The ANZ RDCA Implementation

Risk Management Group's Conference on
Leading Edge Issues in Operational Risk Measurement
Federal Reserve Bank of New York

New York, 30 May 2003

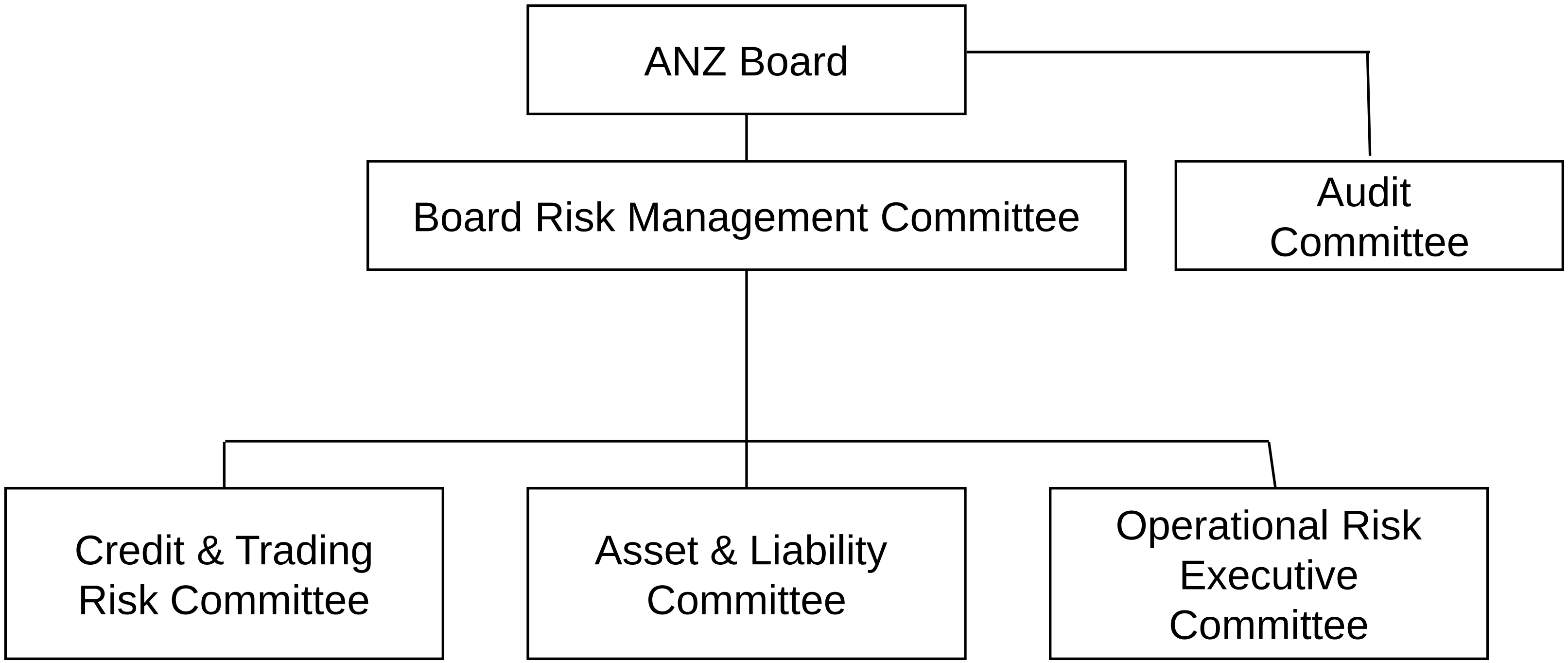
Dr Mark Lawrence
Group Chief Risk Officer
ANZ Bank
Melbourne, Australia

The ANZ RDCA Implementation: *Generating Business Unit Buy-in*

Agenda

- Organizational Context
- RDCA implementation:
  - Specific objectives
  - Project plan and timeframe
  - Project structure
  - Business Unit involvement
  - Internal Audit
- Economic Value Added: "EVA"
- *Demonstration:* "Manage My Capital"
- Benefits

ANZ Governance Structure



Credit & Trading Risk Committee

- Policy
- Major Lending Decisions
- Asset Writing Strategies
- Portfolio Management
- Trading Risk

