



The GARP Risk Series

OPERATIONAL RISK MANAGEMENT

Chapter 12 | Operational Risk

Chapter 12 – Operational Risk

- **The Definition of Operational Risk**
 - Operational Risk Management and Operational Risk Measurement
 - Operational Risk Management
 - Operational Risk Measurement
 - The Relationship between Operational Risk Management and Other Risk Types
- **Drivers of operational risk management**
- **Operational Risk Framework Overview**
 - Governance
 - Who should own the operational risk function?
 - Operational risk is owned by the Chief Risk Officer
 - Operational risk is owned by the Chief Operating Officer, or the Chief Financial Officer
 - Operational risk is owned by the Chief Compliance Officer
 - What should the operational risk function own?
- **Culture and Awareness**
 - Marketing and Communication
 - Planning
 - Training
- **Policies and Procedures**

Chapter Focus

- The place of operational risk management in the context of risk management
- The difference between operational risk management and operational risk measurement
- The role of operational risk in Governance, Risk and Compliance and Enterprise Risk Management
- Good practice for operational risk management
- The role of Basel II and other regulations
- The policies and procedures needed to support operational risk management
- The array of operational risk management tools available to implement
- The benefits and challenges of different governance structures for operational risk management
- Designing and selecting reporting that can drive decision making and risk behavior
- Modeling techniques for the calculation of economic capital for operational risk

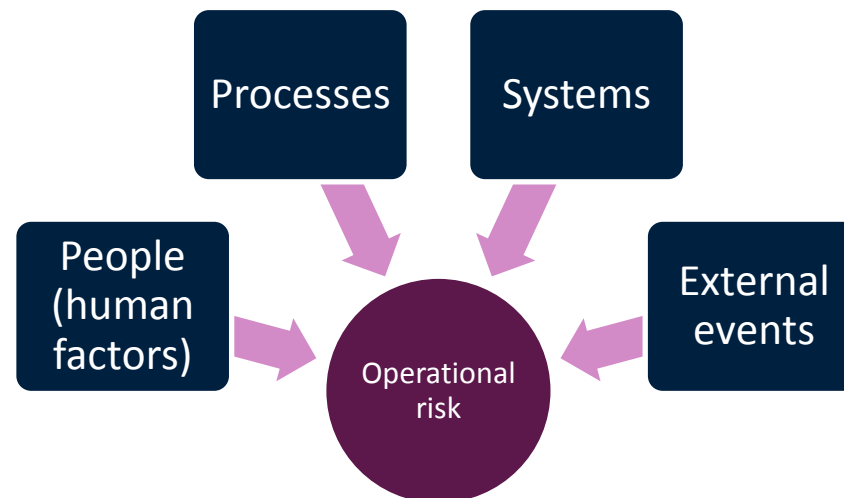
The Definition of Operational Risk

- **Basel II defines operational risk**

- Operational risk is defined as the risk of loss resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.
 - Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements

- **JP Morgan Chase defines operational risk**

- Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events.



