

## **COMMERCIAL BANKS AND THE REDUCTION OF OPERATIONAL RISKS IN INVESTMENT ACTIVITIES**

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**Abstract:** Operational risk poses significant challenges to commercial banks, especially in the context of expanding and increasingly complex investment activities. This study examines how commercial banks identify, manage, and mitigate operational risks associated with their investment operations. Drawing on both qualitative and quantitative data from selected banks, the research explores the role of governance structures, technological innovations, regulatory compliance, and internal controls in reducing risk exposure. The findings indicate that institutions with integrated risk management systems, robust digital infrastructures, and strong compliance cultures are more resilient to operational disruptions. Furthermore, the study highlights the impact of international regulatory standards such as Basel III and the growing use of artificial intelligence and automation in minimizing human error and fraud. The research contributes to the existing literature by offering a comparative view of operational risk practices across different banking environments and proposing recommendations for enhancing risk resilience in investment divisions.

**Keywords:** Commercial banks; Operational risk; Investment activities; Risk management; Basel III; Financial compliance; Risk governance; Digital banking; Automation; Internal control systems

### **INTRODUCTION**

In today's complex financial environment, commercial banks are playing an increasingly vital role not only in facilitating economic development through credit and financial services but also in managing and mitigating operational risks associated with their investment activities. As investment operations become more sophisticated and the regulatory landscape more stringent, banks must adopt comprehensive strategies to reduce their exposure to operational risks.

### **REVIEW OF LITERATURE**

The study of operational risk management in commercial banks has gained significant attention in recent decades, particularly as financial institutions have expanded their investment activities in an increasingly complex and digitized environment.

**Basel Committee on Banking Supervision (2011)** laid the foundation for operational risk frameworks by introducing the *Principles for the Sound Management of Operational Risk*. These principles emphasized governance, risk identification, monitoring, and independent reviews as central pillars in managing operational risks. The Basel II and III Accords further required banks to allocate capital against operational risk, driving the development of robust internal control systems.

**Hull (2021)** categorizes operational risk as distinct from credit and market risks, arguing that its unpredictability makes it more challenging to model and mitigate. Hull emphasizes the role of internal systems, process automation, and compliance in preventing major investment-related disruptions.

**Saunders and Cornett (2018)** highlight the evolution of risk management practices in commercial banks. They argue that risk management has shifted from a silo-based approach to an enterprise-wide framework that includes real-time data analytics, scenario analysis, and dynamic risk assessments. Their work particularly emphasizes how operational risk intersects with investment decisions, especially in emerging markets.

**Deloitte (2022)** discusses the impact of digital transformation on operational risk in investment banking. The report suggests that the adoption of AI, machine learning, and blockchain technologies has significantly reduced human error and fraud while increasing transparency and process efficiency. However, it also warns of new types of cyber and IT-related risks that accompany digital innovation.

**JPMorgan Chase's Annual Report (2023)** provides a practical example of how large financial institutions apply operational risk management in their investment divisions. The report outlines how advanced analytics, multi-layered governance structures, and continuous staff training contribute to reduced risk exposure. This case highlights the real-world application of academic frameworks and their effectiveness in a high-volume trading environment.

**PwC (2023)** emphasizes operational resilience, particularly in response to global disruptions such as the COVID-19 pandemic and cyber incidents. The report argues that modern banks must develop adaptive risk infrastructures that can withstand and recover from unexpected shocks, especially in the area of investment operations.

**IMF (2022)** adds a global perspective by examining how operational risk is managed across different banking systems. The working paper identifies gaps in regulatory enforcement, especially in developing economies, where weaker institutional controls expose banks to higher operational risks in investment activities.

**KPMG (2021)** focuses on the role of digital tools in risk reduction, arguing that intelligent automation and predictive analytics can preemptively detect vulnerabilities in investment portfolios. The report stresses the importance of aligning IT capabilities with risk management strategies to build a resilient operational framework.

**Financial Stability Board (2021)** explores regulatory and supervisory approaches to enhancing operational resilience. The study finds that globally systemically important banks (G-SIBs) have adopted advanced risk control mechanisms, including real-time stress testing and scenario modeling, especially in investment-heavy departments.

