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Event C-25: Understanding Operational Risk Governance and Designing its Effective Implementation

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Understanding Operational Risk Governance and Designing its Effective Implementation

To illustrate how to design and implement an effective operational risk governance program:

1. How to leverage the organizational culture and risk philosophy when implementing risk management at the operational level

2. A method to define the priorities for operational risk when uncertainty prevails

3. Assessing the impact of alignment on emerging risks and business performance

4. The importance of strategic capabilities to respond to risks arising from regulatory change

5. The 4 key elements of your Operational Risk Governance performance

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1. How to leverage the organizational culture and risk philosophy when implementing risk management at the operational level

A. Organizational Culture

B. Risk Philosophy

C. Implementing ERM

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1. A. Organizational Culture

Answer the question:

• What objectives do you believe your organization will be able to achieve more effectively with a risk management discipline?
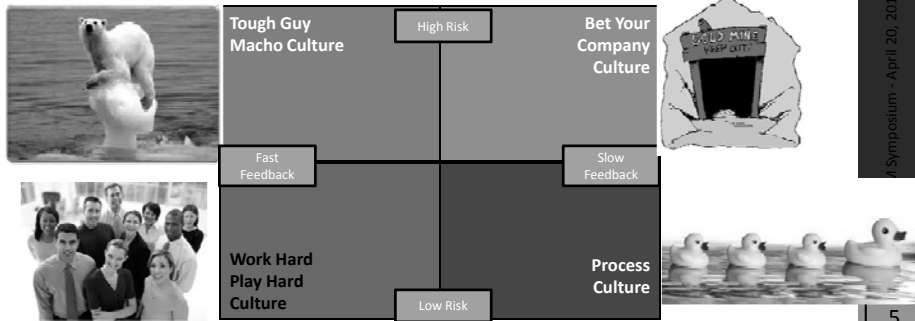
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1. A. Organizational Culture

1) Leveraging culture impacts what you <u>achieve</u>

WHY CULTURE MATTERS . . . .

Tough Guy Macho Culture	High Risk		**Bet Your Company Culture**
	Fast Feedback	Slow Feedback	
Work Hard Play Hard Culture	Low Risk		**Process Culture**

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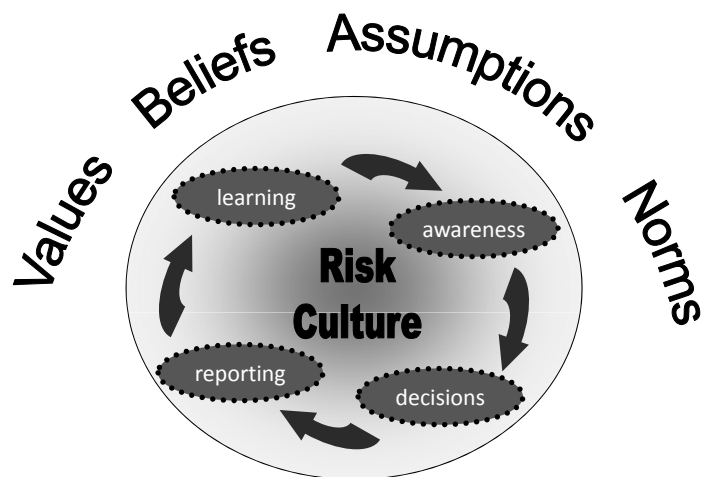**Source:** *T.E. Deal and A.A. Kennedy, (1982) Corporate Cultures: The Rites and Rituals of Corporate Life,*

1. A. Organizational Culture

2) How and when you take risks defines the Risk Culture

Values   Beliefs   Assumptions   Norms

Risk Culture

learning

awareness

reporting

decisions

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1. A. Organizational Culture

3) Defined from the top down –
Applied from the bottom up

    a) The Board's role – legally defined†
        i. *Define TBL Value weights*
        ii. *Empower employees to achieve TBL Values*
        iii. *Monitor and enforce*

† – "Risk management was elevated to the board agenda by the Securities & Exchange Commission (SEC) amended rule 33-9089 and the 2010 Wall Street Reform and Consumer Protection Act (Dodd-Frank)." *Journal of Risk Management in Financial Institutions* "The New Model of Governance and Risk Management for Financial Institutions" John Bugalla, James Kallman, Stephen Lindo, Kristina Narvaez 2012

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1. A. Organizational Culture

3) Defined from the top down –
Applied from the bottom up

    a) The Board's role
    b) The Executive team's role
        i *Recognize fiduciary duties: loyalty, care, disclosure*
        ii *Lead by example = motivate*
        iii *Reward success*

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1. A. Organizational Culture

