Aligning OP Risk and Strategy for Improved Business Performance

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WHAT ARE YOUR THOUGHTS?

How aligned are your firm's operations to it's strategy?

Objectives

In an organisation's bid to achieve its objectives, there are events that could occur which may prevent this achievement. Some of these events result from the organisation's primary activities. These are known as operational risks and while they seem small compared to other strategic risks, their impact on an organisation can be quite large.

A proper understanding of how to manage operational risk and align it with corporate strategy is imperative if an organisation is to thrive in a dynamic business setting. To this end, the objectives of this presentation are to:

- ❑ Gain an understanding of operational risk and the benefits of its integration with corporate strategy.
- ❑ Understand the role of the Board in this process and the Operational Risk Management framework.

Outline

- Overview Of Risk
- Operational Risk – The Basics
- Risk Appetite
- Strategy
- Aligning OP Risk And Strategy
- The Board's Role
- Implementing An Operational Risk Management Framework

Overview Of Risk

What is Risk?

Risk is the "effect of uncertainty on objectives"

ISO31000:2009

The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

"Institute of Internal Auditors"

Overview Of Risk

Overview of Risk

Evolution of Risks

PRIOR VIEW

Avoid risk to preserve value

Focus on what has happened

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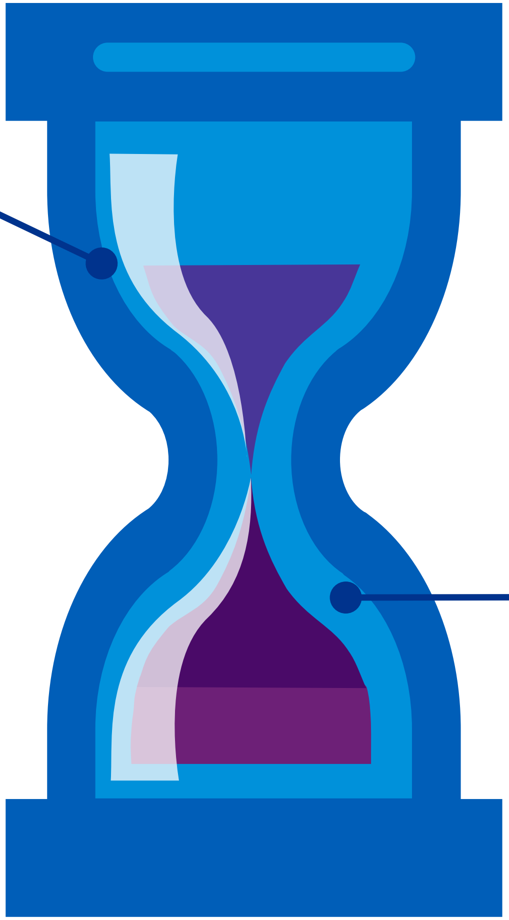

CURRENT VIEW

Embrace risk to create sustainable value

Focus on what could happen

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Operational risk is defined as the risk resulting from people, inadequate or failed internal processes and systems, or from external events [1]

[1] OSFI Draft E-21

Operational Risk – The Basics

Risks derived from an organisation's core business practices, which rely on systems, practices, and people.

It is an unexpected failure in an organisation's day-to-day activities which may be caused by internal factors.

