# Chapter 6
# Operational Risk Framework and Fraud Management:
## A Contemporary Approach

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## ABSTRACT

*The universal financial shake of 2008 altered business and occupational circumstances and will inevitably trigger the outbreak of new forms of operational risk. Under normal conditions, OR does not cause significant losses; thus, severe damage is likely to occur when an operational miscarriage or an unexpected event takes place. Under the Basel III context, the banking sector is trying to increase safety and stability, by focusing on the quality of historical loss data, while cultivating an inside operational risk awareness culture. One of the most perilous types of OR is fraud, and its effects are often dangerous and may have long-term spillovers. In this chapter, an analysis of the meaning and the main characteristics of fraud is provided, focusing on contemporary trends of the issue. Going further, the business anti-fraud strategic plan is described along with how it maximizes its efficiency, while the chapter aims to analyze the demands for an organization to pass through fraud-fragile to fraud-resistant.*

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## INTRODUCTION

Over the last decades, the global financial market has witnessed major changes, concerning both the products and services provided and the way financial institutions do operate. Going along with the digitalization of our times, operations continuously alter in such extend, that new risks - or even differentiated already known risks - unstoppably menace the entities and the market as a whole. As Marshall (2001) mentioned, the countries' financial deregulations started in the 80's (Wernz, 2020), the dynamic aggregated global operations, the high complexity and volatility of new products and services, the outburst of advances in the IT field, and at the same time massive unexpected business scandalous losses, have put Operational Risk (OR) in the spotlight. And even though, global competition, business diversification and economy digitalization have stressed the stability and the profile of the banking industry the last years, however they have touched off operations efficiency potentials for stakeholders and have led to a more service-oriented banking system (Vives, 2019). It is a fact though that markets' liberalization and technological changes motivated financial innovations, new products and services are created, the intense competition enhanced productivity and growth, but at the same time risks profile has been transformed and new types of financial dangers have occurred and are needed to be taken into account.

The financial crisis commenced in 2008, spreading its shadow over the global economy, and 12 years later with some countries still suffering by its socio-economic remains, in 2020, a global pandemic teared down the world we knew up until then. The universal financial shake altered business and occupational circumstances and will inevitably trigger the outbreak of new forms of operational risk. Given that, we provide an operational risk brief yet illuminating description enriched with updated information and experience on the matter. Within the operational risk context, we focus especially to one of its type that over the years has turned into the business world Achilles heel, by causing massive– even fatal in some cases – losses and major spillovers for business entities, financial fraud.

## OPERATIONAL RISK

Coming along with the introduction of Basel II Accord in 2004, the stability and the insurance of the international banking system was a top issue to be managed, while up until before, OR was vaguely described as what was not credit or market risk. Given that OR is related to all the banking activities' range (Chernobai et al., 2007), for the first time it constitutes a totally different kind of all other risks, when Basel Committee gave its proper definition as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk" (BCBS, 2011).

Under normal conditions, OR does not cause significant losses for a financial institution, thus severe damage is likely to occur when an operational miscarriage or an unexpected event takes place. This is the main reason for banking institutions continuously trying to ameliorate the way they treat OR nowadays, especially after the major OR events that had been occurred the last decades leading a number of well-known entities to massive financial losses (Martínez-Sáncheza et al., 2016) or even bankruptcies, such as Bear Stearns and Lehman Brothers (Calluzzo & Dong, 2015).

However, managing risks is a highly demanding operational context, which includes significant direct and indirect costs, in the sense of its implication but mostly under the shadow of the misleading assumption that *if it is not measured, it is not there*. Keeping in mind that a large number of potential risks may

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