3) Defined from the top down –
Applied from the bottom up

    a) The Board's role
    b) The Executive team's role
    c) The Operational managers' roles
       i Apply enterprise risk management processes
       ii Motivate workers
       iii Monitor success

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1. A. Organizational Culture

    4) Summary:
      i. ERM is part of the culture at all levels
      ii. Everyone is a risk manager – participation is not an option
      iii. Everyone is responsible for managing their risks

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1. How to leverage the organizational culture and
   risk philosophy when implementing risk management
   at the operational level

   A. Organizational Culture
   B. Risk Philosophy
   C. Implementing ERM

B. Risk Philosophy (Attitude or Position)
   1) Purpose: *describes the range of acceptable outcomes – both up and down*
   2) Defined: *the combination of the organization's risk appetite and risk tolerance*

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B. Risk Philosophy (Attitude or Position)
   1) *Purpose*
   2) *Defined*
   3) *Risk Appetite:*
      1) Defined: *the willingness and ability to pay to take on volatile new projects*

      2) Examples: Spending money on R&D to develop a new product, spending money on hiring a new salesperson, Investing in an advertising campaign

      3) Metrics: (proxy) (R&D + Mktg)/Revenues
                    (so we can compare)

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B. Risk Philosophy (Attitude or <u>Position</u>)
1) *Purpose*
2) *Defined*
3) *Risk Appetite*
4) *Risk Tolerance:*
    i. Defined: *the willingness and ability to pay to transfer volatile situations*

    ii. Examples: Buying insurance, hedging volatile commodities, backing up to a cloud

    iii. Metrics: (proxy) (RC + RF exp)/Revenues
          (so we can compare)

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B. Risk Philosophy (Attitude or <u>Position</u>)
1) *Purpose*
2) *Defined*
3) *Risk Appetite*
4) *Risk Tolerance*
5) *One picture….*

| Risk Tolerance | Optimal Range | Risk Appetite |

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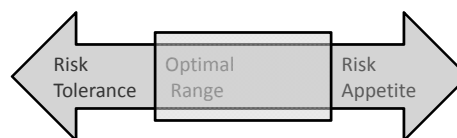
A. Organizational Culture
B. Risk Philosophy
C. Implementing ERM

    1) *Board Participation: an essential component of a successful ERM system*

        a) Stand alone Board level risk committee
            (complements audit)

        b) "Expert" member of the board
            (MF Global hypothesis)

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C. Implementing ERM
    1) *Board Participation:*
    2) *Executive Risk Committee – reports to the Board risk committee*
        a) Chief Risk Officer (CRO) – independent?
        b) Chief Executive Officer – independent?
        c) Independent of finance and audit committees
        d) Ensures a cross-disciplinary view
        e) Sends two critical signals:
            i. *Managing risk is essential for success*
            ii. *Collaboration is essential for success*

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C. Implementing ERM
   1) *Board Participation:*
   2) *Executive Risk Committee*
   3) *Operating (working) Risk Committees*

   a) Specialized operations require specialized risk management skills
   e.g., finance, human resources, marketing, operations, IT

   b) Continuous training means continuous improvement

   c) Promotes "shared intelligence"

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2. A method to Define priorities for operational risk when uncertainty prevails

A. Operational Risk Management is about managing the losses from failures of people, processes, systems, or impacts from external factors.

B. Operational Risk Governance is about the oversight and awareness of the behaviours *(patterns)* of people, processes, systems, and external factors that could impact the achievement of operational objectives.

The question was asked earlier:

What **objective** do you believe your organization will be able to achieve more effectively with a risk management discipline?

When the business landscape is uncertain, business must have confidence and reliable processes to achieve the objectives.

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2. A method to Define priorities for operational risk when uncertainty prevails
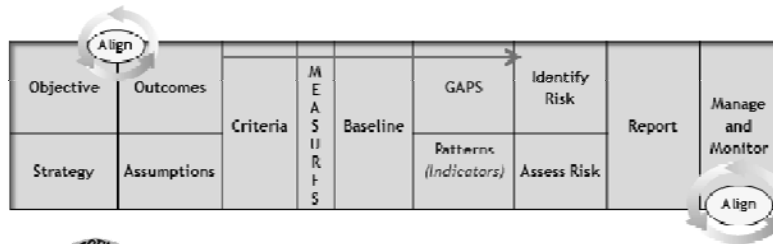
C. Uncertainty:

raises questions about strategies and plans

D. Alignment:

A method to integrate critical business processes and risk management processes to create value for the organization
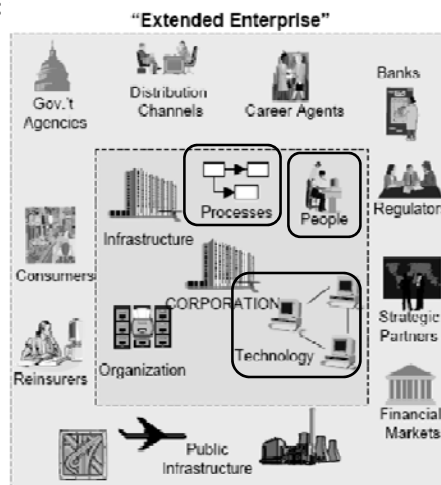