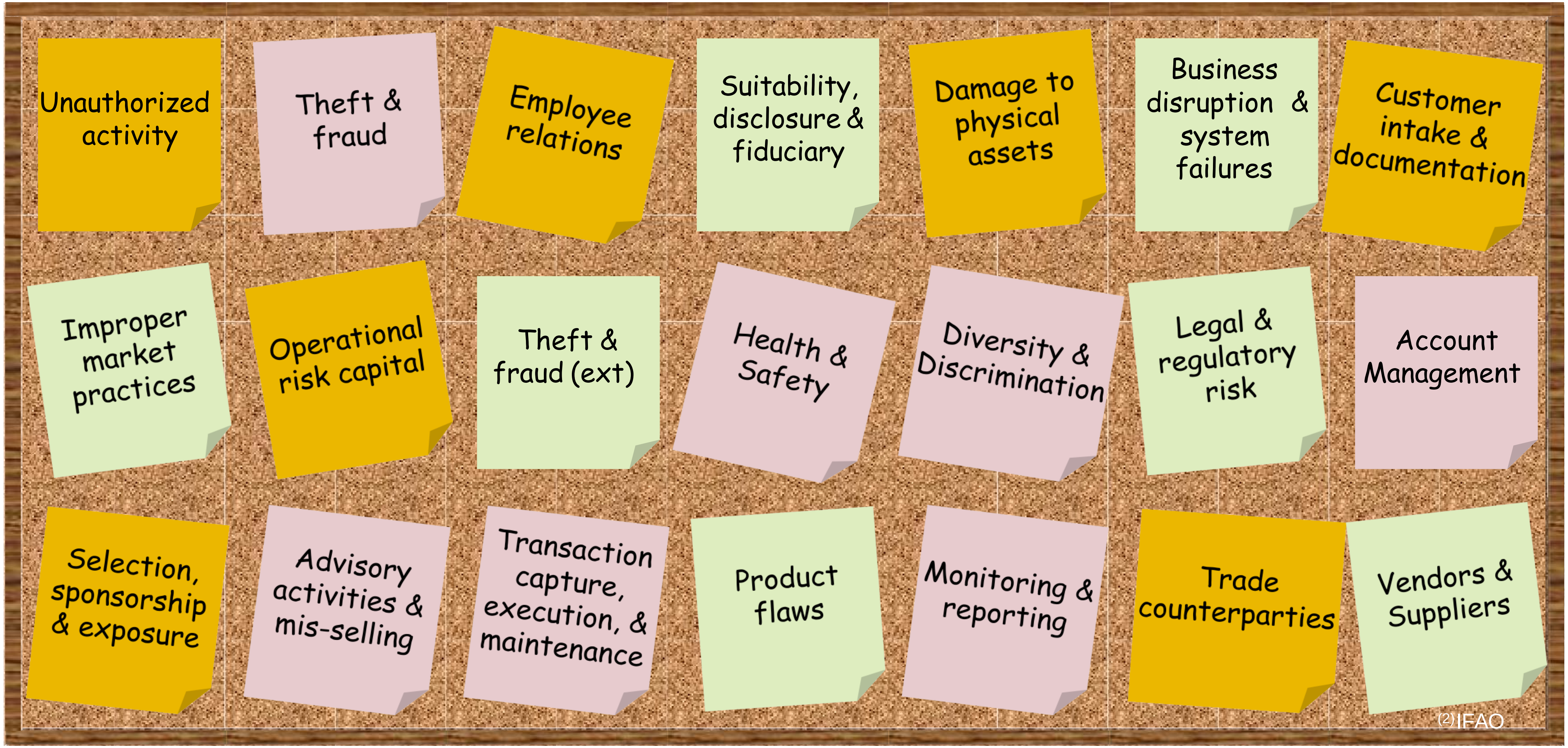
Because it is embedded in an organisation's activities, it differs from industry to industry and as such careful consideration must be made in order to evaluate operational risks.

By identifying the risks directly associated with its activities, an organisation is able to take calculated steps to improve efficiency and seize opportunities.

Losses From Operational Risk Failures

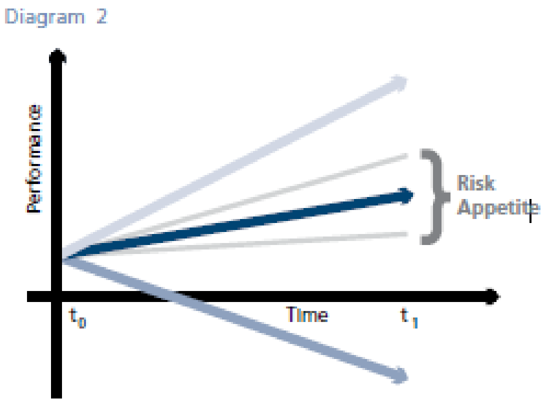
Bank	Risk Event	Causes of Risk Event	Amount Lost
Wells Fargo	❑ Creation of fictitious accounts	❑ Failure or inadequacy of internal controls ❑ Lack of effective risk management practices	❑ Over US$ 1 Billion
Societe Generale	❑ Unauthorised trading ❑ Balancing each real trade with a fake one using knowledge of the bank's system to avoid detection	❑ Significant deficiencies in internal controls ❑ Short supply of oversight and risk management ❑ Inefficient well-defined structured of limits on risk taking	❑ Approx. EUR 4.9 billion (higher than the banks total market capitalization) ❑ Market capitalization reduced by 23%
Multiple banks in Ghana	❑ Collapse of some banks in Ghana due to multiple causes	❑ Poor corporate governance ❑ Non-adherence to risk management practices ❑ Compliance and regulatory breaches	❑ Approximately GHS 12 billion