Asset & Liability Committee

- Balance Sheet Risk

Operational Risk Executive Committee

- Regulatory Compliance
- Payments/operational risk
- Security

ANZ Risk Management Goals

“Risk management at ANZ will be directed to achieve strong risk control, resulting in no “surprises" for management and the market, and a distinctive risk management capability, enabling ANZ business units to meet their performance, growth and breakout objectives”

Group Risk Management Goals

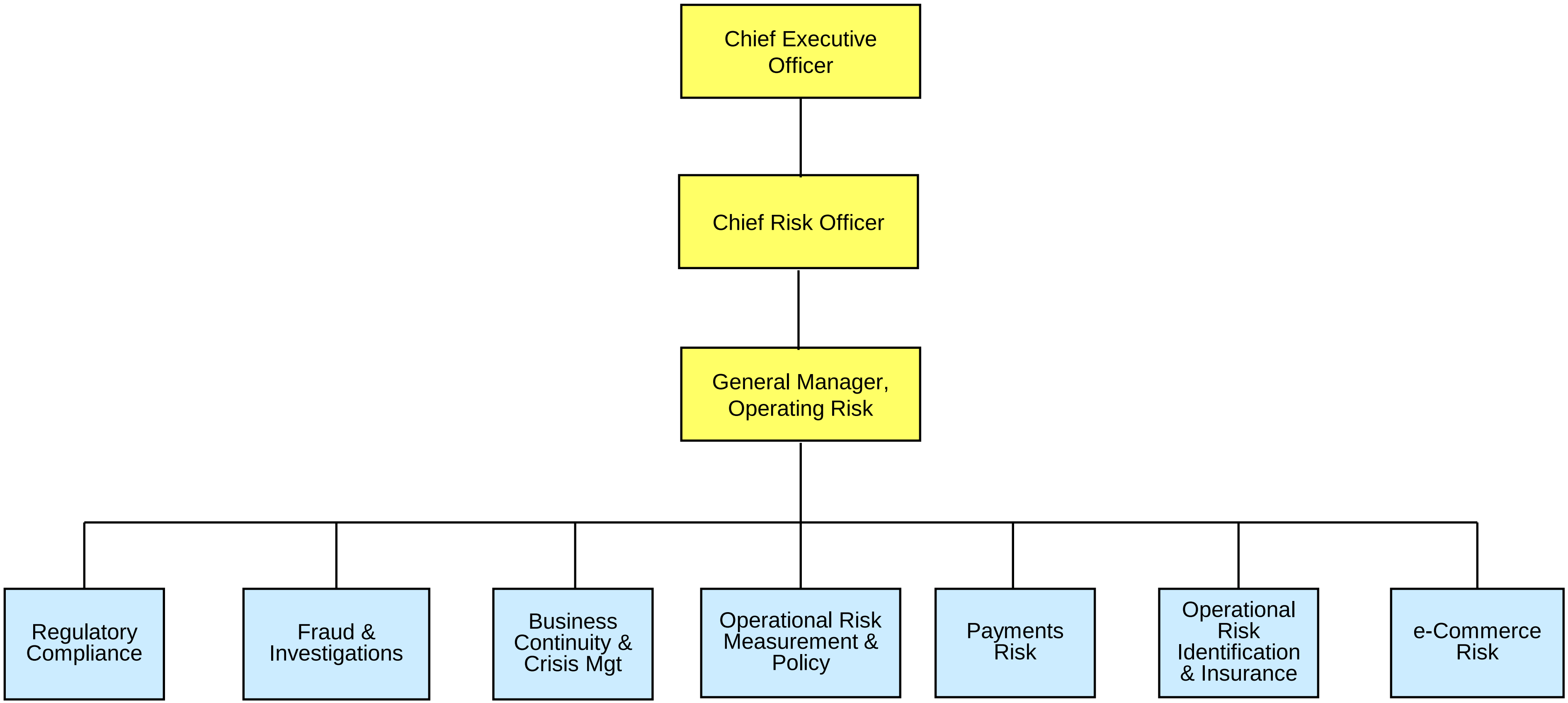
- **Effective Risk Governance**
- **Collaborative Partnership**
- **Operational Excellence**
- **Distinctive Risk Capability**

