

# Capturing operational risk impacts due to the coronavirus (Covid-19) pandemic - guidance note

ORX Definitions Working Group 29 January 2021

## Scope and purpose

This is the fifth edition of a guidance note for ORX Members on capturing operational risk losses that relate to the 2020 coronavirus pandemic. The purpose is to ensure consistency amongst ORX members on capturing pandemic impacts, providing a foundation for future data sharing and benchmarking.

ORX **strongly recommends** that members follow this guidance for reporting losses to ORX loss data services. The guidance applies to both banking and insurance members.

There exists a range of views in the ORX membership on capturing some aspects of the impacts of the coronavirus pandemic, reflecting variation in practice across firms and jurisdictions. This guidance represents common thinking on capturing coronavirus impacts on a consistent basis.

Where possible, ORX also intends to align with reporting guidelines on coronavirus impacts created by other industry groups.

The note contains a summary of the guidance given, specific impacts to be included and excluded, and categorisations.

## General approach

**Firms should consider: would the impact have been experienced without the pandemic? If the answer is 'no', then include the impact in operational risk reporting. Include the impact if:**

1. The cost must have arisen as a result of the coronavirus pandemic.
2. It was an unexpected cost, i.e. wasn't planned for, budgeted for, or part of any strategic plan that was in place before the pandemic.
3. It was not a goodwill payment / cost incurred (e.g. ex-gratia payments etc).

Rationale: this approach is simple to apply. It captures the range of immediate impacts and costs that firms have incurred in order to maintain operations as a result of the pandemic. This will provide a good range of impacts for future pandemic analysis and scenarios.

## Cost impacts that are reportable to ORX

ORX strongly recommends that the following costs should be included. In exceptional cases, an exemption may be documented by a member.

## Impacts on operations

- **Working from home** –one-off costs of **additional** work-at-home equipment (e.g. laptops) and services (e.g. increased VPN capacity) required specifically as a result of the pandemic. Only include equipment purchased that was essential for **maintaining operations** that would otherwise have been disrupted by the pandemic. Include costs of equipment that was not already budgeted for and accounted for as part of any existing IT upgrade plan. The full equipment cost should be used as the loss amount.
- **Cleaning costs** – cleaning costs clearly attributable to the pandemic, such as the cost of deep cleaning buildings where staff have tested positive for coronavirus should be considered as a loss, as the clean would not have been required without the pandemic.
- **Protective equipment** – for example plastic screens in branches, face masks, gloves required to maintain operations during the pandemic.
- **Building costs** - immediate additional costs of building closure caused by pandemic (for example, additional security costs).
- **Cost of establishing a pandemic command centre** – only include costs over and above existing business continuity planning /control spend. For example, additional costs incurred in providing food and accommodation for staff during the pandemic period are additional costs incurred because of the pandemic and would be reportable.

### **(For insurance members) – Claims payments on contracts with pandemic exclusions.**

Some insurers have come under pressure from regulators, governments and consumer groups to make claims payments on policies that have pandemic exclusions.

If there is a court judgement or regulatory instruction to pay out on the claim, this is reportable as an operational risk loss, as this would be an example of a retroactive change in the law.

If the firm decides to make an ex gratia payment or make an out-of-court settlement with a customer, the payment is only reportable if there is an underlying operational risk event (for example if the contract is defective).

This situation is continuously evolving. The ORX Insurance Definitions Working Group will monitor and issue updated guidance as necessary.

The suggested Event Type categorisation for this event would be EL0403 – Product Flaws. If firms consider that the pandemic was a causal factor in the loss, this can be tagged from C3 data cycle with a pandemic flag.

## Impacts on logistics

- **Costs of cancelled travel or events** – losses due to cancellations caused by the pandemic are reportable, as these are incurred by the firm as a direct impact of the pandemic

## Impacts on people

- **Consultants** – cost of external consultants required by the pandemic. Only include costs for providing business support to maintain operations. Strategic consultancy costs should be excluded.
- **Special payments** (e.g. one time add-to-pay, or top-up for employees that are required to go to the office), include where these are required in order for essential operations to continue.

## Impacts not reportable to ORX

The following costs should be excluded:

- **Fee waivers and mortgage holidays** – these are considered to be a goodwill gesture to customers, with the precedent of fee waivers following storm events being considered goodwill. The costs of administering these programmes would not be reportable unless there are additional costs due to the pandemic (such as hiring external staff to process high volumes of transactions).
- **Reduced revenue** – for example, if the firm will generate less revenue due to the economic downturn caused by the pandemic. This is a longer-term change in the operating environment and would represent an opportunity cost.
- **Staff wages** - continuing to pay staff that are not working because the firm has made a decision to shut a branch, and staff are unable to work at home. This is not an additional cost so should not be considered a loss.
- **Sick pay and health premiums** - Additional sick pay costs, higher workers compensation payments or health insurance premiums. Sick pay costs would be considered a cost of doing business and therefore not reportable.

