

Operational Risk Management (ORM)

Suitable audience: CFO, CEO, CRO

WHY ORM MAKES SENSE?

- Basel II requirement
- 15% of gross profit is a price
- how large capital needed?
- a way to reduce capital requirements

CHALLENGES

- quantifying operational risks
- collecting appropriate data
- choosing a framework
- getting board involvement.

DEADLINES

- January, 2009 for banks
- ~2011 for insurance companies

NEXUM ORM ENSURES

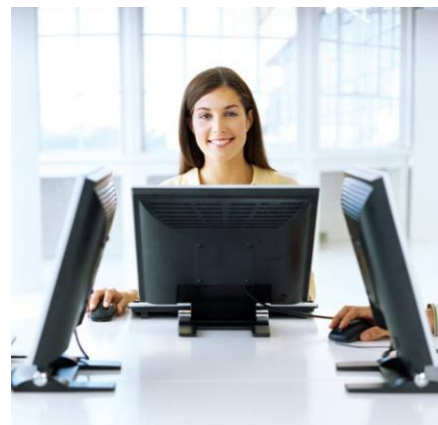
- lower capital set-asides under Basel II requirements
- risk mitigation and high personnel and management involvement
- high degree of outsourcing capabilities of ORM functions
- step-by-step implementation of advanced measurement technique

Executive summary

- Basel II regime acknowledges the importance of risks other than credit risk and requires that financial institutions set aside capital for coverage of losses associated with **operational risks**.
- **15% of gross profit** is a price of failing to apply advanced measurement technique for demonstrating **how much capital the company needs** to cover operational risks.
- In order to support the efforts of financial companies **to reduce this number** supervisory institutions' position is to encourage development of individual operational risk management (ORM) frameworks suitable for particular credit organizations.

Deadlines for ORM

Financial institutions need to have consistent data of at least 4-5 years in order to qualify for the use of advanced measurement tools for operational risks. Therefore, in order to avoid a requirement to set aside a lot of capital (in Jan 2009 for banks, in ~2011 for insurance companies), credit organizations must start setting up their operational risk programs as soon as possible.



ORM Challenges

There are numerous challenges related to the advanced measurement approach in operational risk management. Most widely acknowledged are:

- quantifying operational risks
- collecting appropriate data
- choosing an appropriate framework, i.e. combination of qualitative and quantitative techniques
- getting management and board involvement

NEXUM ORM SERVICES

- **Business analyst expertise**
(1st and 2nd phases of Nexum ORM framework cycle)

- **Collection of loss data, software**
(3rd and 4th phases of Nexum ORM framework cycle)

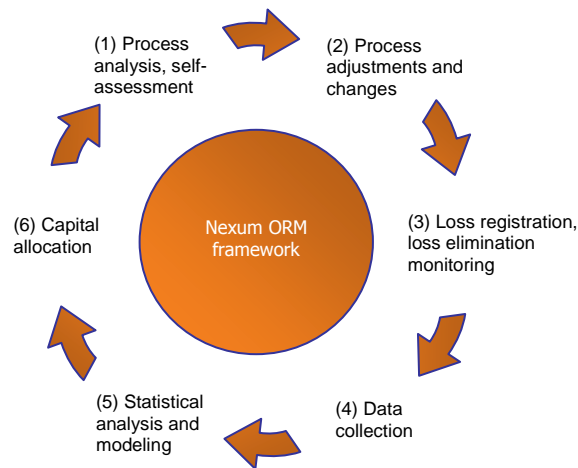
- **Qualitative and quantitative research consulting**
(5th phase of Nexum ORM framework cycle)

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Nexum ORM framework



Advanced measurement technique is at the heart of **Nexum ORM framework**. It addresses key challenges of ORM making possible to **reduce the amount of capital** organization must set aside.

It targets both the management and a regular employee making ORM a natural part of company's everyday life. While it **brings a complete measurement of operational risk** exposure of the company for the management it also **helps operational departments to get through the incidents as fast as possible** and mitigate the impact of the materialized risk.

Nexum Operational Risk Management framework is a management cycle consisting of qualitative and quantitative techniques used to evaluate and quantify operational risk exposure of an organization.

Process audit, process adjustment

The cycle begins with process audit, which maps all processes within the organization, and process analysis, which **finds gaps in the processes and locates points of potential losses**. Along with independent process analysis, risk self-assessment is completed across all business units to comprehend internal risk perception of managers at all levels. Self-assessment and process analysis help **establish key risk indicators** as perceived by company employees and management.

Loss registration and elimination

Key risk indicators set guidelines for **loss registration and elimination monitoring software** – a risk management tool. Its purpose is twofold:

- **Collection of loss data** based on the real incident resolution track records. This information is very precise and is not based on management surveys only.
- **Minimization of loss** by providing people incident resolution paths.

Statistical analysis and modeling

Statistical analysis of data collected through loss registration software establishes preliminary operational risk capital, whereas simulation and scenario analysis adjust the initial estimate taking into account future directions of the company.

Capital allocation, next cycle

Such quantitative analysis leads to **setting aside an appropriate level of capital** for operational risk coverage. In 6-12 months the cycle returns to qualitative analysis. Through self-assessment and past experience it sets new priorities for operational risk management, which are explicitly integrated into the software tools that are used within the organization.

About NEXUM Insurance Technologies

Nexum Insurance Technologies specializes in software and business solutions for financial institutions, particularly in the field of business process discovery, analysis and management (operations management). Based on experience in the banking and insurance sector, process consulting for financial institutions, Nexum Insurance Technologies delivers a comprehensive approach to ORM implementation in few weeks.

