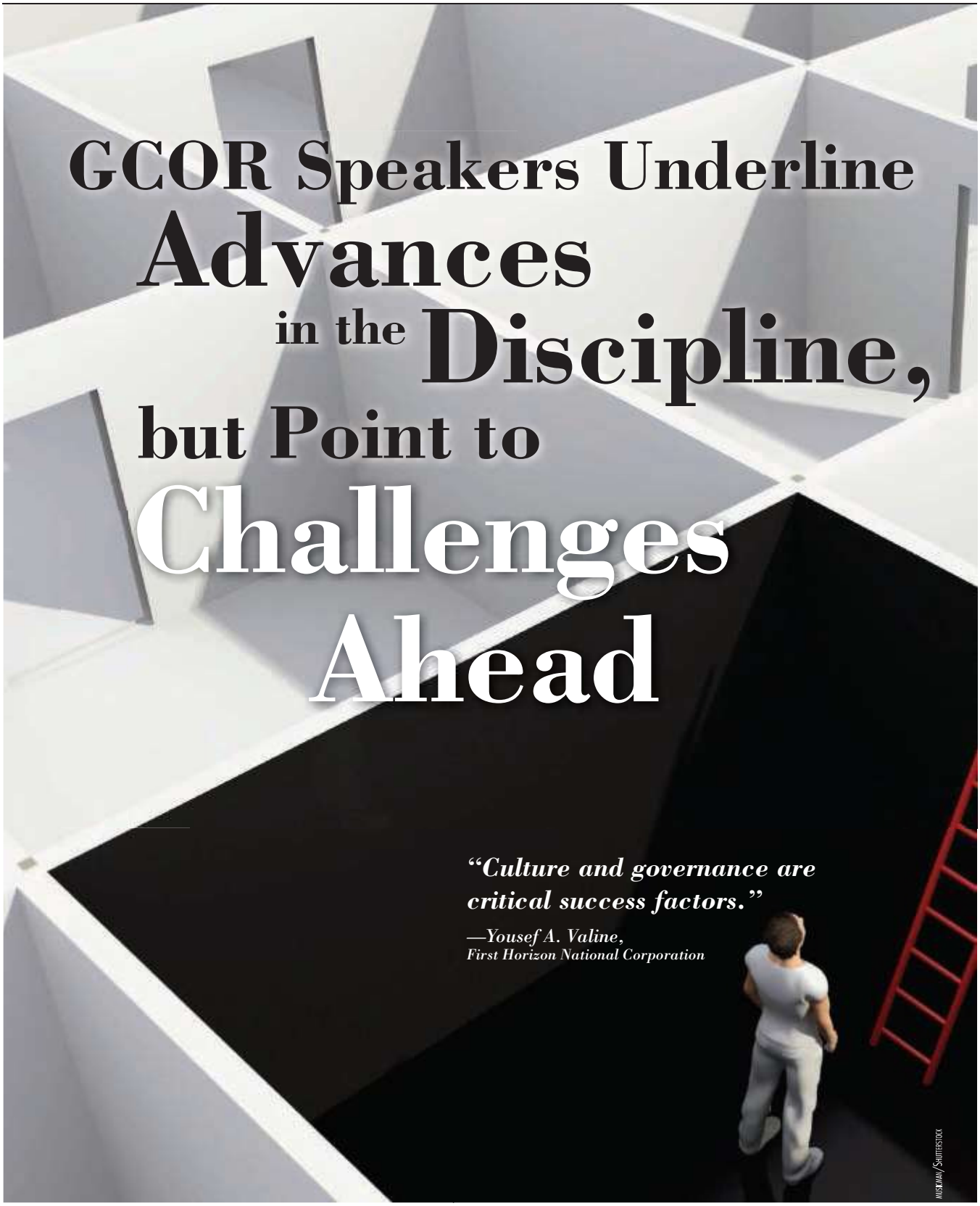

GCOR Speakers Underline Advances in the Discipline, but Point to Challenges Ahead

"Culture and governance are critical success factors."