Definition of Operational Risk

ANZ's definition of Operational Risk (1999):

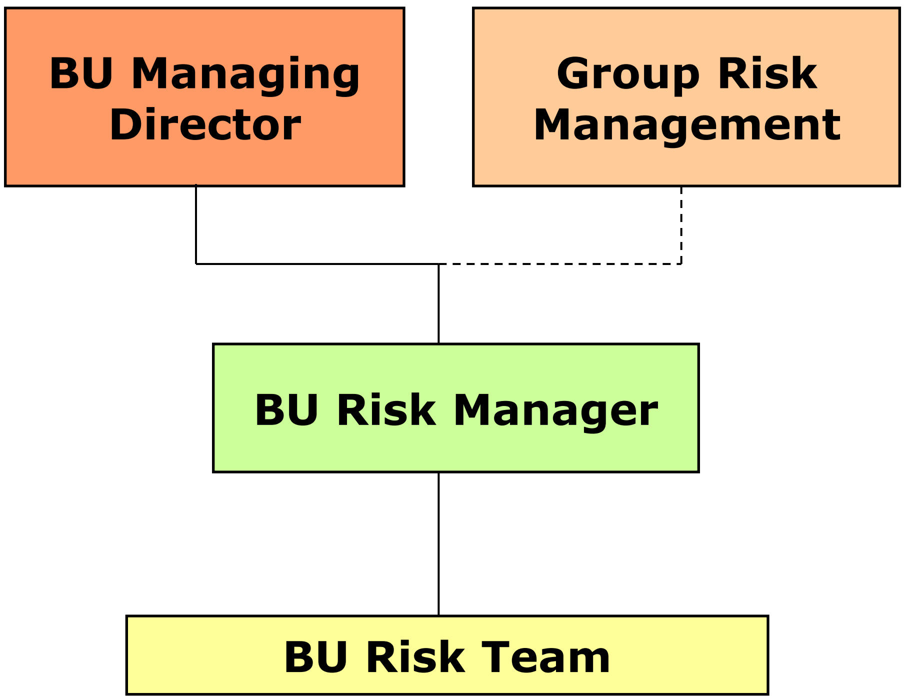
"The risks arising from day to day operating activities which may result in direct or indirect loss. These losses may result from failure to comply with policies, procedures, laws and regulations, from fraud or forgery, from a breakdown in the availability or integrity of services, systems and information, or damage to ANZ's reputation".

Central Operational Risk Structure



Business Units have Dual Reporting Lines

All Bus have dedicated risk managers, with dual reporting lines. This strengthens the framework of risk accountability allowing for open and transparent communication of risk issues.



Key Benefits:

