Sounding Board (CORPS) forum for all policies, including data collection**

- **ORP&S chairs Operational Loss Working Group (OLWG) as a forum for co-ordination**

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Loss Data Collection and AMA Qualification

GOAL: Collect three years of complete and correct operational loss data by 1 January 2007.

Option 1: Compile loss data set on 31 December 2006.

Option 2: Start collection process, with intent to back-fill data as needed to 01 January 2004.

Option 3: Complete process in place by 01 January 2004.

- ◆ **Define what must be achieved by 01 January 2004**
- ◆ **Compile an inventory what can be done later**
- ◆ **Prepare a gap analysis**

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Despite initial accomplishments….

…we knew we needed to keep building.

Next Steps

- **Introduction of CoCoCo principles**

  (Coverage, Completeness, Correctness)

- **Introduction of G/L Accounts for Operational Losses**

- **Procedures for co-operation between Finance and ORM**

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CoCoCo

- **Coverage**

  Implement an infrastructure (technical/procedural) to capture operational losses <u>world-wide</u>

- **Completeness**

  Implement procedures to identify <u>all</u> operational losses

- **Correctness**

  Implement procedures to guarantee that all data fields are entered <u>accurately</u> into the CLD

OpRisk Loss Recognition

Three options to populate loss database:

1. Event Recognition

2. Via G/L Entries (input)

3. Derived from G/L Data (output)

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1. Event Recognition

- **Directly linked to ORM knowledge**

- **Completeness dependent on awareness, discipline**

- **Positive for correctness of data**

- **Cumbersome reconciliation to G/L**

2. Via G/L Entries

- **Finance personnel are not (fully) ORM aware**

- **It is not the core task of Finance**

- **Reduces correctness (and completeness?)**

- **Reconciliation is easy (same source!)**

3. Derived from G/L Data

- **Inconsistent identification of events**

- **Multiple G/L entries per event lead to multiple events**

- **Categorisation (especially cause categorisation) is difficult**

Enrichment of G/L data could lead to improvement
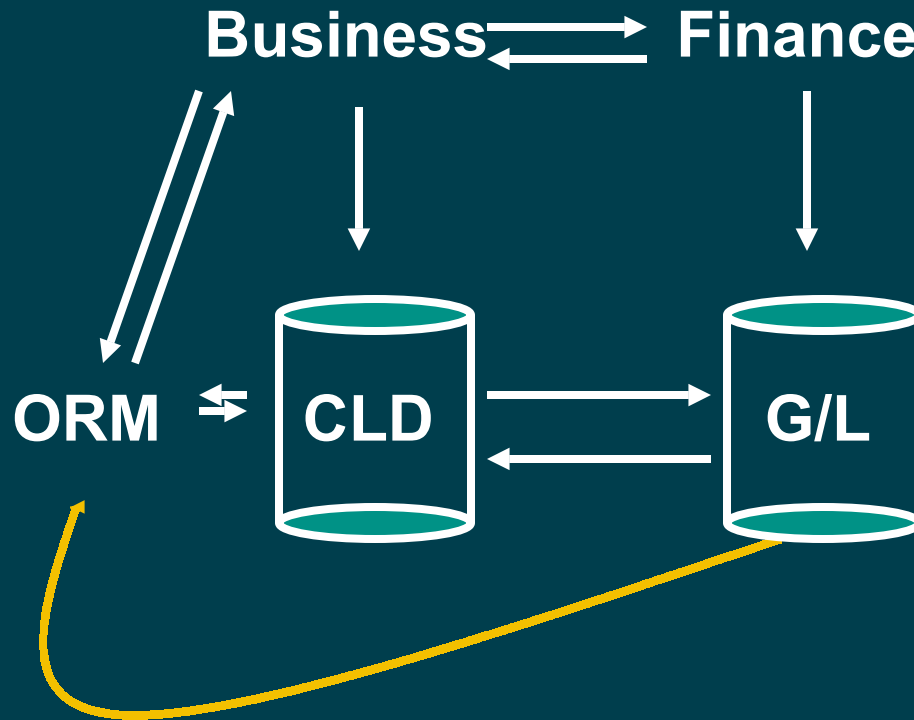
OpRisk Loss Recognition
Which method to choose?