—Yousef A. Valine,
First Horizon National Corporation

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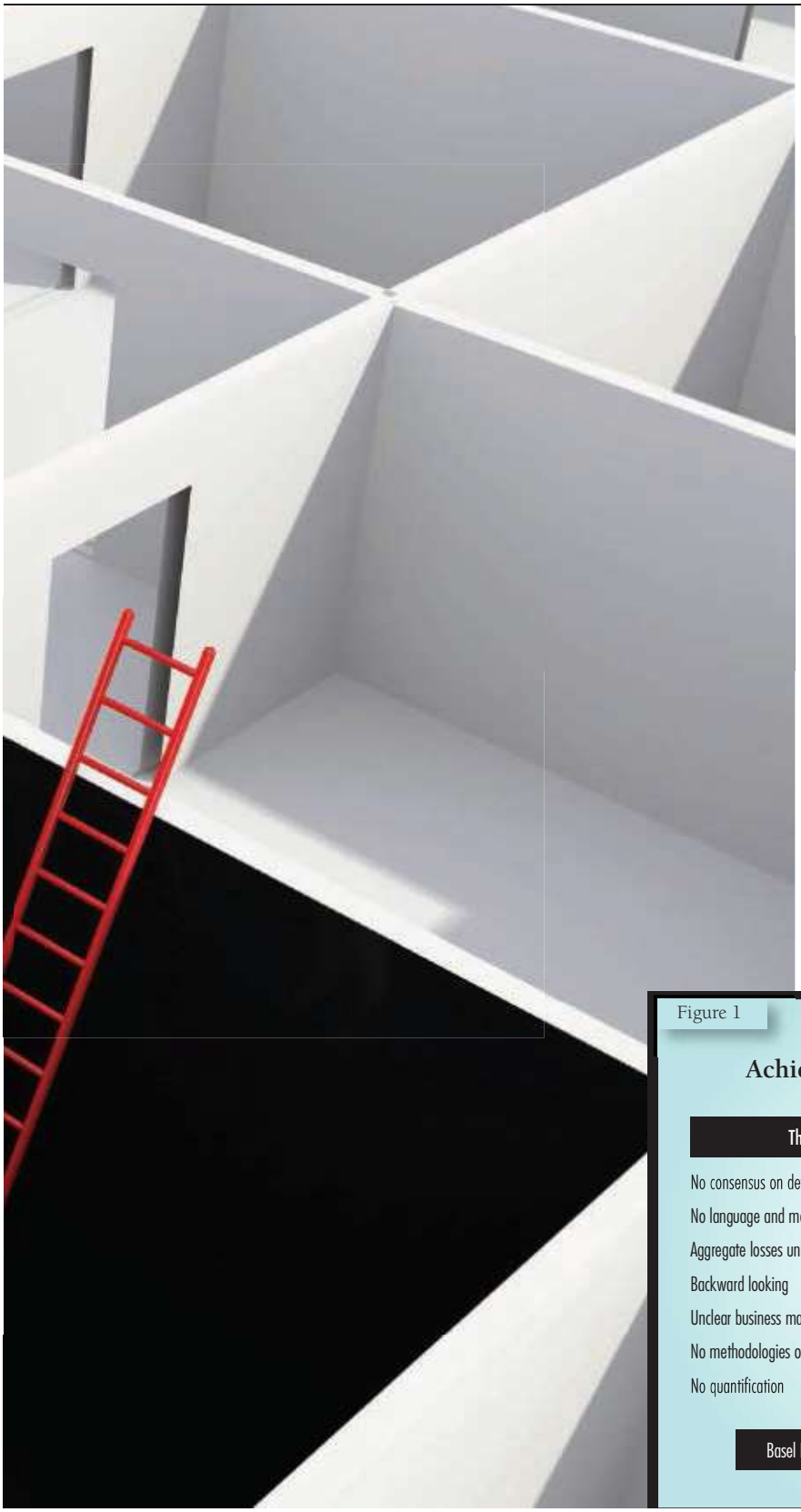

BY KATHLEEN M. BEANS

THE DISCIPLINE OF operational risk management has advanced significantly in the past 10 years. Many institutions have implemented operational risk governance practices, while heads of businesses within banks recognize that these practices can add value to their units. The advances of the discipline are due in part to Basel II, but also to the excellent working relationships that practitioners have with the regulators.

These comments were made by GCOR's opening keynote speaker Yousef A. Valine, chair, First Horizon National Corporation, Memphis, Tennessee.

Valine noted that one of the chief accomplishments for the discipline was to gather data on operational risk losses, citing the data collation efforts of several national and international consortia. Valine also used the occasion to remark about the valuable contributions made to the industry by former RMA Operational Risk Council member Joe Sabatini of JPMorgan Chase, whose duties have recently shifted from operational risk management to regulatory relations.

"Joe understood that we couldn't manage operational risk without data," said Valine, who chairs RMA's Operational Risk Council.

