

Operational Risk Management...Where to Start

Our last article about RISK, the “four-letter word,” drove a lot of inquiries to us at CE3 Solutions. We received many requests for more information about the risk assessment process and how CE3 Solutions can help. This article will dive into the topic in more detail and help you assess whether we can assist you in your Risk Management Planning and Assessment needs.

I remember when I was first informed that I had been tapped to be the Risk Executive for Technology and Operations. After the initial shock, I asked, “Why me?” The response was that I had experience in technology support, change and problem management, application development and testing, information security, business continuity, and disaster recovery planning, so I would have some good insight as to where to look for risks. I agreed that I knew *where* to look, but then thought about the big WHATs!

WHAT do I know now?

WHAT am I doing about it?

WHAT else is out there that I do not know, what can happen and why?

WHAT are the consequences?

WHAT do I need to do?

WHAT is the future probability of occurrence for the identified risks?

WHAT are the current controls and are they enough to mitigate the consequences of the identified risks or to reduce the probability of their occurrence?

The questions above are simple, yet perplexing. What was missing was a common repeatable process or measurement system for the most basic step, the risk assessment. The operational risk landscape has expanded to include everything but the kitchen sink (minus the more mature Market Risk and Credit Risk). This was coupled with the reality that the industry had muddied the waters with global risk programs and tools that over-promised and under-delivered, resulting in confusion and poor adaption. Most of the tool and process providers took a top-down approach rather than a bottom-up approach (where the risks are best understood). I am not implying that senior management does not play a key role in the risk assessment process, just that the folks closest to the work and responsible for executing it each day have a unique vantage point that cannot be overlooked.

Larger deep-pocket organizations have used in-house knowledge, expertise, and resources to build their processes and tools. Smaller organizations continue to struggle through with insufficient expertise, experience, and funding, while operational risks continue to have greater importance and priority, both for regulators and institutions. I won't attempt in this article to name all of the operational risks; however, the ones that are getting the most press are sophisticated cyberattacks, anti-money laundering and know your customer, well-publicized instances of inappropriate behavior at major institutions, and risk events at third parties employed by institutions resulting in significant financial

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losses and reputational damage. While larger institutions make more headline news, these issues and risks affect institutions of all sizes and across all industries.

So, let's start at step one, the risk assessment. Risk assessments are used to analyze threats in terms of consequences and their probabilities before the organization decides to accept, mitigate, or transfer those risks. Operational risk management is complex but can be tackled by taking the first step, the risk assessment, and doing it right. As the saying goes, "You can't manage what you don't know." Most, if not all, of an institution's risks are known by someone in the organization, most likely the SMEs (Subject Matter Experts). The problem in most cases is that the SMEs lack common processes, tools, and measurement systems to identify, document, and measure the risks and make them visible across the institution.

The management decisions around risks are difficult because leaders are using different processes and measurements to identify the risks in their organizations. What does the leader do? How do they decide which risks are most critical? How does that decision get weighed against limited resources, budget, timing, organizational priorities? Do you go with your "go-to" leader? Listen to the more reserved and thoughtful leader? Bring in some SMEs? Go with your gut, experience, and intuition or some combination?

The real issue is the lack of a risk assessment methodology and process with consistent, well-defined taxonomy and measurement criteria. Therefore, the most important first step is defining a risk assessment methodology including buildout of supporting processes and measurements.

At its core, risk assessments deliver the following:

- 1) Identify threats (risks) to the operation of an organization's business and strategic objectives
- 2) Evaluate and prioritize risks
- 3) Reduce and monitor those threats so that they remain at or below agreed tolerance levels.

By understanding and managing risk, organizations achieve greater certainty and confidence for shareholders, employees, customers, suppliers, and the communities in which they operate.

Organizations are better positioned to analyze threats in terms of consequences and their probabilities before decisions are made on how to treat risks. Once risks have been identified and assessed, all techniques to manage the risk fall into one or more of these four major categories:

- Avoid: Exit the activity
- Reduce: Take action to reduce Impact/Likelihood/Both
- Share: Transfer, Insure, Hedge
- Accept: No action taken

Continuous risk assessments must be integrated with strong governance and monitoring processes since the identified risks rarely will be entirely eliminated. Even a world-class operational risk reporting and measurement system will not reduce risk without a supporting organizational structure and framework within which to manage the identified threats.

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Questions to consider:

- Does your company have a robust risk assessment process?
- Do you have adequate knowledgeable resources and tools?
- Does your risk assessment process effectively surface, analyze, and prioritize operational risks?
- Are identified key risks aligned with your company's strategic goals and objectives?
- Does the process facilitate updates to your risk profile as the business environment changes?
- Does the process ensure continuous monitoring of inventoried risks for compliance with agreed control limits?

By understanding and managing risk, organizations will have greater certainty and confidence for shareholders, employees, customers and suppliers, and for the communities in which they operate, while improving the consistency and efficiency of operations, leading to more satisfied customers.

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