Operational Risk Management Framework

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Scope of Presentation

- Need of an ORM Framework
- Risk Perspective
- ERM Framework
- ORM Framework
- How to Make ORM framework Effective
  - Optimizing Risk Management Committees
  - Building Up a Strong Leadership and Team
  - Monitoring and Reporting
- GRC Model – Integrated Model
- ORM Key Concerns

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Need for an ORM Framework

- Significance based on incidents and losses in the last 10 years
- Increase focus on operational aspects by investors, regulators and business partners
- Regulatory Requirement – Internal Efficiency towards an integrated process
- Governance, Risk & Compliance (GRC – Internationally $18 Billion 2013)
- Not an Isolated Function – It's a Cultural Shift
- Operational Risk Measurement is Subjective – Traditional models are yet to be proven

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Risk Perspective

- Risk can never, and should never, be completely eliminated.

- **Regulators are not attempting to do so**. Their role is to protect markets and investors by ensuring that:
  - The risks being taken are **understood** by the business
  - **Unnecessary** risk are not being taken
  - There are **controls** in place to measure and reduce risks
  - There is **protection** built in (financial and operational) in the event of a risk materializing
  - The risks being taken by the business are understood by the investors in that business
  - Sufficient information is **disclosed** to ensure that all investors are operating under the same conditions
  - Market **stability** is not being effected

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Not All Risks Can Be Mitigated!

- **Accept Risk:** Continue operations as is with a consensus to accept the inherent risk

- **Transfer Risk:** Transfer the risk from, e.g., from one business unit to another or from one business area to a third party (i.e. to an insurer)

- **Eliminate Risk:** Eliminate the risk(s) through the dissolution or sale of the business unit or operating area

- **Increase Risk:** You decide that current return/risk ratio is attractive and so increase exposure to achieve anticipated greater returns

- **Reduce Risk:** Reduce current risks through improvement in controls and processes

- **Mitigate Risk:** Accept current level of risk but undertake actions to mitigate risks through changing the way you conduct business

Definition ERM

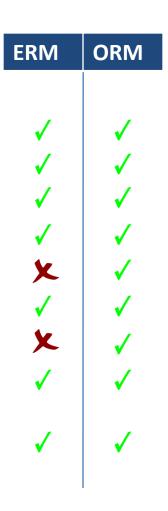Enterprise risk management is a **process**,

- **effected** by an **entity's board of directors**, **management** and other **personnel**,

- **applied** in **strategy** setting and **across the enterprise**,

- **designed** to **identify potential events** that may affect the entity, and

- **manage** risk to be within its **risk appetite**,

- **to provide** reasonable **assurance** regarding the achievement of **entity objectives"**

What is an ORM Framework

	ERM	ORM
• Committee/Department Mandate	✓	✓
• Strategy	✓	✓
• Risk Appetite Matrix	✓	✓
• Policies and Procedures	✓	✓
• ORM Training Plan Bank-Wide	✗	✓
• Risk Classification	✓	✓
• Capital Charge Targets - Switch	✗	✓
• Roles and Responsibilities Defined (ORM Dept and Risk Reps)	✓	✓
• Deliverables – Linked to Performance	✓	✓

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What Makes ORM Framework Effective

- Operational Risk Management Strategy (3-5 Year)

- **Leadership Role in ORM Implementation (THE TEAM)**

- **Involvement of Executive Management and Oversight of Board**

- **Monitoring Deliverables and Milestones - Linked to Performance**

- Understand and Promote – Cultural Shift

- **Decentralize ! – Decentralize ! – Decentralize !**

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Leadership Role – ORM Team

- An integrated structure combining
  - Operational Risk
  - Internal Control
  - Anti Fraud Unit
  - Business Contingency
  - Compliance
- Experienced Team
  - Good communication and correspondence
  - Understanding the business
  - Getting things done
- Agreed and Defined Road Map
  - Three year road map of deliverables
  - Annual Performance of ORM Core team and Risk Reps
  - Incentives

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Board Oversight

- Operational Risk Management Committee
  - Mandate Approved by the Board
  - Introduce **Operational Risk Package** Approvals i.e. Credit Approvals in Credit Committee
  - Operational Risk translated into **Financial Terms**
  - Progress on Action Plans and Escalations
- Elevating the Position of ORM/ ERM Head
  - Direct Reporting to CEO
  - Approved Budget for Dedicated Resources
  - Decentralize
- Performance Evaluation
  - Incentives tied with reduction in Penalties
  - Action Plans Completed and Translated in cost reduction
  - Training of Staff for Operational Risk Reduction
  - Reduction in Losses

Monitoring and Reporting

- Define Benchmark/Standards
  - Monitoring against meaningful thresholds – reduction in penalties YOY basis
  - Assessment of controls associated against top 30 risks for each function
  - Reduction of losses by means of incident ANALYSIS !!! Not reporting only
  - Reduction in Insurance premiums by effective controls
- Define Reporting Standards
  - Losses (Transactional Losses, Fraud, Penalties, Claims)
  - Risk Package – Decisions to accept, reject, mitigate
  - Residual Risks Reporting in Financial Numbers
  - Action Plans

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Operational Risk Concerns

1. You cannot summarise all operational risk into a single measure.
2. Operational Risk will remain subjective – Don't try to translate it into scores
3. The operational risk model is never complete.
4. Manage the risks, not the model.
5. Do not focus only on the easy quantifiable risks.
6. No history does not mean an event will not happen.
7. The target is risk, not capital reduction.
8. Do not divert risk staff to process management.
9. Assessment is not a witch hunt.
10. Do not discourage whistle blowers.
11. Do not assume everyone completes data accurately.

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Operational Risk
"How We Suggest Management"

Operational	Compliance	Reputational

Operational

Evaluation
- Human Resource
- Clear Policies
- Standard Appraisal Tools

Policy
- Over all ORM Policy and procedures development
- Implementation of policy and procedures

Automation
- Comprehensive automation in order to enable the firm in creating efficiency and effectiveness

Compliance

Compliance Risk
- Identify and prioritize
- Assessment and testing

Application
- Awareness and distribution in changes/notifications
- MIS / Monitoring

Reduce Losses
- Loss reduction in penalties
- Action plans for non-compliance

Reputational

Documentation of clear policy & procedures

Customer complaints and claims recorded and integrated in ERM

Non financial risk appetite matrix developed and applied

Swift action and process to meet customer requirements as per regulations

Recap

1. Define Strategy – Know your objectives of three years

2. Objectives should be financial not activities only

3. Build a Strong ORM Leadership and Team

4. Involve the Executive Management – Formalize it

5. You cannot achieve results without training staff at all levels

6. Performance should be linked to deliverable

7. Decentralize ! First Year – **SELF** ASSESSMENT !!

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Thank You!
Questions?

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