



## Operational Risk Management Charter

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## A. INTRODUCTION

### I. Background

The management of operational risk is a key feature of sound risk management practice in modern financial markets. The recognition of operational risk as a specific category next to market and credit risk by the Basel Committee on Banking Supervision in the Revised International Capital Framework demonstrates its growing importance.

While the management of operational risk is the primary responsibility of each function or service responsible, the implementation of an integrated Operational Risk Management Framework shall be coordinated by a dedicated and independent team to achieve operational excellence and to ensure alignment with best market practice. At EIF, the development and implementation of that framework forms part of the remit of Compliance & Operational Risk (COR).

### II. Purpose and Scope

The Operational Risk Management Charter (the “Charter”) applies to all EIF Staff, services, functions and external offices.

The Charter codifies EIF’s approach to identifying, measuring, managing, reporting and controlling operational risk. It documents sound practices to help ensure that operational risk is managed and measured in an effective and consistent manner across EIF and describes the key elements of the EIF Operational Risk Management Framework (the “Framework”), including the main roles and responsibilities. The Charter also sets the basis of EIF’s operational risk culture.

### III. Definitions

The definitions establish a common language for describing, understanding, reporting and classifying Operational Risk. Core definitions are outlined in this section.

**Operational Risk** is defined as the risk of loss or reputational damage resulting from inadequate or failed internal processes, people and systems or from external events.

At EIF, this definition includes **Legal Risk, Compliance Risk and Reputational Risk** in line with standard market practice and in the light of the specific importance of reputational risk for EIF as a European International Financial Institution.

**Legal Risk** arises from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations or conditions of the organisation.

**Compliance Risk** is the risk of legal or regulatory sanctions, material financial loss or loss to reputation, the organisation may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards and codes of conduct applicable to its activities.

**Reputational Risk** is the risk resulting from adverse perception, whether true or not, of the image of the organisation on the part of EIF stakeholders, contractual counterparties, the public or supervisory authorities.

**Operational Risk Management** encompasses the mechanisms, tools, policies, procedures and processes, including management oversight, to identify, assess, monitor, report, and control operational risk.

An **Operational Risk Event (ORE)** is defined as a failure of internal processes, people or systems, or a result of external events. OREs may result in direct or indirect financial loss or, where this is not the case, in **near-misses** or may lead to an adverse effect on EIF’s reputation, a breach of internal procedures, laws, regulations or good market practices.

Whereas operational risk represents the *potential* occurrence of a risk, an ORE is the *actual* occurrence of a risk.

OREs are categorized according to the following Operational Risk Event Types:

- Internal Fraud
- External Fraud
- Employment Practices and Workplace Safety
- Clients, Products and Business Practices
- Damage to Physical Assets
- Business Disruption and System Failures
- Execution, Delivery and Process Management

## B. GOVERNANCE

### I. Key Principles

*“At EIF, Management of Operational Risk is Everyone’s Responsibility.”*

#### Guidance

The EIF Board of Directors approves the Charter, including the governance aspects and the general framework. The Board of Directors also approves EIF’s tolerance to operational risk as described under section E of the Charter.

#### Ownership

The Chief Executive (CE) and the Deputy Chief Executive (DCE) are responsible for ensuring that the appropriate operational risk management practices are in place and operating effectively. The CE and DCE retain the ultimate responsibility for the effective management of operational risk at EIF within the limits set by the Board of Directors.

#### Independence

In line with the principles set by the Basel Committee, COR is an independent operational risk management function that is responsible for the design and implementation of the Framework.

#### Access to information

COR has unrestricted access to any document or information deemed useful for the identification and assessment of operational risk at EIF.

#### Oversight

Internal Audit performs regular reviews of the operational risk management processes. These reviews include both the activities of the business units and of the independent operational risk management function.

## II. Responsibilities

The CE and DCE

- provide sufficient human and technical resources to support effective management of operational risk;
- maintain an appropriate culture and set a tone conducive to effective and transparent operational risk management;
- sponsor the EIF Operational Risk Program.