Operational Risk Management and Operational Risk Measurement

Operational Risk Management

- Qualitative assessment of operational risk

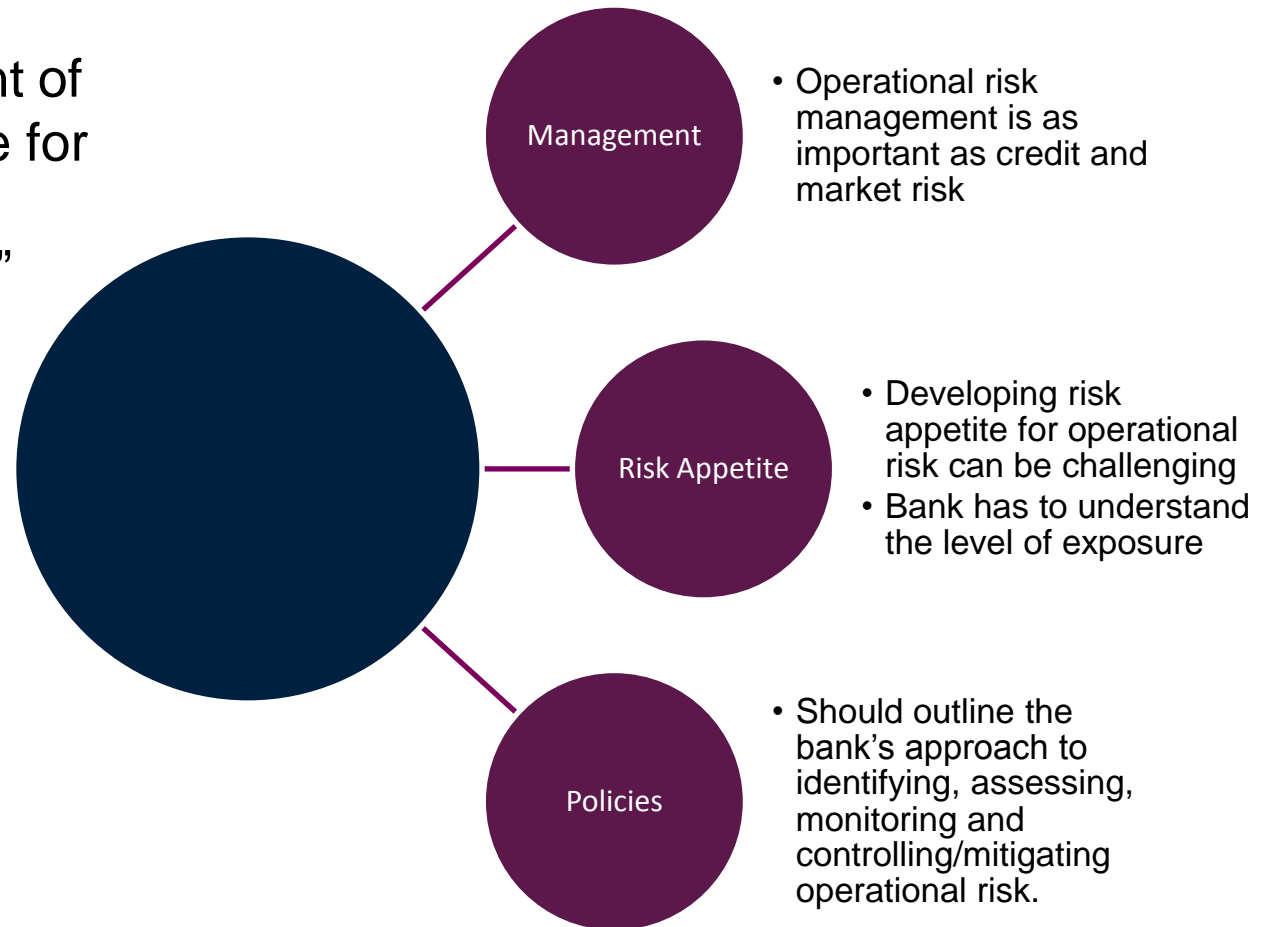
Operational Risk Measurement

- Quantitative assessment of operational risk

Operational Risk Management

- “similar rigour should be applied to the management of operational risk, as is done for the management of other significant banking risks...”

Basel Committee



Operational Risk Management Toolbox

- In the operational risk management toolbox are loss data collection programs, risk and controls self-assessments, scenario analysis activities, key risk indicators and powerful reporting

The Relationship Between Operational Risk Management and Other Risk Types

- Operational risk is often present with other risk types
- Credit and operational risk events can overlap

Example

- One of Gamma Bank's business lines offers retail customers the ability to trade bonds. One of the customers calls the broker at Gamma Bank and instructs the broker to buy Andromeda Corporation bonds for the customer's account. The trade is executed, but it is mistakenly booked as a sell, instead of a buy, this will result in a significantly larger loss if the market moves up.
- The cost of making the customer whole will now be much higher than if the market had remained stable. In fact, there could be a gain if the market drops. It is clear then that market risk can magnify operational risk.

Operational Risk Measurement – the ERM Wheel