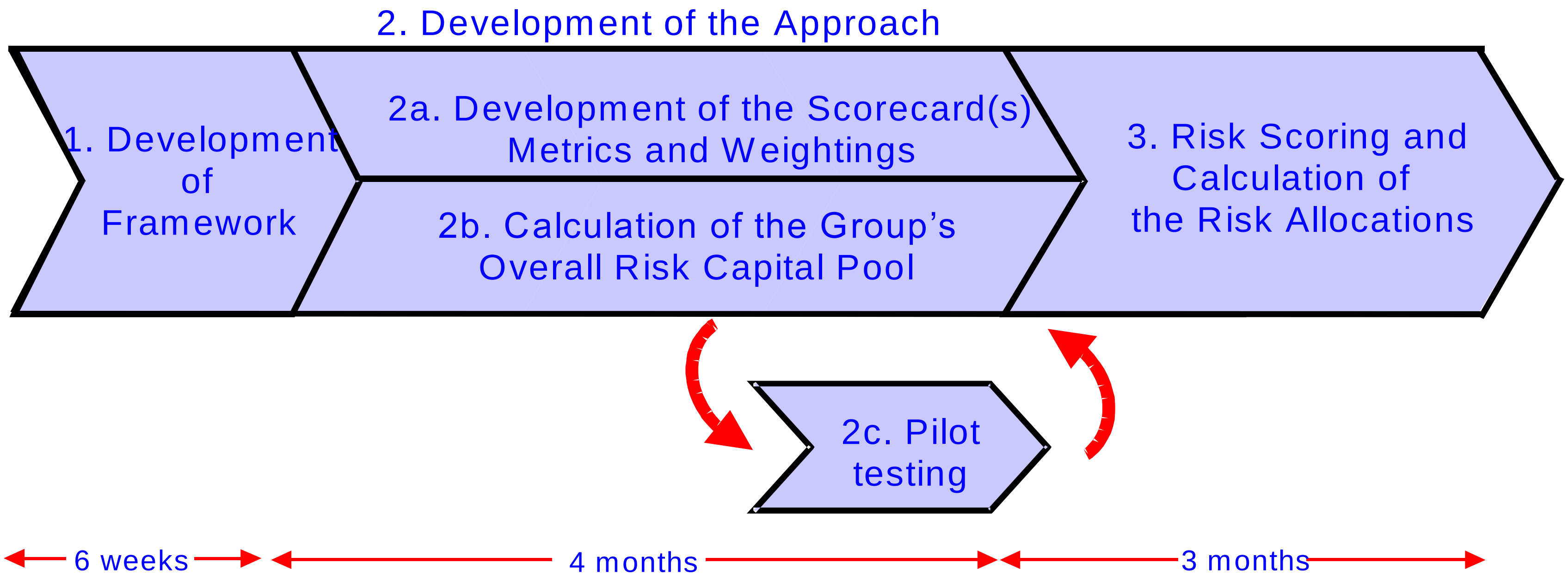
- Business Units retain accountability for compensation and benefits.
- Improved communications
- Rapid resolution of issues
- Specialist coaching and training
- Strengthens risk culture across the Group

RDCA Implementation: We set ourselves some clear, short-term objectives to design a new measurement approach

- Design and implement a framework for operational risk measurement and capital allocation that:
  - *links capital directly to the operational risks of each business unit*
  - *gives business managers strong and clear incentives to reduce operational risks*
- Improve the understanding and ownership of operational risks by the business units
- Develop MIS that allows for consistent tracking and reporting of operational risk exposures and trends
- Provide a foundation for optimising the operational risk management process (identification, mitigation etc.)

We devised a project plan to achieve our objectives in a short space of time

Summary Approach for Enhanced Measurement of Operational Risk and Allocation of Operational Risk Capital



In the final phase of implementation, business units completed the RDCA questionnaires, and initial capital allocations were made