## Gains from the pandemic are not reportable

The following gains should be excluded (i.e. they are outside the scope of reporting to ORX):

**Cost savings** - for example reduced electricity bills due to headquarters building being closed. This is not in the scope of operational risk reporting as it can be considered an 'opportunity gain'

## Categorisation of losses

Unless otherwise listed above, ORX guidance is that direct impacts should be captured using **Event Type EL0501 – Natural Disasters & Other Events**. The rationale for this is that there is no control failure with a pandemic event, it is similar to an 'act of god' like other events in EL0501.

However, the European Banking Authority (EBA) issued [guidance](#)<sup>1</sup> on 21 December 2020 and indicated that the primary impacts of the pandemic should be categorised with the Basel event type 'Business disruption and system failures', equivalent to the ORX event type 'Technology and infrastructure failures'.

Although the consensus view of the ORX DWG is to use the EL0501 event type, given the EBA guidance, members may wish to code direct pandemic impacts with the EL06 event type. It is important that members continue to flag these events with the IL0012 flag to enable useful analysis on overall pandemic impacts.

All direct impacts should be grouped at a group level as a single event per Business Line (see ORRS 3.2.1 Grouped Losses). If multiple countries contribute to the group impact, use the country where the corporate group is headquartered for the country. If losses impact more than one business line, these should be linked (see ORRS 3.2.2 Linked Events)

Please see the attached document "Supplementary guidance note on aggregating loss impacts" for a worked example on aggregating and linking losses. Available from <https://members.orx.org/coronavirus/capturing-operational-risk-impacts-coronavirus>

Dating: Date of Occurrence (when the event started) will vary from region to region.

Date of Recognition: for the grouped loss, use the date when the loss or a provision is first recognised in the P&L

## Pandemic flag to track secondary events

ORX will provide an [Industry Loss Event](#) (ILE) flag that will enable members to tag both primary and secondary events associated with the pandemic.

The threshold for using the flag is EUR 20,000. (This is different to other ILEs which have a EUR 10 million threshold). Data will be available on a give to get basis.

Use the code IL0012 in column AE of the Insight submission template (for banking data)

Guidance for insurance members will be provided before the C3 data cycle.

Primary pandemic impacts (discussed above) should all be tagged with the ILE flag.

For secondary impacts, such as frauds, processing errors or cyber-attacks that clearly have the **pandemic as a causal factor**:

- The event can be categorised with its primary event type (for example EL0201 – External Fraud) but be tagged with the pandemic ILE.

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<sup>1</sup> See section 3.3.5

- **Use the ILE flag only if the loss would not have happened without the pandemic.**

For example, a control failure because staff responsible for a process were working at home due to the pandemic, and a particular control was not implemented into the home-working environment – categorise with Event Type *EL0701 – Transaction Capture, Execution & Maintenance* and tag as a secondary event with the ILE flag.

The flag will be available from the **C3 2020 data cycle**. It can be used to track impacts including:

- Increased incidence of successful cyber-attack (e.g. arisen because of weakened security controls in the pandemic working environment)
- Increased incidence of fraud and other conduct events (related directly to the pandemic, e.g. related to specific products designed to provide pandemic relief or inability to identify customer effectively).
- Increased frequency of process errors (as per example above).
- Trading - losses from existing trades not properly executed or settled due to disruption in trading operations due to coronavirus.

## ORX Reference Taxonomy & Coronavirus

ORX published an industry [Non-financial Risk Reference Taxonomy](#) in November 2019. If you use this Reference Taxonomy to classify coronavirus related events, it would result in a similar approach as advocated for the Basel Event types where the pandemic is a cause of a number of risk events resulting in multiple impacts (the Reference Taxonomy is based on the cause-event-impact bow tie model). Treating the pandemic as a cause, events arising would be classified in the Reference Taxonomy under a number of categories such as failures in Business Continuity planning, Transaction Processing & Execution errors, Physical Security and Safety concerns and Fraud. The Reference Taxonomy methodology approach would also advocate grouping these events using a 'pandemic flag' to allow collective analysis and reporting.

To complete the taxonomy work, ORX is developing a Reference Cause & Impact Taxonomy (to be published in Q4 2020). When reporting the results, we will present a case study for the pandemic using the full taxonomy and setting out how flags could be used to support.