EIF function or service responsables

- ensure that operational risks (i) associated with their respective processes, people and systems, and (ii) from external events are identified and understood;

- verify that internal controls and practices are in place, appropriate, operating effectively, and consistent with EIF Policies, legal and contractual obligations, and regulatory requirements;
- timely contribute to the monitoring, reporting and escalation processes such that EIF Senior Management is made aware of material changes to EIF's operational risk profile.

#### EIF Compliance & Operational Risk

- implements the Framework to support the management of operational risk;
- develops operational risk management procedures in compliance with the Charter;
- operates and/or coordinates processes for the identification, assessment, reporting, monitoring and mitigation of operational risk;
- provides advisory support to EIF services with regard to operational risk management and internal controls;
- organises an operational risk awareness and training program.

### III. Procedural framework

The operational risk procedures establish processes, roles and responsibilities for the implementation of the Framework in compliance with the Charter and good market practices.

## C. OPERATIONAL RISK MANAGEMENT FRAMEWORK

The Framework is a set of integrated processes, tools and mitigation strategies that assist EIF in managing and measuring operational risk.

The Framework supports EIF Senior Management in the alignment of business and risk management goals and provides a foundation which enables a consistent approach to operational risk across the organisation. Furthermore, the Framework aims at establishing a common understanding of operational risk and risk management, promoting consistent application of techniques, and capture of relevant data.

### I. Operational Risk Management Tools

The main components of the Framework, supporting the identification, assessment, measurement and reporting of operational risk, and the objectives of each, are the following:

#### **Process Risk & Control Assessment**

The identification of the risks inherent to EIF's activities and environment, the assessment of the adequacy of the related internal controls to determine the residual risk for the organisation and the classification of the risks according to their potential impact and likelihood.

#### **Key Risk Indicators**

The identification and analysis of parameters that can be considered as indicators of the level of operational risk within the organisation. The Process Risk & Control Assessment enables a focus on indicators related to the most risky activities and processes.

#### **Operational Risk Events**

The collection and analysis of operational risk events, including the identification of the root cause that has led to their occurrence and the definition of a remediation plan.

#### **Scenario Analysis**

The assessment of the impact and the likelihood of potential OREs and the proactive mitigation of the identified risks. Scenario Analysis enables an organisation to gain a better understanding of the risks that it could face under extreme conditions.

### **New Mandates, Products & Processes**

The framework for the proactive identification and assessment of risks inherent to new products and mandates as well as to projects that have a material impact on EIF's operational processes.

### **Operational Risk Awareness Program**

The organisation of trainings, workshops and information sessions to build up an operational risk management culture within the organisation and to inform EIF Staff about specific operational risk management tools and processes. The internal operational risk culture is the combined set of individual and corporate values, attitudes, competencies and behaviour that determine a firm's commitment to and style of operational risk management.

## **II. Relationship with Stakeholders**

### **EIB Group**

The Operational Risk function of EIB and the COR function of the EIF continuously co-operate and maintain a mutual flow of information on policies, standards and operational risk issues with potential relevance for the EIB Group, particularly on functions or services outsourced by one EIB Group entity to the other.

### **Audit Board**

The overall assessment of operational risk at EIF resulting from the implementation of the Framework, and particularly the Process Risk & Control Assessment, will be shared with the Audit Board in the form of the EIF Internal Control Framework (ICF).

## **D. CAPITAL REQUIREMENTS**

The Framework encompasses value-adding processes and aims at improving the quality of the internal controls and at mitigating operational risk.

In this context, and taking into account the nature and size of the business, EIF adopts the Basic Indicator Approach as proposed by the Basel Committee on Banking Supervision for the quantification of its operational risk.

## **E. OPERATIONAL RISK TOLERANCE**

It is the objective of EIF not to incur any operational loss or damage to its reputation. For that purpose, EIF puts policies, procedures and systems in place in order to mitigate the impact and/or probability of occurrence of the operational risks inherent to its activities adopting a cost/benefit approach.

## **F. CHARTER ADMINISTRATION**

This Charter was approved by the EIF Board of Directors on 12 April 2010. The Charter is developed and maintained by COR and is reviewed annually. The Charter is distributed to the EIF Audit Board and is available to all EIF Staff on the EIF Intranet.