

## EVERY WALL IS A DOOR



Annie Searle

The Risk Universe columnist Annie Searle shares questions posed to her by new students of operational risk that pose some home truths for the industry

I started teaching about operational risk at the University of Washington's Information School a little more than a year ago. I've designed two courses for graduate students on operational risk that are now permanent parts of the curriculum. Answering questions from graduate students keeps me intellectually nimble. The students have no stake in the questions except their own curiosity. As I answer, new patterns and sometimes themes start to emerge from the material on which we are focused. And there you have it: answering to students in a seminar is quite different than preparing consultant reports or making a presentation to respectful executives, where both culture and the politics of an institution must be taken into account.

In a perfect world, we could each think, teach, and write at some scale about what we understand of operational risk. For me, the desire is strong to change the way we think about the subject; to influence the next generation of operational risk practitioners; and to build a heightened awareness of risk tolerances in those on the business side, as well as in those who will manage our security,

business continuity, audit and regulatory programs of the future.

One of the first things a teacher does is to create a course syllabus that includes textbook(s) and readings. Finding good textbooks for either course is a challenge. Though there are a number of books with the words "operational risk management" or "enterprise risk management" or "COSO" in the title, most of these books are dry as dust, often written by auditors. Since both courses also track real world operational risk issues, it is understood that additional reading and discussion from current events is required. In this quarter, looking at both the public and private sector in the advanced risk course, we've not been short of examples across multiple sectors: governance questions at JPMorgan Chase, the US Internal Revenue Service, the US Justice Department, and the US Department of Homeland Security; cyber challenges from Chinese and Iranian hackers; disasters in Bangladesh and Oklahoma; privacy risk from new technology such as Google Glass or various kinds of wearable clothing; emerging public health threats from both the Asian H7N9 virus and the Saudi norovirus; and



terrorism at the Boston Marathon and in London. From this list, you can deduce that we examine risk primarily in six critical infrastructure sectors – banking and finance, energy, information technology, communications, public health and emergency services.

*Here are some of the questions that students have asked in the past year, and that you yourself may have been asking, as an operational risk manager:*

### Is this a young field?

Yes, it's early days yet, to my mind. I once heard a market risk expert describe operational risk as everything that is not market or credit risk. I prefer the Basel definition that looks through the lens of people, process, systems, and external events. Though we have increasingly sophisticated COSO and Basel frameworks and increasing layers of regulation,

especially in the financial sector, we have yet to prove our usefulness to executives making business-based decisions.

### Even if I learn how to recognise and quantify the risk, who will listen to me in a corporate setting?

And therein the rub: How to distinguish operational risk managers from compliance or from internal audit personnel? I am on my second textbook where equivocation and dithering takes place about where operational risk should report. My own view is that operational risk should build its programs in a federated manner, from the ground up, so that "first responders" are actually in the line of business rather than in an oversight function. So part of the answer here depends upon being able to say how operational risk is a value add-on rather than an overhead burden. Since most

business people do not believe that those in risk, compliance or audit functions actually understand the business from the inside out, taking the time to do so could mean all the difference. Sitting with the business as it is, maps its strategic planning and allows risk assessment to be grounded in the "what if?" premise, rather than seen as either a "yes man" or as a predictable "too dangerous" response. In fact, we want business to take risks, but with consideration of what could go wrong, and what type of agile response it would take to self-correct downstream. This is where good risk management, operational or market or credit, begins: with the business. I wrote several months ago (Perfect Pitch, *The Risk Universe*, March 2013) about how to frame up emerging risk projects in the form of executive briefings.

### Aren't some levels of loss acceptable if the end is still accomplished?

It depends upon the risk appetite established at the highest level of the company. A good example would be the London Whale loss at JPMorgan Chase. The company is enormously profitable, and though the loss of more than \$6 billion may look large to us, it was considered small from the perspective of the overall investment portfolio designed to offset losses elsewhere. The bank appears to be mired in two indirectly-related issues that are part of an operational risk pattern: a lack of succession planning and increased regulatory scrutiny as

well. There is no doubt that the bank's reputation, as well as that of its CEO, was impacted. But shareholders just reconfirmed their confidence in both the CEO and the governance structure in the 2013 annual meeting. There seems to be no doubt that the board level risk committee will be strengthened. It remains to be seen if the internal risk management function can be federated at JPMC, so it begins with first responders in the lines of business. Shifts in culture are not unlike turning very large ships in small channels.

### Why should there be an expectation that employees behave any better than their bosses?

This is the perennial question. Though all of our leadership courses teach that tone is set at the top of the corporation, we have proliferating examples of non-executives like Sherron Watkins at Enron, who shine a light upon fraud, corruption or malfeasance. We design our training courses around ethics for employees, not for executives. We don't easily reward candour in the board room or the executive suite if it is going to affect growth or profits. Of course, we don't always reward managers for notifying us about risks either.

That's why I am a teacher at this point: to affect change all the way through the corporation, including at the executive level. To understand the facts of a risk clearly, to analyze what the costs of inaction will be before a decision is made one way or the other, is not yet an executive habit. But it could be. At a time when we are facing so many threats from so many different operational risk situations around the globe, this is a place to begin. As Ralph Waldo Emerson said, "Every wall is a door." **TRU**

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