© ICORM 2012
Proprietary methodology

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2. A method to Define priorities for operational risk when uncertainty prevails

E. Priorities organizations focus on:

1. Agility
2. Resilience
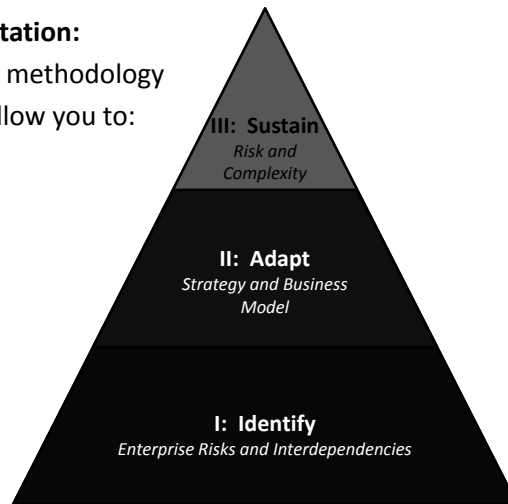3. Adaptability
4. Innovation
5. Robust processes

"Extended Enterprise"

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2. A method to Define priorities for operational risk when uncertainty prevails

F. Implementation:

a repeatable methodology

will allow you to:

III: **Sustain**
Risk and Complexity

II: **Adapt**
Strategy and Business Model

I: **Identify**
Enterprise Risks and Interdependencies

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2. A method to Define priorities for operational risk when uncertainty prevails

G. Method:

1) Board sets vision and mission statements

*2) Board prioritizes long-term strategic goals
(with input from CRO & board risk committee)*

*3) Executive team prioritizes operational objectives
(with input from operating risk committees)*

*4) Managers & Workers prioritize tactical goals
(with input from the CRO)*

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3. Assessing the impact of alignment on emerging risks and business performance

A. Achieving alignment will aid in the identification of two key contributors to emerging risk:

1) Gaps

2) Patterns (Indicators)

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4. The importance of strategic capabilities to respond to risk arising from regulatory changes

A. Strategic capabilities are the combination of
competence + capacity + action
to survive, prosper, and continually deliver value

B. There is no competitive advantage
to being more compliant to new or changed regulations

C. The Board & Executive team must be proactive in anticipating, contributing to, and responding appropriately to regulations
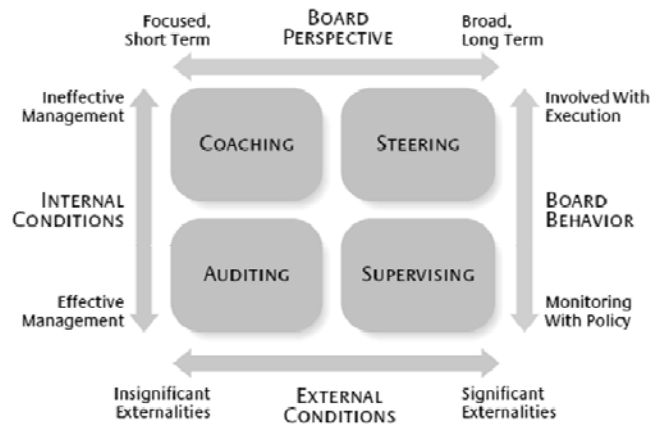
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5. The 4 elements of your risk governance performance

Knowing when to change . . . .

"From *The Case for Contingent Governance*, Paul Strebel , MIT Sloan Management Review, winter 2004".

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What have we said?
     It's all about Organizational Culture

• What objectives do you believe your organization will be able to achieve more effectively with a risk management discipline?

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Summary

Most ERM frameworks lack a robust approach to address operational risks.

Sharing our respective views on Understanding Operational Risk Governance and Designing its Effective Implementation

to design and implement an effective operational risk management (ORM) program:

1. How to leverage the organizational culture and risk philosophy when implementing a risk management approach at the Operational level

2. A method to define the priorities for operational risk when uncertainty prevails

3. A proven approach for assessing the impact of organizational alignment on the identification of emerging risk and business performance

4. The importance of strategic capabilities to respond to risks arising from regulatory changes

5. The 4 key elements of your Risk Governance performance

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