Operational Risk – The Basics



What is Risk Appetite?

Risk Appetite - *a broad definition*	Risk appetite is the amount of risk the organisation is willing to accept in pursuit of value. Risk appetite may be considered qualitatively, with such categories as high, moderate, or low, and quantitatively reflecting and balancing goals for growth, return, and risk. Risk appetite is directly related to the organisation's strategy.



The Institute of Risk Management (IRM) "Risk Appetite and Tolerance Guidance Paper" 2011

There should be a clear link:

Strategic Objectives → Risk Appetite → Risk Tolerance

Risk Appetite ROI: What is the Return on Investment?

There are many benefits from a strong risk appetite process:

- Drive consistent behaviour
- Enable risk-based decision-making
- Align resources & investments with risk appetite
- Put Risk Management theory into practice
- Develop sharper, more intelligent risk reporting
- Improve monitoring of emerging risks
- Assist Board in approving risk “guardrails”
- Strengthen risk roles and responsibilities

A clearly understood and articulated statement of risk appetite can be a powerful tool for managing risk and enhancing overall business performance.

The Link from Inherent Risk to Risk Management

Inherent Risk

The intrinsic risk the organisation takes in operating its business in the absence of actions management might take to control risk

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Risk Appetite & Tolerance

Risk Appetite

Maximum amount of risk management is willing to accept to achieve strategic goals / objectives

Risk Tolerance

The range / variability of risk management is willing to accept to achieve strategic goals / objectives

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Risk Management

Too Much Risk-Taking

Acceptable Risk Taking:

- Key Risk Indicators
- Trend Analysis
- Business Decisions

Insufficient Risk-Taking

Risk Appetite Process

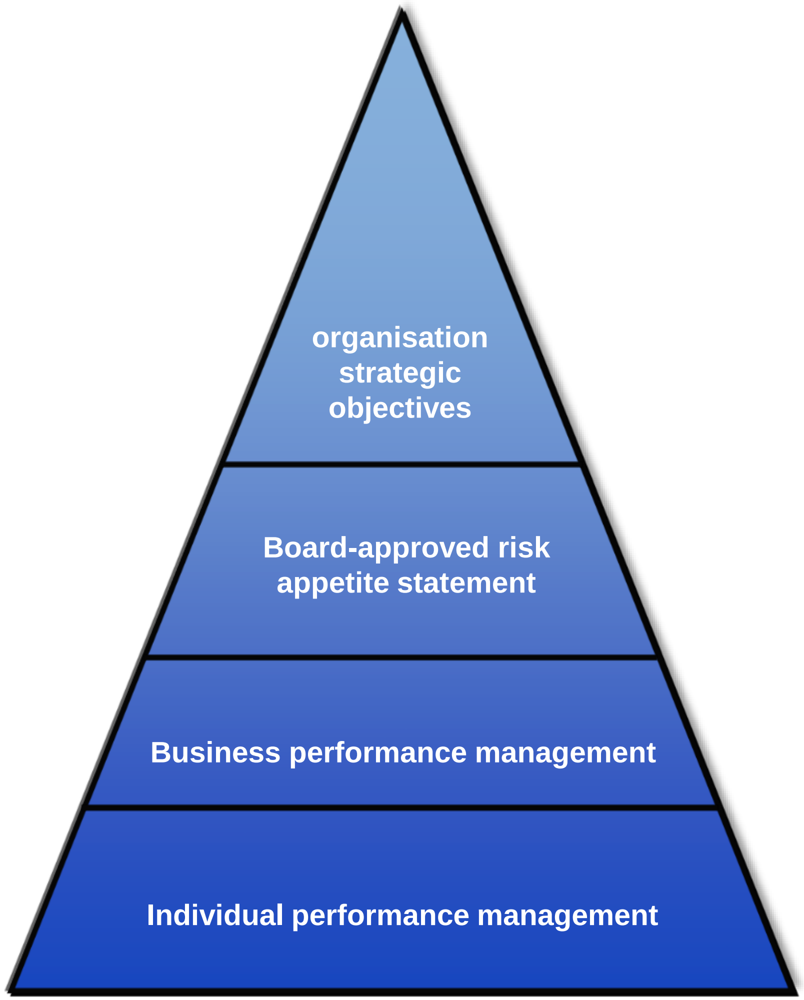
Step 1: Link organisational strategic objectives to risks so drivers of the business plan are understood and leveraged in risk appetite statements.