◆ **None of the approaches in isolation will deliver full completeness and/or correctness**

A combination of these methods is preferred

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Operational Loss Recognition - ABN AMRO's Approach

Stay down to earth…..

…expensive, obsolete, and not in use.

Further Improve CoCoCo (1)

On Site Visits:

- Identify what goes well and what goes wrong

- Assess use of (local) procedures

- Assess co-operation with business/ORM/Finance

- Assess awareness/knowledge

- Compile inventory of best practices

- Co-ordinate with Audit and local ORM

Further improve CoCoCo (2)

- ◆ **Evaluate all documentation**

- ◆ **Improve documentation as required**

- ◆ **Provide complete CLD toolkit with all documentation:**

  - **training materials**

  - **procedures**

  - **examples**

- ◆ **Present CLD roadshow**

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V. Concluding Remarks

Concluding Remarks

- **Things we would do the same again**

- **Things we would do differently**

- **Success Factors**

- **Final Remarks**

- **Questions?**

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Things we would do the same again

- **Start simple**

- **Learn by doing**

- **Standardise Cause and Event categories**

- **Involve local ORM co-ordinators**

- **Communicate intensively with business management**

- **Focus initial implementation in receptive areas**

- **Incorporate CLD in ORM awareness programs**

- **Provide economic capital bonuses**

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Things we would do differently

- **Centralise control of implementation**

- **Grow faster in sophistication**

- **Increase dedicated resources**

- **Perform regular sanity checks CLD data (resources!)**

- **Put more effort into specific training materials**

- **Increase ORP&S involvement in local CLD awareness sessions**

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Success Factors

- **Senior management support (e.g. Group ORM)**

- **Effective functional support in the Corporate Centre**

- **CLD procedures and definitions in ABN AMRO Administrative and Organisation Manuals**

- **Economic capital incentives**

- **Intensive ORM Awareness Programs:**
  - **ORM Training**
  - **Risk Self Assessments**
  - **ORM Game**

Final Remarks

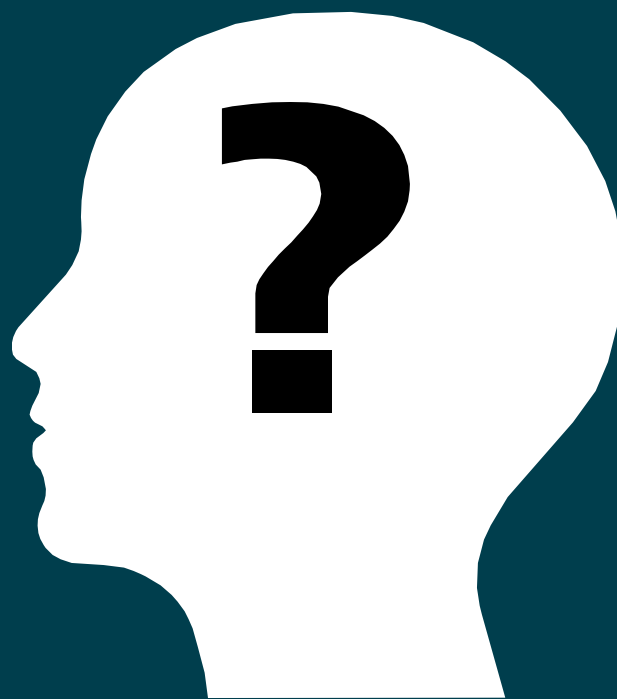- Implementation of the CLD is a success

- The loss data collection process is a continuous challenge

- Ongoing attention is required

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Our goal: To create a structure of unquestionable stability and reliability:

ABN AMRO Bank NV Corporate Headquarters

Questions?

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The Netherlands-based ABN AMRO is a leading international bank with total assets of approximately ε 556 billion. It has over 3,000 branches in 66 countries and territories, and has a staff of about 105,000 full time equivalents world-wide.

ABN AMRO operates through three Strategic Business Units, each responsible for managing a distinct client segment. Wholesale Clients provides integrated corporate and investment banking services to corporate, institutional and public sector clients world-wide. Consumer & Commercial Clients focuses on retail and SME clients in three home markets - the Netherlands, the US and Brazil and in a number of selected growth markets. Private Clients & Asset Management provides private banking services to wealthy clients and investment products to financial intermediaries and institutional clients.