



Institute
and Faculty
of Actuaries

Operational Risk Modelling – Spuriously and Spuriously...

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15 November 2013

Agenda

- This house believes operational risk modelling is spurious
- Value adding operational risk modelling
- How well do you understand your operational risk model?
- Common problems
- Hints and tips
- Conclusions



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The debate

“This house believes there is no point modelling operational risk capital - fundamentally it’s guesswork”

Versus

“Operational risk capital modelling should be a significant value add – deepening your understanding of risks and driving improved risk management behaviours”



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Actuaries in wonderland?



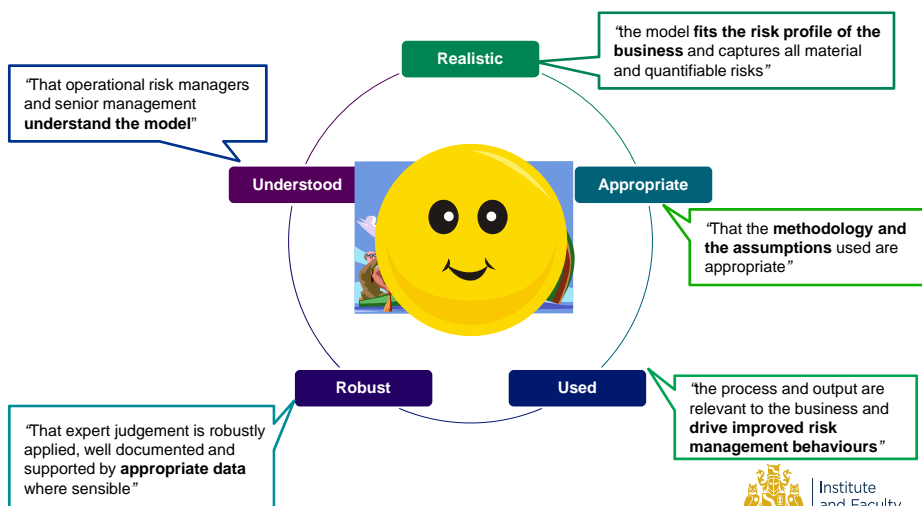
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The call to action!



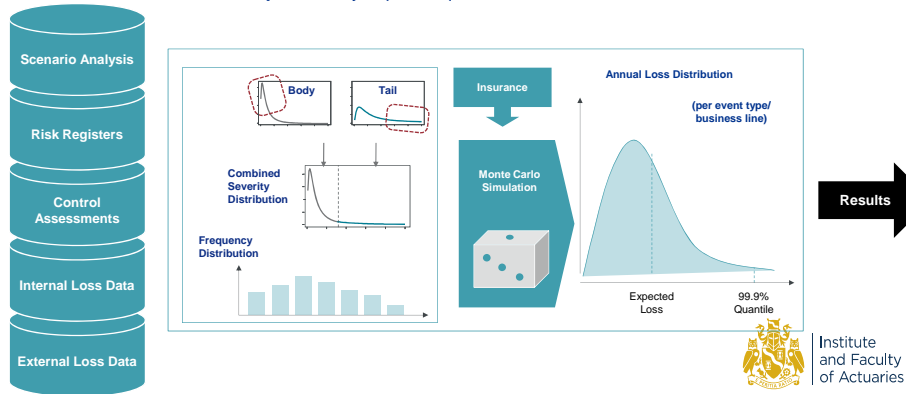
Value adding operational risk modelling



So what really drives capital?

Questions:

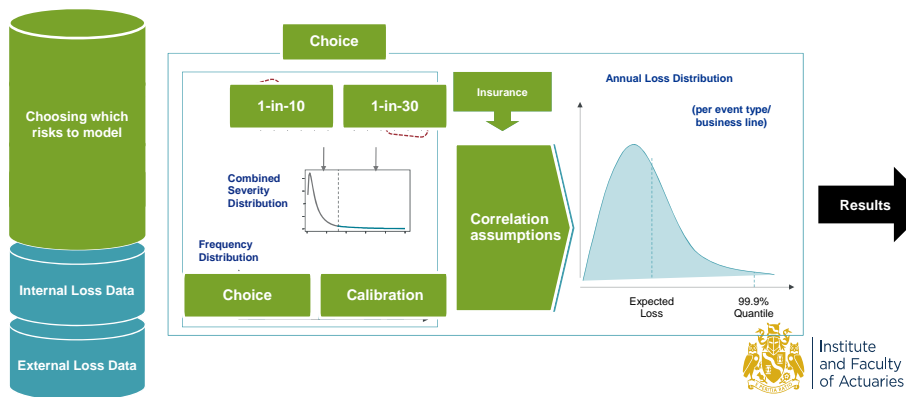
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- How **sensitive** is the model to these?
- What can I do to **optimise** my capital requirement?



