

# Implementing a Sound Operational Risk Management Framework at HSBC

Hazel Taylor

Head of Operational Risk and  
Regulatory Reporting  
HSBC Holdings plc

# Context - the HSBC Group

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- We operate in 76 countries
- Not all are EU or G-10 members
- We have diverse portfolios and operations

# The HSBC Approach

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- Harness the intellectual expertise dispersed in Group
- Avoid pointless bureaucracy
- Don't issue orders from Group if you want buy-in!

# Early history

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- Set high level principles - May 2002
- Told sites to apply these in their environment
- Harvested the results after a year of experimentation - June 2003

# Promoting best practice

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- Identify and promulgate best practice - GCL  
Dec 2003
- Site visits to “spread the word” throughout  
2004
- Enshrine in detailed company instruction  
manuals - FIM Jan 2005

# Components of the OpR framework

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- Risk identification and assessment
- Actions/controls
- loss data collection
- KRIs (being developed)

# Risk self-assessment

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- Brainstorming sessions
- What risks keep you awake at night?
- Distinguish between inherent risk and controls in place
- Express in common risk language

# HSBC Operational Risk Matrix

- Impact x Likelihood = Inherent level of Risk
- Exposure = effect of controls/mitigation

		<i>E X P O S U R E</i>				
		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>R</i>	<i>&gt; 10</i>	C	B	B	A	A
<i>I</i>	<i>8-10</i>	C	C	B	B	A
<i>S</i>	<i>5-7</i>	C	C	C	B	B
<i>K</i>	<i>3-4</i>	D	C	C	C	B
	<i>0-2</i>	D	D	C	C	C



# Risk Self-Assessment current status

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- All major sites have assessed their risks at least once
- Minimum annual review required or when there is significant change
- In practice some regions chose a quarterly cycle to revisit their risks

# Action plans and controls

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- Assigned to high inherent risks
- Tracked by line management
- May be no action - accept risk
- Record of the risk reward profile judgement

# OpR Loss Reporting

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- Integral part of Operational Risk Management process
- Losses have been reported to Group since January 2001
- Quarterly Group Loss Reporting

# Why report losses?

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- This will lead to:
  - Improved risk management
  - Improved efficiencies
  - Improved business decision making
  - Meeting regulatory requirements!

# Individual incident loss reporting

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- Nearly six years experience with loss data
- Many issues about quantification of individual losses
- Boundary issues between credit and OpR

# Loss reporting issues

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- Near misses and potential losses
- The nightmare of “reconciling” to the financial records!
- We handle by providing individual guidance and then standardise via reporting instructions/FIM

# How do we record our OpR framework?

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- Group Operational Risk Database Online Network (GORDON)
- Web-based browser
- Risks input and approved by business line

# Implementation and rollout

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- Live for risk self assessments
- Loss reporting (was previously Excel based)
- All losses linked to risk assessments
- Language translation – Brazilian Portuguese, Spanish & French.
- Matrix management reporting being developed



HSBC Bank USA, N.A. - Risk Add - Microsoft Internet Explorer

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Address http://mcswebprd.eds.us.hsbc/opr/servlet/com.hsbc.us.pcms.opr.servlet.risk.UPHHiskAddPage Go

Menu

**GORDON**

- Risks
- Compliance Risk
- Templates
- Loss Events
- Unit Hierarchy
- KRI
- Controls
- Overview By Unit

**Management Control**

Customer Support

Group/CFU 44 20 799 21380  
 US (716) 841 7140  
 UK 44 20 7991 0309  
 CA (604) 641-3027  
 AP (852) 2288 0294

## Risk Add

To add a new Risk, complete the following information, then click **Next**.  
 To return to the Risk Summary page without updating, click **Cancel**.  
 The \* indicates a mandatory field.