Step 2: Develop and measure the aggregate risk profile and the level of unexpected losses. What risk will we accept? Where is there "zero tolerance"?

Step 3: Quantify risk appetite and tolerance ranges for specific risks

Step 4: Communicate risk appetite to the Board and then to the wider organisation.

Step 5: Monitor and report risk to ensure processes and controls are in place and identify when risk appetite needs to be refreshed.



Strategy

A Strategy is a plan of action designed to achieve a long term aim or goal.

A strategy is an organisation's game plan for

- Strengthening it's competitive position
- Satisfying customers
- Achieving performance targets
- Realizing its visions and objectives

An entity ought to

- Have a detailed documentation of its strategies
- Continuously monitor progress on the implementation of its strategies
- Regularly review the strategies for relevance and alignment to current trends and developments.

Aligning OP Risk And Strategy

Reducing operational surprises and losses:
By enhancing capability to identify potential events and establish responses, the organisation reduces the risk of unwanted surprises and their associated costs or losses.

Enhanced Enterprise Risk Management:
Aligning Operational Risk (which is a key risk category) to organisational strategy enhances the implementation of a robust, holistic and value driven ERM framework

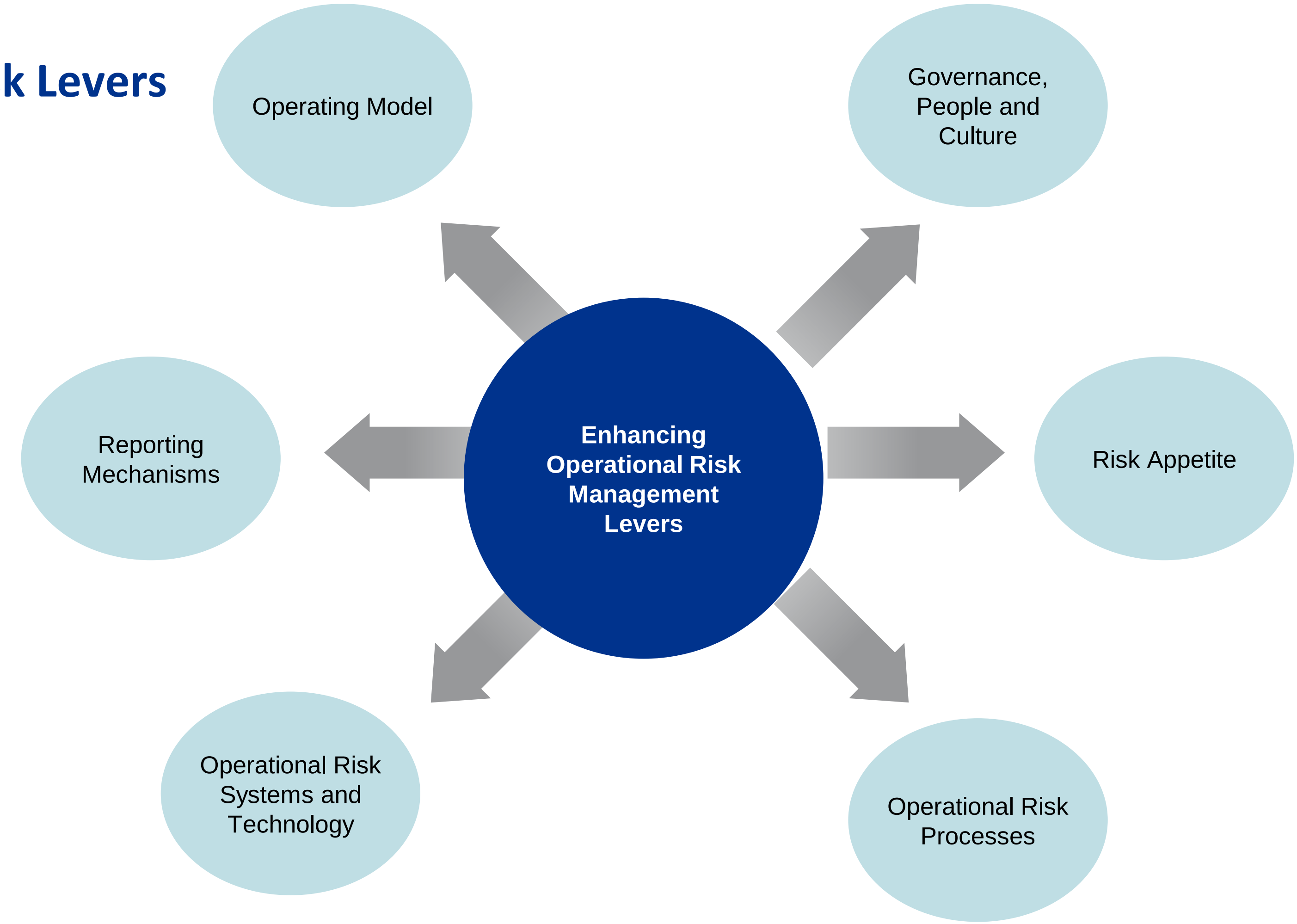
Seizing opportunities:
By considering a full range of potential events, management is positioned to identify and proactively pursue opportunities that are consistent with the strategy. Risk management becomes more than a means to limit costs or losses; it also helps give visibility to unforeseen opportunities to sustain profitable growth.

Leadership buy-in:
By considering operational risk management at a strategic level, risk owners obtain management support to implement risk mitigating processes in order to improve operations and thus improve business performance.

Improving deployment of capital:
Obtaining robust risk information allows management to effectively assess overall capital needs and enhance capital allocation.

