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MANAGING THE NEW TRANSPARENCY OF LEGAL RISK POST BASEL II

Operational Risk: An Overview

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Definitions of Operational Risk

- Risk of loss resulting from failed or inadequate people, processes, systems or external events.
- Includes legal risk.
- Not only 'Operations Risk'
- All risk that is not market or credit risk.
- Includes many risks already managed in the firm:
 - SOX
 - BCP
 - Info Security
 - Compliance
 - Legal
 - Operations

Categories of Operational Risk

- Internal Fraud
 - Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party.
- External Fraud
 - Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party.
- Employment Practices and Workplace Safety
 - Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events.
- Clients, Products & Business Practices
 - Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.
- Damage to Physical Assets
 - Losses arising from loss or damage to physical assets from natural disaster or other events.
- Business Disruption and System Failures
 - Losses arising from disruption of business or system failures
- Execution, Delivery & Process Management
 - Losses from failed transaction processing or process management, from relations with trade counterparties and vendors.

Impacts of Operational Risk

■ Impacts of operational risk events include:

■ Financial

- Economic losses

■ Reputational

- Adverse publicity

■ Legal and regulatory

- Fines and settlements

■ Client and customer

- Client dissatisfaction

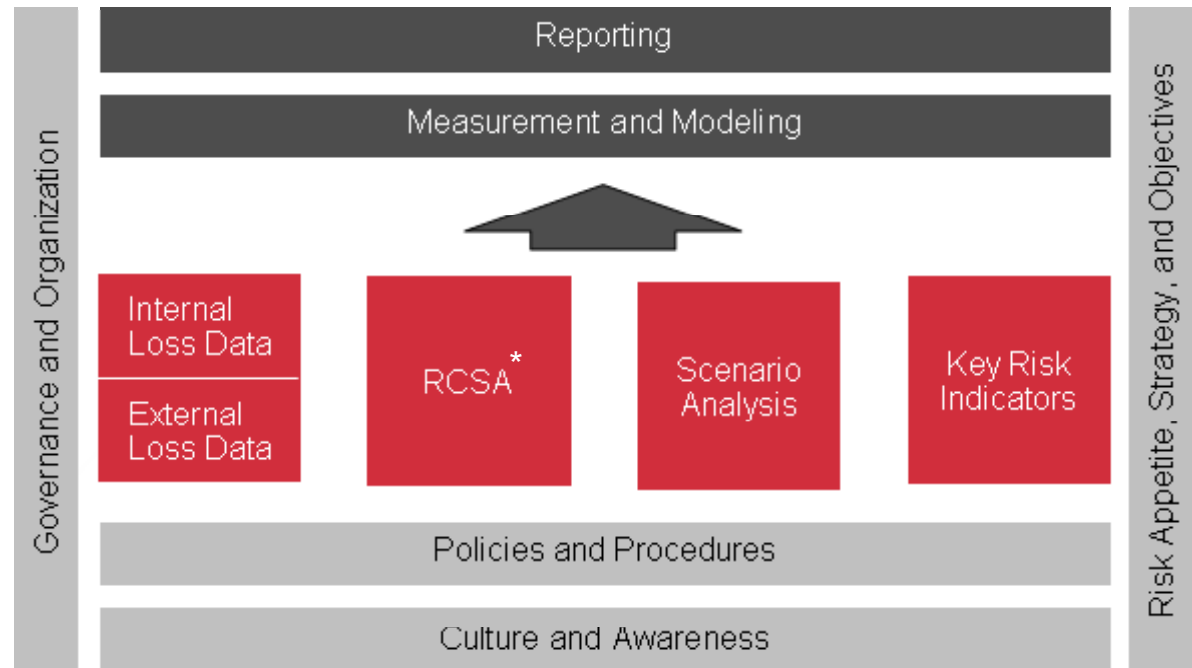
■ Life safety

- Employee safety compromised

Conceptual Operational Risk Framework

■ Basic Requirements

- Identify, assess, control/monitor & mitigate operational risk
- Considers all Op Risk Categories
- Independent function
- Approved by the board
- Subject to audit
- Regularly updated
- Integrated into business
- Included in New Product Approval activities
- Continue to evolve as experience develops



*RCSA = Risk and Control Self Assessment