Figure 1

Achievements in the Last 10 Years

Then	Now
No consensus on definition	Single definition
No language and metrics	Improved language and metrics
Aggregate losses unkown	Transparency of losses
Backward looking	Somewhat forward looking
Unclear business mandate	Improved business mandate
No methodologies or tools	Early stages of quantification
No quantification	We know more about the nature of operational risk

Basel II did serve as a catalyst for the focus and improvements

Figure 2

Challenges Lie Ahead

Although much has been accomplished, there's still much to be done. Valine reminded everyone that models are not a substitute for common sense and judgment. And although measurement is helpful, Basel II put too much emphasis on it.

"Culture and governance are critical success factors," he said. "And since it's almost impossible to get the operational risk capital calculation on a transaction level, it's best to keep the capital calculation methodology simple."

He advised risk managers to focus their attention on three simple questions:

- Should we do it? (Is it aligned with strategy, risk appetite, culture, values, and ethics?)
- Can we do it? (Do we have capability in our people, processes, structure, and technology?)
- Did we do it? (Have we assessed expected results and provided for continuous learning and a system of checks and balances?)

Culture, perspective, courage, and common sense were common themes at GCOR. (See Caryl Athanasiu's keynote address on p. 42 and a summary of the panel discussion involving senior risk professionals, p. 46.)

Meaningful Board Reporting

Overflow crowds packed into the session on meaningful board reporting, conducted by Valine and Bruce Gupton, cofounder and chairman, Gupton Marrs International. In this highly practical presentation, both speakers discussed the 10 steps to meaningful reporting, issues and challenges, and how to get started.

"Success requires ongoing focus on asking the right questions, getting the right answers, and taking the right action," said Gupton. He and Valine outlined the steps necessary to begin a process of enhanced risk management and board reporting (Figure 2).

Role of Operational Risk in the Recent Crisis

Although operational risk failures—aggressive accounting, inflated valuations, and fraud—played a role in the recent financial crisis, there has not been much discussion about the role of operational risk. That's because it has a smaller capital impact and also because its failures are often conflated with market risk and credit risk, said Patrick de Fontnouvelle, vice president, Supervision, Regulation, and Credit, Federal Reserve Bank of Boston, and a member of the Basel Committee on Banking Supervision's Standards Implementation Group on Operational Risk. "Can we point to one institution where operational risk was the proximate cause of failure?" he said.

Outreach is critical for operational risk managers, noted de Fontnouvelle. "There is a lack of understanding and/or a misunderstanding regarding the nature and impact of operational risk," he said, noting also that the risk function must have sufficient stature and authority to take action against questionable practices.

De Fontnouvelle also observed that sound operational risk management often can be distilled into simple tenets such as the following:

- Beware of suitability/compliance issues.
- Remember that "all models are wrong."
- Undertake due diligence and be wary of fraud.
- Don't do what you don't understand.
- Be suspicious of the "free lunch."
- Understand that incentives drive behavior.

"It is perhaps not an exaggeration to say that the crisis

would not have happened had tenets such as these been better emphasized," said de Fontnouvelle.

He said an important governance issue is whether the risk manager has full authority to enforce good behavior.

Product Risk Assessments

James E. Sproull Jr., senior vice president, chief operational risk officer, SunTrust Banks, Inc., stressed the importance of carefully vetting the risk in products. He offered the following advice:

- Have a clear definition of new product/service for appropriate scope.
- Develop a robust product risk review and approval process.
- Include relevant stakeholders.
- Avoid a siloed approach to insure consideration of risk linkages.
- Understand the full scope of risks involved and your risk appetite.
- Develop a rigorous business case, including full costs of risk mitigation.
- Document the process and final requirements on which approval was based.
- Monitor implementation for compliance with approval conditions.
- Have a post-implementation assessment process to evaluate product performance from both a financial and risk management perspective, as well as the performance of the product development risk assessment process.

As in past years, GCOR IV attracted an international audience. Speakers addressed issues in three streams: regulation, practical approaches, and dealing with issues.

This year's conference was a success thanks to robust programming, as evidenced by the positive reviews and the number of attendees, said RMA Director of Operational Risk Ed DeMarco.

"Clearly, the practice of operational risk is evolving as emphasis shifts from measuring operational risk to creating a strong culture of risk awareness and applying operational risk thinking to all important products and processes across an institution," said DeMarco. " It's vitally important that RMA continue to advance the operational risk management discipline by fostering dialogue among practitioners and regulators through events like GCOR, as well as through our various working groups—the AMA [Advanced Measurement Approach] Group and ORMDG [Operational Risk Management Discussion Group]." ❖

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