<b>Risk Title:</b> *	<input type="text"/>
<b>Business Unit:</b> *	HSBC Holdings plc
<b>Primary Risk Type:</b> *	Select One
<b>Secondary Risk Type:</b> *	Select Primary Risk Type First
<b>Tertiary Risk Type:</b> *	Select Secondary Risk Type First
<b>Unit Reference:</b>	<input type="text"/>
<b>Risk Categories:</b> *	
Operational <input checked="" type="checkbox"/>	FDICIA <input type="checkbox"/> Sarbanes <input type="checkbox"/> Compliance <input type="checkbox"/> Fiduciary <input type="checkbox"/> Credit <input type="checkbox"/>
Insurance <input type="checkbox"/>	Economic Capital <input type="checkbox"/>
<b>Insurance Category 1:</b>	Select One
<b>Insurance Category 2:</b>	Select Insurance Category 1 First

Impact Score *	Likelihood Score *	Exposure Score *	Overall Risk Assessment
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

HSBC Bank USA, N.A.: Loss Event Add - Microsoft Internet Explorer

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Address <http://mcswbuat.ods.us.hsbc/opr/servlet/com.hsbc.us.pcms.opr.servlet.lossEvent.OPRLossEventAddPage> Go Links >>

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 AP (852) 2288 0294  
 HBIO (847) 291-3309  
 HTSU (716) 841-7126

## Loss Event Add

To add a new Loss Event, complete the following information, then click **Next**.  
 To return to the Loss Event Summary page without updating, click **Cancel**.  
 The \* indicates a mandatory field.  
 The \* indicates a mandatory field when "Near Miss" is set to "No".

**Loss Event Title:** \*

**Loss Event Description:** \*

**Clean Description:** \*

**Near Miss?:** \*

**Remedial Action & Lessons Learnt:**

**Security Case #:**

**Country Of Loss:** \*

# Governance

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- Group manuals structure used
- Approved by Board
- Reporting to committees of Board
- Locally, challenge process by the ORMG

# ORMG

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- Oversees OpR framework in site/business
- Challenges business OpR assessments and loss data
- Reviews exposures and mitigation
- Escalates issues to executive management

# Six key principles

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- Board awareness
- Subject to Internal Audit
- Senior management implementation and responsibility

# Six key principles (cont'd)

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- Risk identification
- Monitoring
- Mitigation and control

# Principle 1 - Board awareness

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- Policy set out in Group Standards Manual
- Reporting to Risk Management Meeting  
(delegated authority from the main Board)
- Reporting to Group Audit Committee (GAC)

# Principle 2 - Internal Audit

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- Close liaison with Group audit - informed them of development of the OpR framework
- OpR is an input to risk based auditing process
- Audits carried out of major Group sites implementations



# Principle 3 - Implementation and Responsibility

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- Group Circular Letter issued by Group COO & CFO
- Framework issued as FIM endorsed by Group COO and Group CFO
- Formation of local ORMGs with Senior Executive membership in all Group sites

# Principle 4 - Identification & Assessment

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- Risk Self Assessment framework
- Impact x Likelihood = Inherent Risk  
(Score 1-5 on variables)
- Overlay exposure/controls over the inherent risk
- Inherent risk x control = mitigated risk
- All risks graded A,B,C or D

# Principle 5 - Monitoring

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- Losses and risk assessments reviewed and challenged by the ORMG
- Feedback reports on loss events provided to Group sites to share learning experience
- Reports to Risk Management Meeting and Group Audit Committee

# Principle 6 - Mitigation & Control

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- Risk limitation and control strategies are part of risk identification and assessment
- As with all Banks, we manage our risks
- We do not mitigate all our operational risks
- We decide based on the risk/reward profile.

# Management - Training

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- Local sites implemented training to meet business needs e.g. case studies, workshops.
- Material live on Group Intranet January 2005

