Adding Value Though Operational Risk Management

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Definition of Operational Risk

- The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.” Basel
- The residual risk after taking out Credit and Market risk

Operational Risk = Total Risk − Market Risk − Credit Risk

- Thus all that you are worried about, except credit and market risk
- Besides, OR is entrenched in Credit and Market risks (boundary events)

OR In Perspective

Operational risk losses rose by more than a quarter in 2018, reversing the trend of previous years that had seen annual falls in the loss total. However, a large part of last year's $34 billion total is a single loss: Chinese insurer Anbang's $12 billion embezzlement case. The number of individual loss events has increased, though, with 2018 seeing 728 incidents against 2017's 710. The figures refer to losses that are publicly reported. This relates to only reported risk **Risk.net**

- The greatest threat faced by organisations
- Recent developments in the banking industry landscape have laid bare the importance of Operational risk management.
- It is no longer a burden to be carried in fulfilment of a regulatory requirement.

Uniqueness of Operational Risk

- Unavoidable - Usually not willingly incurred
- No reward for “taking” operational risk
- Not easily quantifiable with models – the Basel back and forth
- It is inherent throughout all firms.
- Operational risk cannot be fully eliminated

Value

- Value is traceable to profit and profit from:
  - Increased revenue
  - Reduced costs / losses
- This is supported with
  - Sound corporate governance
  - Reduced loss incidents
  - Customer interest protection – product design, after sales service/complaint management.
- For a listed entity in an efficient market, this should reflect in share prices

The Sergio Galanti Operational Risk Puzzle

Risk & Control Self Assessment

- A structured approach that proactively identifies risk inherent in processes / products and the design of controls to manage them.
- Identification of risks – risk workshop recommended
- Design of adequate controls – remember OR cannot be eliminated
- Regular control testing – minimum annual

How could you effectively manage your risks when you lack knowledge of them and their possible impacts?

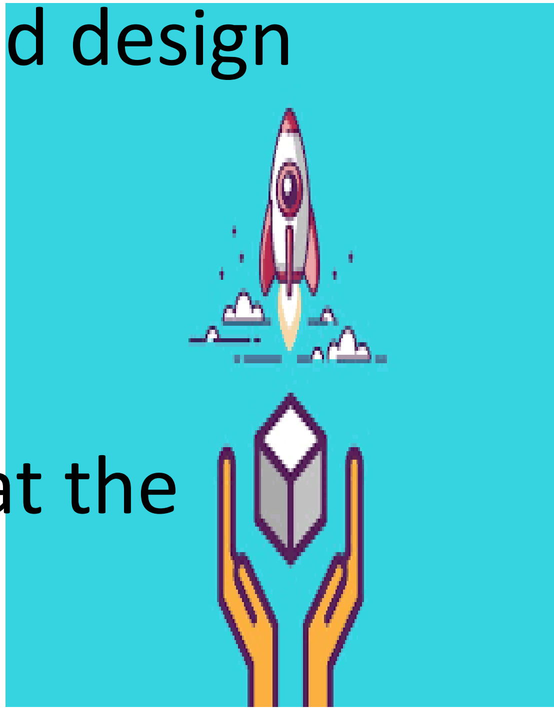
Benefits or RCSA

- An exhaustive library of business risks and controls
- A document that provides answers to why controls must be observed - not just orders
- A strong control education tool
- Regular effective testing reveals the 'health' status of the business
- Control testing proactively unveils ineffective controls for timely action to be taken.