**Note:** the Reference Taxonomy is not currently reportable to ORX.

## Subsequent waves of infection

There may be subsequent waves of virus infection some time after the initial coronavirus impact. As the pandemic impacts are experienced at different times in different regions, it is suggested that subsequent impacts from potential future waves are aggregated as part of the same loss event. For this reason, ORX is not proposing an 'end date' for this coronavirus pandemic, although this can be kept under review.

When do costs associated with the pandemic become costs of doing business in a new operating environment, and not reportable as operational risk losses?

## General principle

**Costs to enable the firm to restore operations following the impact of the coronavirus pandemic are reportable as operational risk losses. \***

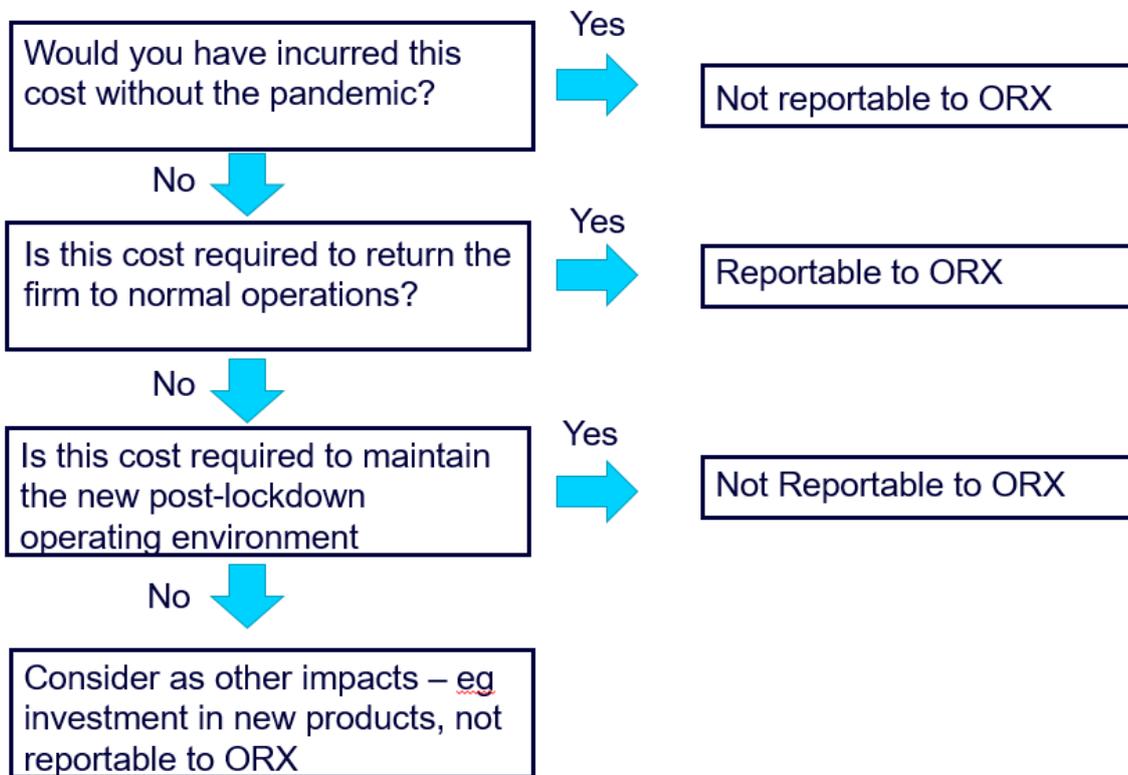
Ongoing, expected costs required after the pandemic lockdown period to maintain operations are not reportable. For example, if these ongoing costs are incorporated as items in post-pandemic budgets in response to measures mandated by public health agencies, then they would be seen as preventative measures and therefore not reportable to ORX.

Please refer to the decision tree below to help determine if a cost is reportable or not.

\*see [BCBS 196](#), section 85 (b) “The following specific items should be included in gross loss computation...Costs incurred as a consequence of the event that should include external expenses with a direct link to the operational risk event ...and costs of repair or replacement, to restore the position that was prevailing before the operational risk event.”

**Decision tree to determine whether a coronavirus impact is reportable to ORX**

## Pandemic impacts decision tree



### Version control

Version No	Change	Date
4	Final Guidance for C3 2020 removed from header. Reference to this being 'draft' guidance removed from webpage. Link to supplementary guidance on aggregating impacts added.	29 January 2021
5	Guidance on event type categorisation in light of EBA guidance from 21 December 2020 included.	29 January 2021