

Operational Risk Management: Key Risk Indicators (KRIs)

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Selecting Key Risk Indicators

- Good mix of external, global and local KRIs
 - All global – great for entire business, may let your business unit down
 - All local – help BU, but could be blind to general conditions
- Not all KRIs are created equal
 - All are important, but some are *critical*
- Start small and expand over time
 - Trying to develop too many KRIs – boiling the ocean?
 - Too many KRIs could distract from accurate risk readings
- Not all KRIs need to be quantitative
 - Overly quantified KRIs could distract from the main purpose
- A few well-defined and incisive KRIs could be worth more than a whole phalanx of indeterminate ones
 - Keep Signal to Noise ratio as high as possible

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Challenges with KRIs

- Quality of information source that generates the KRI reading
 - Cry wolf?
- Lack of enterprise-level understanding/ visibility of critical KRIs
 - Might lead to local effectiveness, but still lead to major risk materialization
- Precision of the reading might distract from the accuracy (and effectiveness)
 - Saying “Washington is 128.9 miles from New York” may be more *precise*, but “Washington is around 200 miles from New York” is more *accurate*

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Assessing Risk

- A KRI could be the tip of an iceberg
- Timeliness of the assessment is critical
 - Spotting the iceberg in time could avoid a Titanic
- Operational factors could move at different event speeds
 - Jetliner and ship
 - Align assessment schedule with event milestones
- Some changes in values of external KRIs may contribute to changes in values of internal KRIs
 - Rise in the price of oil may lead to slightly lower employee satisfaction
- Sometimes combinations of KRIs can tell stories better than just one KRI alone
 - Combination of forecasts of high precipitation levels and approaching cold front
- Automation of reporting on KRIs is important
 - But, the assessing operational risk should not be overly ritualized

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Important Considerations

- Static portfolio of KRIs might lose value over time
 - Need to change with external and internal changes in the business
 - Beneficial to have systematized and periodic review of the portfolio
- Important to establish and understand a baseline for the report
 - Changes in the values are usually important
 - But, contextualizing them with the baseline could yield better insights (change of 100% from a very low base could be less important than a change of 25% from a very high base)
- Important to understand cause and effect
 - Rise in customer complaints could be a result of employee attrition, but is it?
 - Is change in a global KRI a result of changes in a local activity?
 - How do local activities contribute to global readings?
 - What types of changes in global activities might render your local KRIs to be less useful?

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