

Proactive Risk Solutions LLC

Banking Industry Operational Risks Going Forward



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Summary: Current operational risk management programs are cumbersome, costly and may not always result in successful identification of risks and monitoring of controls. A transformational approach utilizing key performance indicators will allow near real-time monitoring by functional management and allow needed audit resources to be reallocated to emerging high risk areas.

The banking industry has a history of risk management starting with Compliance Regulations and expanding into financial with the passage of Sarbanes-Oxley (SOX) in 2002. It then experienced a second expansion to operational risk through the Basel Accord II requirements. Risk categories were expanded from merely financial to include general operational, third-party, technology (including Data Security), and reputational. Other risk categories not deemed to be classified as operational were also included. For purposes of this article, however, risks directly related to regulatory compliance are outside the scope.

From a historical perspective, SOX and later Basel Accord II required institutions to implement an expanded operational risk program given only minimum guidance. As a result, the initial programs built became excessively large and costly. Going forward, however, institutions are facing an environment where cost cutting in general will be required. This is coupled with the need to move toward advanced technology. The latter will require substantial costs as well as an increased need for data security. Additionally, this will result in increases to risk profiles related to activities in third party, technology, security and regulatory compliance. To be clear, third-party risk will increase as institutions move toward artificial intelligence and other applications that may run off third-party servers. As a result of these new areas of concern, the need to provide continuing levels of ,scrutiny over general functional operational risks should be questioned. Consider the following questions.

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- Is there a continuing need for the same level of audit scrutiny now being exercised over general operational risks?
- Is there a need for the detailed level of identification of operational risks at the functional level assessments?
- Should the functional operational risk assessment levels be raised to more overarching risks within each function?
- How will implementation of artificial intelligence impact the need for the existing general operational risk environment?

At Proactive Risk Solutions we believe the answers to many of these questions are “yes”. Our transformative approach would move these detailed level functional risks to continuous monitoring through the alignment of the appropriate key performance indicators. The concept was developed based on many years of risk management experience within the banking industry. It recognizes that current risk programs have become cumbersome, costly, and do not always result in successfully identifying issues and problems.

How does this approach work? Basically, it allows for continuous near real-time monitoring of risks and related controls by management thus potentially reducing the need for audit hours to test controls. That can translate into the ability to reallocate this time to emerging higher risk areas without the need for additional staff. KPI's, when properly aligned, can provide sufficient information on how controls are working. That is, are they properly designed and are they being implemented and followed as designed. In addition to monitoring the control environment, this approach can assist in identifying potential risks.

We would be available to discuss this approach further with you. Our publication “Risk Management and Key Performance Indicators”, while geared toward other industries, provides a detailed level of information on how the program is designed. We also offer speaking engagements and presentations. Our publication is available on Amazon, our speaking engagements can be requested by contacting us at prorisksolutionsllc@gmail.com or calling 440-465-6993.