Implementing An Operational Risk Management Framework

Operational Risk Levers



Implementing An Operational Risk Management Framework

Governance

1	Appetite	• Articulation and approval • Monitoring and reporting • Top down, bottom up connect
2	Board & senior management governance	• Oversight • Committee structure and mandates • Sponsor the lines of defence
3	Policies	• Policy hierarchy • Language and definition • Coverage and effectiveness
4	Culture	• Risk perceived to be value add • Emphasis placed on risk by senior management
5	Disclosure	• External reporting

Operating Model

6	Organisation structure	• Reporting lines • Risk management, control, assurance
7	Mandate, responsibilities, and competencies	• Key roles, responsibilities and accountabilities • Resourcing, skills and training
8	Performance management	• Risk features in performance appraisal and remuneration
9	Procedures & guidance	• Procedures to support policy and consistent practice • Clear and practical guidance
10	Systems	• Infrastructure to support risk management and reporting
11	Control environment	• Activities to control and monitor risk on a day to day basis
12	Specialist areas	• Specific skills and functions eg: BCP, physical and information security

Processes & Methods

13	Risk assessment	• Assessment tools, coverage and range.
14	Scenario analysis	• Selection • Review and challenge • Use of outputs
15	Indicators	• Setting of KRIs • Monitoring and reporting
16	Loss data capture	• Granularity of data • Near misses
17	Trigger management	• Triggers for changes in the risk profile such as: acquisitions; complex programmes; and new products
18	Incident management	• Reporting and escalation of loss (and near miss) events
19	Reporting	• Decision support • Consistent, complete and accurate • Business and risk communities
20	Capital management	• Appropriate coverage • Applying risk data

This approach gives organisations a detailed view of key aspects of the framework which can then be aligned with strategy in order to improve performance.


Questions
Answers

Thank you