



SESSION 4 : OPERATIONAL RISK

THE PRINCIPAL BUILDING BLOCKS OF AN OPERATIONAL RISK FRAMEWORK AS APPLIED TO GOVERNMENT DEBT MANAGEMENT

OPERATIONAL RISK FRAMEWORK

- **ALM PROJECT INITIATED IN 2005/6**
- **AIM & PURPOSE**
 - Research and discuss **how best to manage operational risk** within the context of ALM.
 - To set a theoretical **framework** for operational risk as related to ALM as a business unit and its divisional functions.
 - It is the **responsibility** of managers to at least identify these risks.

OPERATIONAL RISK FRAMEWORK

DEFINITION:

- type of risks that if left **unidentified, unquantified, and unmonitored** could have a detrimental impact on the business. These risks could be **explicit or implicit**, and they could result from **various sources** within a business unit or as a result of an exogenous shock to the business unit.
- Basel II defines operational risk as **“the risk of loss resulting from inadequate or failed internal processes, people, systems or from external events. This definition includes legal risk but excludes strategic and reputation risk”**.

OPERATIONAL RISK FRAMEWORK

SOURCES:

- **PEOPLE** (HUMAN ERROR, RELIANCE ON KEY INDIVIDUALS, COMMUNICATION, CHALLENGES FACING MANAGEMENT- understanding, information, clearly assigned ownership & responsibility)
- **PROCESS** (SEGREGATION OF RESPONSIBILITIES THROUGH “6-EYES APPROACH, ACCESS TO SPECIFIC DATA BY VARIOUS)
- **SYSTEMS** (USING LIVE DATA vs HISTORIC DATA, FIREWALL)
- **BUSINESS STRATEGY** (CHANGE IN MANAGEMENT)
- **BUSINESS ENVIRONMENTS** (RECOVERY PLANS – SITE)

OPERATIONAL RISK FRAMEWORK

SUCCESSFUL MANAGEMENT THROUGH SIX PILLAR :

- Identification
- Measurement
- Monitoring
- Reporting
- Control
- Mitigation

OPERATIONAL RISK FRAMEWORK

SUCCESSFUL FRAMEWORK

- **Clear Responsibilities**
- **Independent Risk Reporting Function**
- **Responsibility for managing risk at business level**
- **A Corporate Culture fostering the Identification and Reporting of operational losses**
- **A Robust modeling programme**

–(Fitch Rating- 2005)

OPERATIONAL RISK FRAMEWORK

TOOLS

- **Risk Control self assessment** (management brainstorming sessions)
- **Scorecards** (risk identified by corporate risk management)
- **Key risk indicators** (alert management to changes within the organisation)
- **Scenarios** (forward looking, modeling process)

OPERATIONAL RISK FRAMEWORK

KEY PERFORMANCE INDICATORS

- **QUANTIFY**
- **QUALIFY**
- **MONITOR**
- **COMMUNICATE**
- **BENCHMARK**

OPERATIONAL RISK FRAMEWORK outcome

Link to Objectives		Risk Identification and classification				Inherent Risk Assessment			Current controls	Residual Risk Assessment			Risk Mitigation & Monitoring			Time scale
Objective	Risk Title	Risk Description	Risk Classification	Risk Category	Causes/ Contributing factors	Inherent Impact	Results	Inherent Priority		Residual Impact	Residual Likelihood	Residual Priority	Actions to improve management of the risk	PRG	Chief Directorate	

- **Linked to objectives:**
 - Objective and risk title
- **Risk identification and classification**
 - Description, classification, category, causes & contributing factors
- **Inherent risk & Assessment**
 - Impact, results, priority
- **Current controls**
- **Mitigation & monitoring**
 - Action to improve management of risk, owner allocation