

Operational Risk Management



The Issues

The definition of operational risk can be somewhat elusive. There are some specific definitions available, such as that provided by the New Basel Accord for the banking industry which is “the risk of losses resulting from inadequate or failed internal processes, people and systems, or external events”, but there is no standardised precise definition that has broad applicability across different industry sectors. What is certain is that operational risk has a very wide scope.

Operational risk management is a trade-off; if there is a risk associated with taking a particular course of action there is also a risk of not doing so, and associated with both is a potential business opportunity. Furthermore, individual risks interact in complex ways and if one risk is mitigated, almost certainly at least one other risk in response will increase. A very broad view of operational risk, therefore, needs to be taken to manage it successfully.

Some of the major problems encountered in attempting to measure operational risk are:

- ⊙ The available data on risk events is largely anecdotal and very sparse, making statistical analysis problematic
- ⊙ Even if data were available, unravelling the probability of a threat event from the probability of a control failure is complex – thus measuring the effectiveness of controls is difficult
- ⊙ The highest impact events are very rare, rendering statistical forecasting error-prone and unreliable unless great care is taken
- ⊙ Each category of operational risk has an individual loss distribution, making it complex and difficult to integrate into a single loss distribution for calculating economic or regulatory capital allocations against operational risk losses
- ⊙ The correlation coefficients between different operational risk types are rarely zero, but isolating these values is also difficult.

The Solution

idRisk will help you to put in place an operational risk management framework that achieves the following objectives:

- ⊙ Embed operational risk management into the fabric of the business processes
- ⊙ Provide a complete, up-to-date view of your portfolio of operational risks
- ⊙ Automate the collection, analysis and reporting of operational risk information
- ⊙ Define effective measurement approaches to define key risk indicators (KRIs) for each operational risk type
- ⊙ Integrate real-time operational risk data from disparate sources that is needed for calculating the real-time KRI values
- ⊙ Set thresholds on the KRI values that provide early warnings of upcoming risk events
- ⊙ Link the KRIs into your MIS and executive management dashboards
- ⊙ Develop effective usable methods for calculating economic capital to set against operational risk.

Benefits

- ⊙ Embedded operational risk management has been shown to improve overall business performance
- ⊙ Early warnings of potential risks enhance the quality of management decisions.

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