

Operational Risk Management

**A Complete Guide for
Banking and Fintech**

Second Edition

PHILIPPA GIRLING

WILEY

Contents

Preface	xiii
Acknowledgments	xv
CHAPTER 1	
Definition and Drivers of Operational Risk	1
The Definition of Operational Risk	1
2012 London Olympics: A Case Study	5
Operational Risk Management and Operational Risk Measurement	9
Drivers of Operational Risk Management	13
Key Points	14
Review Questions	14
Notes	15
CHAPTER 2	
The Regulatory Push	17
History of the Basel Accords	17
Rules of the Accords	22
Adoption of Basel II in Europe	27
Adoption of Basel II in the United States	27
Impact of the Financial Crisis	29
Basel III	34
Key Points	36
Review Questions	36
Notes	37
CHAPTER 3	
The Operational Risk Framework	39
Overview of the Operational Risk Framework	39
The Foundations of the Framework	40
The Four Data Building Blocks	42
Measurement and Modeling	44

Reporting	44
Risk Appetite	45
Key Points	45
Review Questions	46
Note	46
CHAPTER 4	
Operational Risk Governance	47
Role of Governance	47
First Line of Defense	50
Second Line of Defense	51
Third Line of Defense	63
Risk Committees	66
Key Points	68
Review Questions	69
Notes	69
CHAPTER 5	
Culture and Awareness	71
Winning over the Firm	71
Marketing and Communication	72
Agile	73
Training	75
Planning	76
The “Use Test”	82
Key Points	84
Review Question	84
Note	84
CHAPTER 6	
Policies and Procedures	85
The Role of Policies, Procedures, Guidelines, and Standards	85
Best Practices	88
Operational Risk Policy	88
Sample Operational Risk Policy	89
Sample Standards, Procedures, and Guidelines	95
Key Points	97
Review Question	97
Note	97

CHAPTER 7

Internal Operational Risk Event Loss Data	99
Operational Risk Event Data	99
Internal Loss Data or Internal Operational Risk Events	100
Risk Event Categories	103
Using the Basel Risk Categories	112
Minimum Operational Risk Event Data Standards	113
Where Should Operational Risk Event Data Be Collected?	129
When Should Operational Risk Event Data Be Collected?	130
How Should Operational Risk Event Data Be Collected?	130
Key Points	132
Review Questions	132
Notes	134

CHAPTER 8

External Loss Data	135
External Operational Risk Event Data	135
Sources of External Loss Event Data	136
Challenges of External Data	139
Key Points	147
Review Question	148
Notes	148

CHAPTER 9

Key Risk Indicators	149
Key Risk Indicators	149
Selecting Kris	153
Thresholds	154
Kri Standards	154
Kri Challenges	155
Metrics Examples	155
Key Points	161
Review Question	161
Note	161

CHAPTER 10

Risk and Control Self-Assessments	163
The Role of Assessments	163
RCSA Methods	166

RCSA Scoring Methods	169
RCSA Best Practices	173
Key Points	178
Review Question	179
Note	179
CHAPTER 11	
Scenario Analysis	181
Role of Scenario Analysis	181
Scenario Analysis Approaches	183
Scenario Analysis Output	192
Key Points	195
Review Questions	195
Notes	196
CHAPTER 12	
Capital Modeling	197
Operational Risk Capital	197
Basic Indicator Approach	199
Standardized Approach	202
Advanced Measurement Approach	208
Insurance	221
Future of Capital Requirements: Basel III	223
Key Points	235
Review Questions	236
Notes	236
CHAPTER 13	
Reporting	239
Role of Reporting	239
Operational Risk Event Reporting	241
Risk and Control Self-Assessment Reporting	247
Key Risk Indicator Reporting	248
Scenario Analysis Reporting	249
Capital Reporting	249
Action Tracking Reporting	250
A Consolidated View	253
Dashboards	253
Key Points	253
Review Question	255

CHAPTER 14	
Risk Appetite	257
The Role of Risk Appetite	257
Regulatory Expectations	259
Implementing a Risk Appetite Framework	264
Monitoring Operational Risk Appetite	268
Risk Appetite Today	272
Key Points	272
Review Question	273
Notes	273
CHAPTER 15	
Reputational Risk and Operational Risk	275
What Is Reputational Risk?	275
Reputational Impact	277
Regulatory Oversight of Reputational Risks	283
Reputational Risk Management Framework	284
Key Points	289
Review Question	289
Notes	290
CHAPTER 16	
Operational Risk and Convergence	291
Operational Risk as a Catalyst for Convergence	291
Governance, Risk, and Compliance (GRC)	292
Converged or GRC Reporting	301
Key Points	302
Review Question	303
Notes	303
CHAPTER 17	
Best Practices in Related Risk Management Activities	305
New-Product Approval	305
Supplier and Third-Party Risk Management	306
Legal Risk Management	307
Regulatory Risk Management	308
People Risk Management	308
Fraud Risk Management	309
Technology Risk Management	310
Climate Risk	311

Pandemic Planning	312
Strategic Risk	314
Key Points	316
Review Question	317
Notes	317
CHAPTER 18	
Case Studies	319
JPMorgan Whale: Risky or Frisky?	319
Review Questions	324
Notes	339
Appendix: Answers to Review Questions	341
About the Author	351
About the Website	353
Index	355