Deep Involvement in New Product

To ensure new products are excellent, viable and sustainable OR must support, ensuring:

- Involvement in product design – efficient and safe process
- Proactive product risk assessment – identify risk and design controls
- Challenge product viability
- Ensure customer interest is adequately considered
- Follow-up review (self/independent) to confirm that the designed controls are being observed

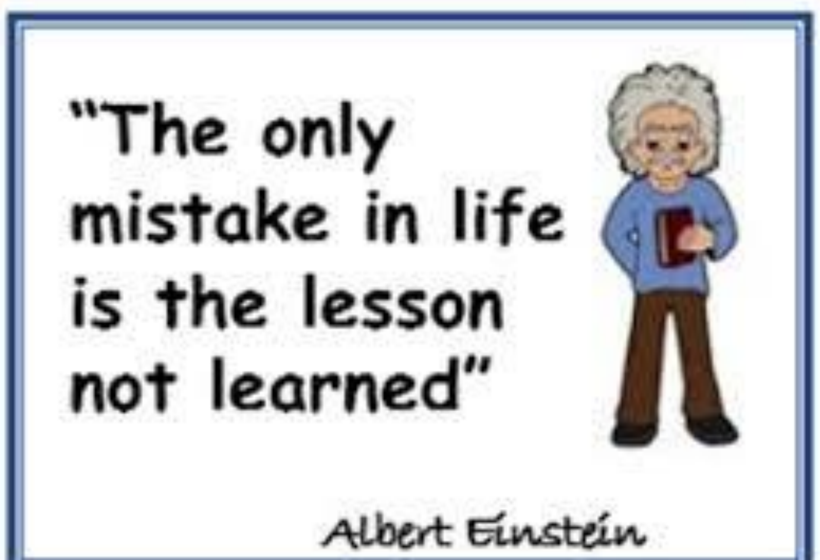


Risk Event

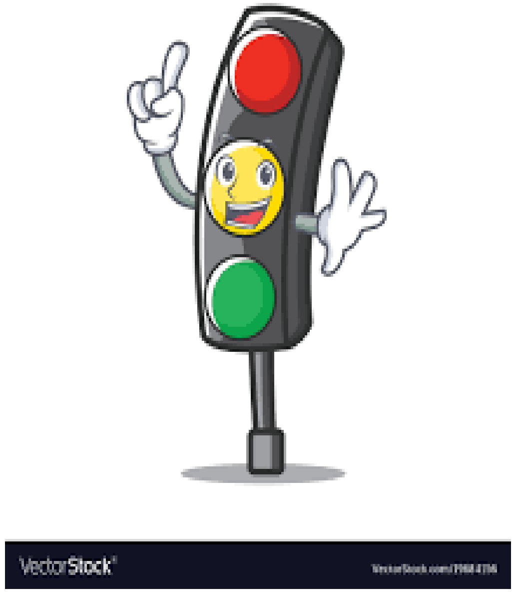
- Loss events that are traced to inadequate or failed internal processes, people systems or from external events.
- Every organisation must have, if not a system, the an excel or access database for recording all lost events.
- **Terminologies**
- May have financial or nonfinancial impact
- Direct/Indirect impact
- Near Misses – Where an impact was avoided outside standard control.
- Boundary event – Impact associated with market or credit events
- Rapid recovery – where the funds left the organisation, but were recovered within a pre-specified time interval.

Benefits

- Provides important and reliable database of loss events for reference
- Supports objective OR loss budgeting and capital provisioning.
- Effective tracking of events, ensuring exhaustive resolutions are reached.
- Loss recoveries are enhanced
- **Lessons learnt from events are essential for guiding the future - prevention of repeat events. Set threshold for formal lessons learnt.**
- Update of related RCSAs / CPAs



Key Risk Indicators (KRIs)



Metrics designed to provide timely prompt that the organization is getting over exposed

- Identification or **Key** Risk business wish to monitor
- Clear / unambiguous documentation of the indicator
- Setting and agreeing the following with indicator owners:
  - Limits/triggers
  - Sources of actual data
  - Measurement interval – daily, monthly etc, depending of criticality of risk
- KRI outcomes must be tabled in appropriate governance forums to generate the needed attention and change

Governance Committee Set up

- Types, hierarchy of Committee to set up - per need
- Terms of reference of committee
- Agreement of escalation structures

Essence of the commitees

- Forum to discuss the control environment
- Opportunity for sound oversight - minimises negative surprises
- Two heads better than one in thinking through controls
- Demonstration of senior leadership commitment