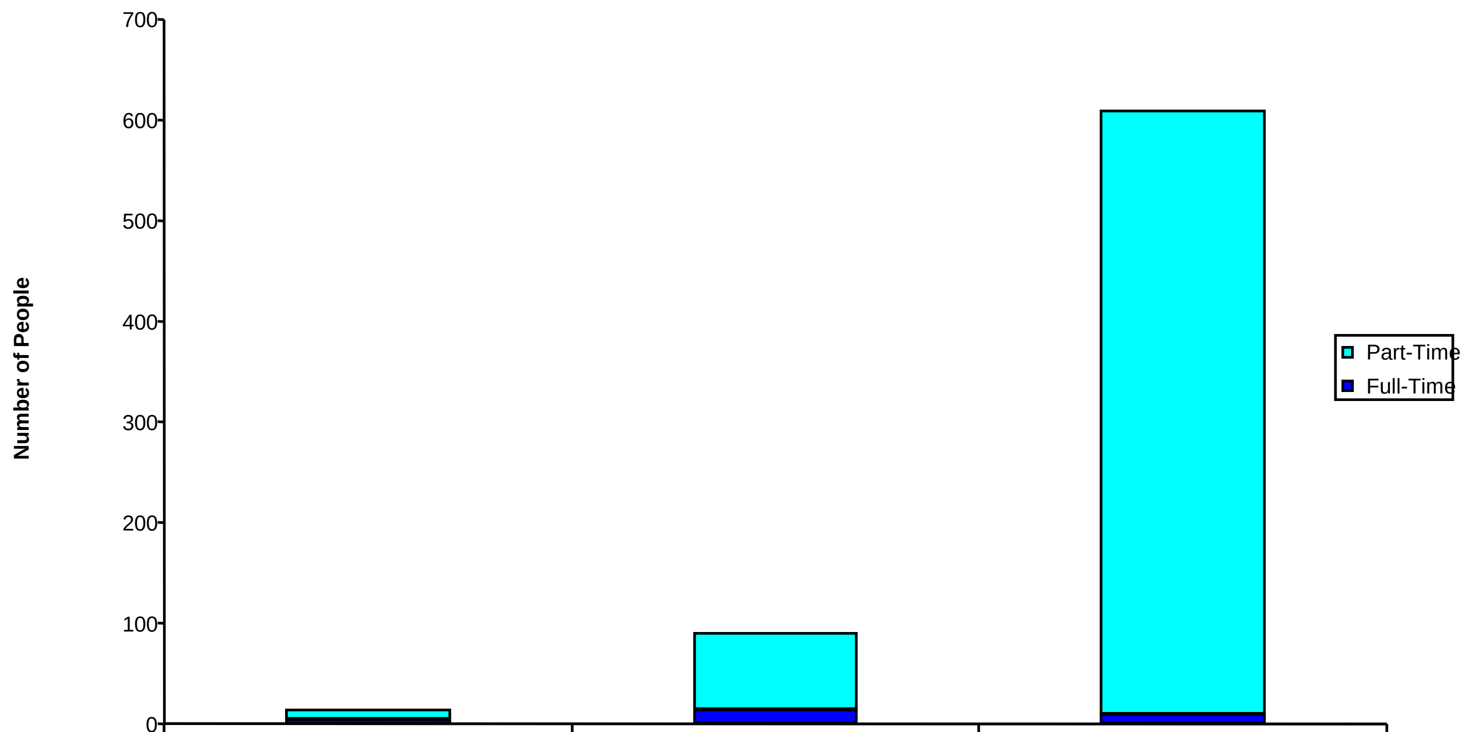
- All units within ANZ - including “support” units such as IT, Risk Management, etc. - were scored in the process
- As well as Australia and New Zealand, over 20 overseas countries participated in the rollout
- In all, 65 different business units each completed 13 scorecards and a scalar data questionnaire
- The questionnaires were completed by self-assessment, and reviewed centrally by Group Risk Management and Internal Audit
- Capital allocations were then calculated, and reviewed with the Business Unit MDs before final sign-off by the Executive Committee

The RDCA project team brought together experience from across the ANZ Group

- The full-time project team (between 5 and 15 people at various stages of the project) was composed of:
  - staff from Group Risk Management
  - secondees from each business division and Group Audit
  - consultants from PA Consulting
- The team worked closely with operational risk managers from around the Group, and business experts on the different types of operational risk
- Throughout the project, we kept the key stakeholders (eg business unit heads, CFO, etc.) closely involved

The number of people involved increased substantially through the project, leveraging specialist expertise and increasing awareness