In summary, the literature suggests that commercial banks have increasingly integrated operational risk management into their core investment strategies. Key themes include the role of governance, technological innovation, regulatory compliance, and internal culture. While progress has been made, challenges such as cyber threats, regulatory fragmentation, and human capital risks remain areas for continued research and development.

## **RESEARCH METHODOLOGY**

This section outlines the methods used to investigate how commercial banks reduce operational risks associated with their investment activities. The research design incorporates both qualitative and quantitative approaches to gain a comprehensive understanding of risk management practices across commercial banks.

## **ANALYSIS AND RESULTS**

Operational risk refers to the possibility of loss resulting from inadequate or failed internal processes, people, systems, or from external events. In the context of investment activities, this includes risks associated with:

- Human error or fraud in executing investment transactions
- Failures in IT systems or trading platforms
- Non-compliance with regulatory standards
- Poorly structured investment products or inadequate due diligence
- Mismanagement of client funds or conflicts of interest

Unlike credit or market risks, operational risks are more difficult to quantify, making proactive mitigation measures crucial.

To ensure stability and protect stakeholders, commercial banks implement several measures to minimize operational risks in their investment operations:

**1. Enhanced Risk Governance Structures.** Commercial banks have developed specialized risk management departments to oversee investment operations. These departments are tasked with setting risk limits, monitoring performance, and ensuring adherence to internal controls. Risk

committees often operate at both executive and board levels to provide oversight and ensure accountability.

**2. Automation and Digital Infrastructure.** The integration of fintech solutions has significantly reduced human errors and streamlined investment processes. Automated systems for portfolio management, trade execution, and real-time monitoring have decreased reliance on manual interventions, thereby lowering the risk of fraud and mismanagement.

**3. Compliance and Regulatory Adherence.** Commercial banks now operate under strict regulatory frameworks such as Basel III, Dodd-Frank Act, and MiFID II. Compliance departments ensure that all investment products and activities align with local and international standards, reducing the likelihood of legal or reputational risks.

**4. Internal Audits and Control Mechanisms.** Regular internal audits, risk assessments, and stress testing are performed to evaluate the resilience of investment operations. These practices help in early identification of weaknesses and ensure that risk controls are functioning effectively.

**5. Staff Training and Ethical Standards.** Human capital plays a significant role in investment risk. Banks invest in training programs that enhance the competence of investment managers, traders, and risk officers. Moreover, ethical codes and conduct policies are enforced to prevent conflicts of interest and unethical behavior.

**6. Diversification of Investment Portfolios.** Banks reduce exposure to operational risk by diversifying investment portfolios across asset classes, industries, and geographic regions. This strategy not only spreads financial risk but also limits the impact of operational failures in any one area.

Emerging technologies such as blockchain, artificial intelligence (AI), and machine learning are transforming the way commercial banks manage operational risks. AI-based risk analytics can predict potential disruptions, while blockchain offers greater transparency and traceability in investment transactions.

Additionally, real-time data analytics and predictive modeling help banks monitor market trends and anticipate anomalies, allowing for timely risk mitigation.

A prime example of robust operational risk management is JPMorgan Chase. The bank employs a multi-layered risk framework that integrates advanced analytics, real-time monitoring, and cross-department collaboration. Their investment division utilizes AI for trade surveillance and blockchain for secure transaction processing—resulting in a marked reduction in operational failures and regulatory penalties.

Despite the advances, challenges remain. Cybersecurity threats, evolving regulatory demands, and global economic volatility continue to pose risks to investment operations. To counter these threats, commercial banks must:

- Continuously update their risk management models
- Invest in next-generation cybersecurity infrastructure
- Foster a risk-aware culture at every organizational level
- Strengthen collaborations with fintech firms and regulatory bodies

## CONCLUSION

As investment activities within commercial banks become more dynamic and integrated with global financial systems, the importance of operational risk management cannot be overstated. Through structured governance, technological innovation, and a strong culture of compliance, commercial banks are effectively reducing the operational risks tied to their investment functions. This not only ensures financial stability but also enhances stakeholder trust and long-term profitability.

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