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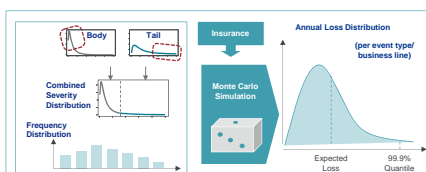
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Thoughts on optimal solution

- ✓ Fits the risk profile of the business and captures all material and quantifiable risks



Results

- ✓ Senior management **understand** the model and use the output of the model in the business

- ✓ Drives **improved risk management** behaviours

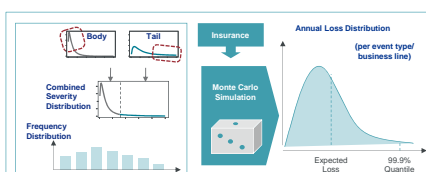
- ✓ Expert judgement is **robustly applied**, well documented and supported by data where possible.

- ✓ Methodology and the assumptions used are appropriate



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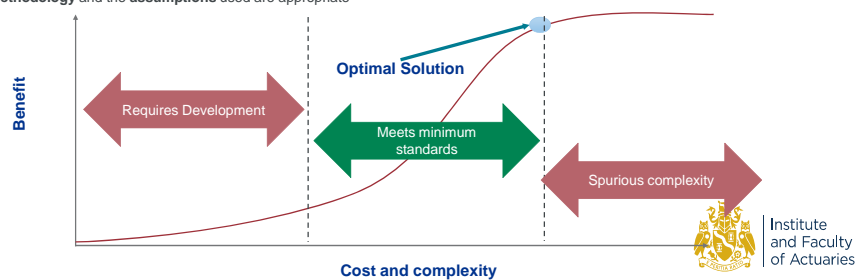
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The view from Operational Risk

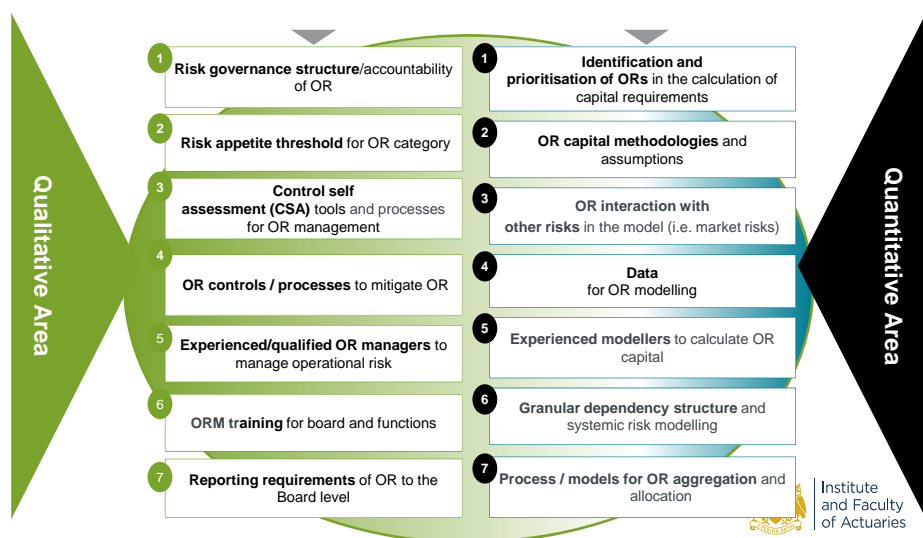
- Typically owned within the OR function...reluctantly.
- OR capital assessment is not an activity of comfort for many OR professionals.
- Frequency and depth of regulatory deep-dives increasing.
- Conduct Risks remain a component of the OR assessment and the risks, driven by the regulatory agenda are significant.
- Senior Management oversight and challenge of the activity is increasing.



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Bringing it together



Common problems

- Confusion about roles and responsibilities, worsened by isolation between teams
- Lack of data / poor use of the data that does exist (including external sources)
- Poor validation of expert judgement
- Correlation approach and diversification impacts
- ICG/Selling it to the regulator – why should they have confidence in the approach



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Hints and tips

- OR capital assessments should clearly outline the role of each department to ensure maximum benefit, for example:
 - Actuarial attending scenario workshops
 - OR working with Actuarial during the modelling activity
 - The business owners involved at appropriate stages
- Use all available data to help justify the chosen parameters, using a pro-forma template to force particular data capture, in particular:
 - Risk and Control Assessment data
 - Internal and External event information (including data consortium, enforcement notices and media coverage)
- OR frameworks to be developed to align with modelling requirements and vice versa
 - e.g. Granularity of risk categorisation



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Hints and tips

- Templates should be used to force capture of required data to support the selection of parameters, drives a consistent approach
- Correlations should be set using a structured process that involves business SMEs, OR teams and Actuarial
 - A workshop is an effective way to drive out the necessary information
 - Formal capture of the output is required, including rationale on the strength of relationships
- The methodology and approach to the OR capital assessment must pass the regulator scrutiny, assisted by:
 - A robust understanding throughout the business of the overarching methodology
 - Robust governance and oversight, supported by documentary evidence



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Conclusions

“This house believes the operational risk capital modelling process should be a significant value add – deepening your understanding of risks and driving improved risk management behaviours”

BUT

“Finding the optimal modelling solution is hard - striking the right balance between practicality and complexity to implement an effective process that will be acceptable to the regulator and value adding to the business”



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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