Project Team Size by Phase

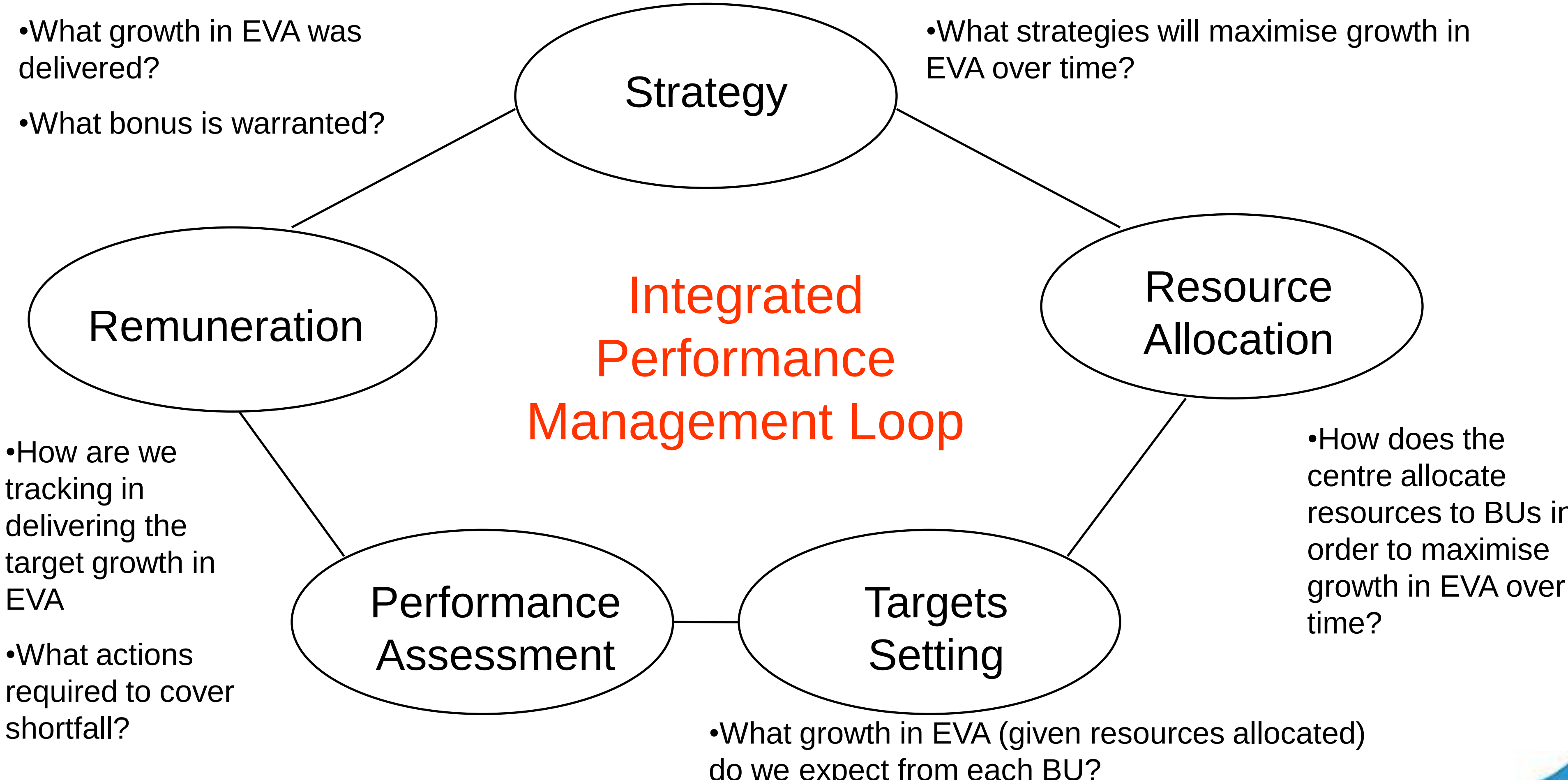


	Phase 1	Phase 2	Phase 3
Part-Time	10	75	600
Full-Time	5	15	10

Internal audits are incorporated into the capital framework – additional capital is allocated for poor audit results, and reduced as required actions are completed