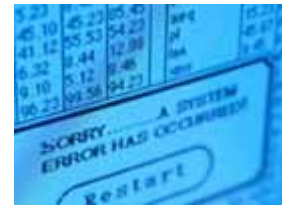
People



Process



Systems



External



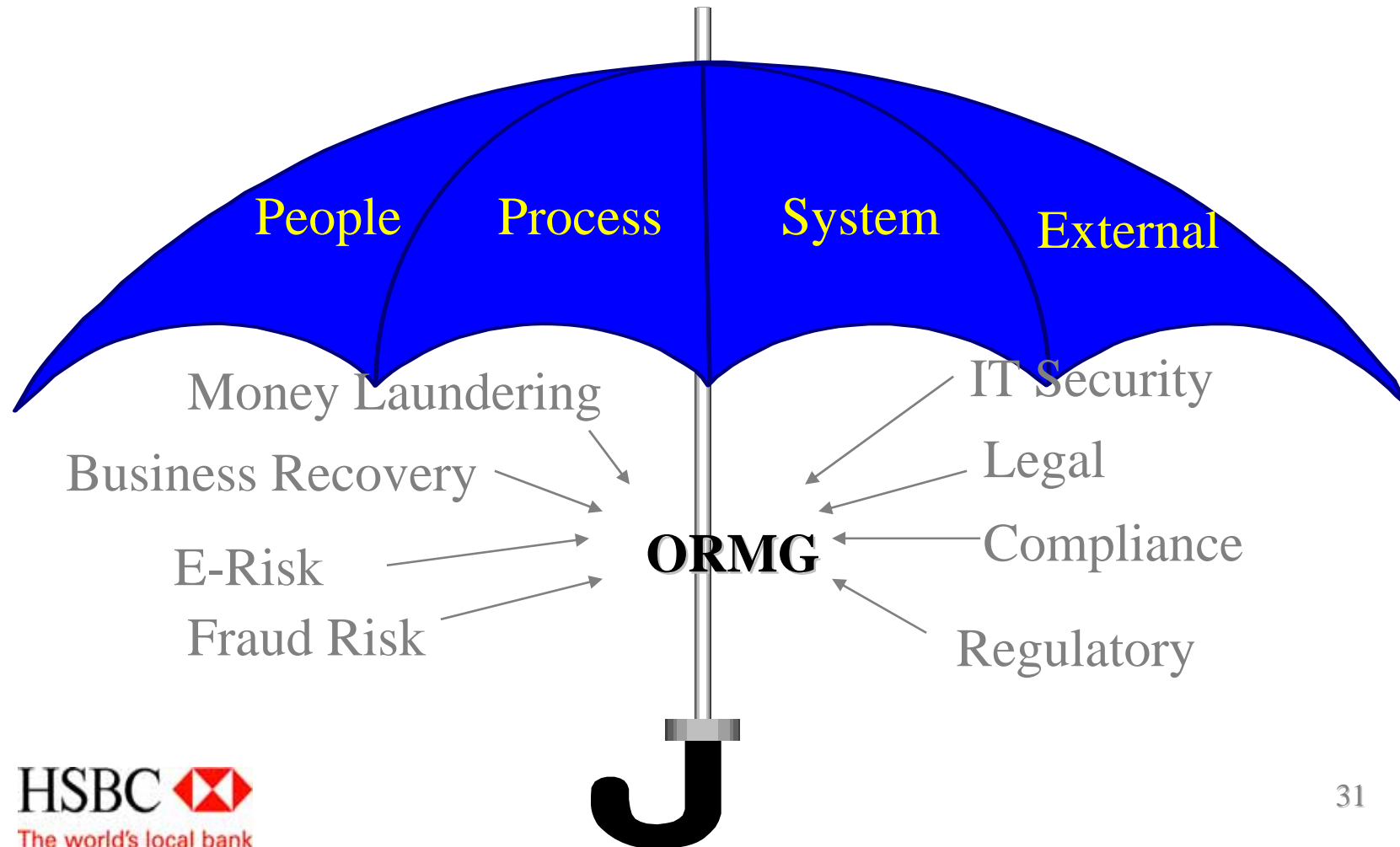
# Education and awareness

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- Article in staff magazine in UK
- face to face training in most Group companies
- “One eyed” monster - Brazil
- Poster campaign – Australia
- Operational risk conference May 2005 and June 2006

# Operational Risk Umbrella

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# Do we believe that we have finished our OpR framework?

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- NO! because OpR is dynamic
- And so is our framework
- We see much potential for future added value



# Future developments for our OpR framework

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- Quality Assurance over sites risks self assessments /benchmarking
- Understand value from linking loss data to risk self assessments.
- Identify and use of generic risks
- Enhanced management reporting to Executive Management
- KRI development is being piloted in a number of Group sites

# Role of measurement - HSBC philosophy (1)

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- We plan to adopt the Standardised Approach for the Group
- But we comply where the local regulator requires AMA
- Currently only our US operations are required to do AMA

# The role of measurement - HSBC philosophy (2)

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- Measurement adds value only if it contributes to management
- We have an AMA which directly harnesses our risk assessments
- The development is being closely monitored

# Any Questions?

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