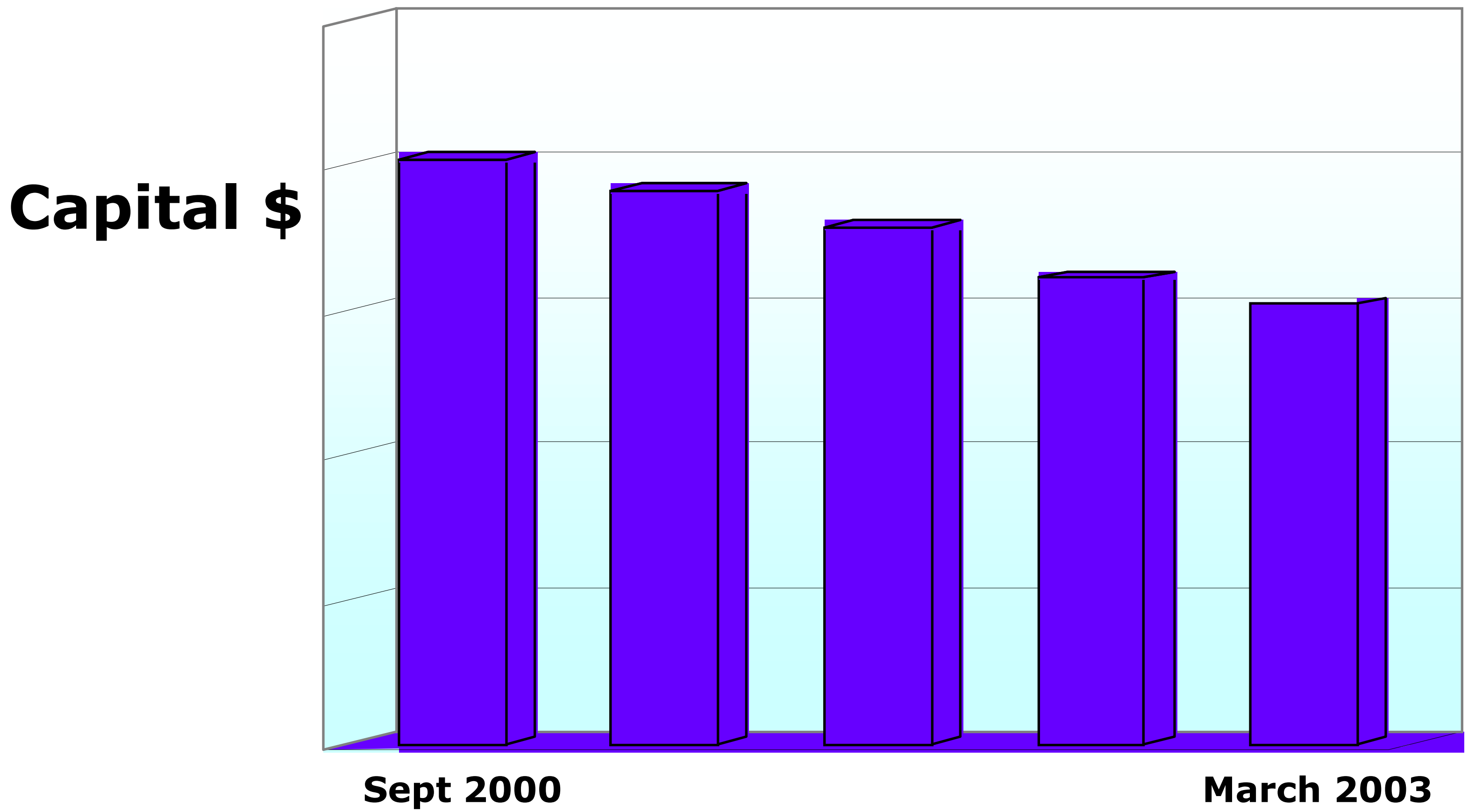
- In addition to the capital allocated from the questionnaire process, additional operational risk capital is allocated for units receiving poor audit scores
- The degree of capital adjustment depends on the severity of the audit issues, and whether the audit was requested by the business unit or not
- The adjustment is based on the capital allocated to the unit(s) and risk categories covered by the audit
- The adjustment then either:
  - reduces over time, as the actions required to clear the audit issues are completed, or...
  - increases over time, if the actions are not completed by the agreed dates

EVA is a cornerstone in allocating resources, measuring performance, and renumerating Business Unit heads at ANZ



Link to tool demo here

Improved operational processes and internal controls have reduced the need for Operational Risk capital



In summary we have gained considerable benefits over 3 years:

- An operational risk capital allocation mechanism that closely mirrors the actual operational risk management process, and which the business units understand and believe in
- A strong, structural incentive for business units to manage and control their operational risks going forward
- A huge amount of engagement, buy-in and education from the development and implementation process
- A much better understanding - at Group and business unit levels - of where our biggest operational risks are, and how they might be reduced, including a great deal of risk data
- A platform for optimising the other stages of the operational risk management process

Operational Risk Capital & Performance …

"...and one of the things I think that really does matter to this is the earlier introduction of EVA at the transactional and the customer level, means that we have a self correcting mechanism that is in fact ensuring that risk comes down overtime, without it being necessarily driven from the centre.

And in fact the fact we are one of the few banks in the world that allocate capital to Operational Risk in our EVA model, is also a leading edge indicator, which means that Operational Risks also get managed in the same way ...

And we think that's a very important device because it means that an individual decision that leads to a negative EVA does not get done."

John McFarlane, CEO, ANZ Banking Group (25 October 2001)