

## Insuring Operational Risk

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## Main Themes

- Background
- Recommendations
- Conclusions

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## The Benefits of Insurance

- Risk Pooling
  - cash flow smoothing
  - avoidance of catastrophes
- Risk Management
  - real service efficiencies
  - monitoring

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### Some Issues:

- Capacity constraints
- Withdrawal of insurers
- Disputes and delays in payment (e.g. due to exclusions and language problems)
- Complexity of op-risk. How can we establish proximate cause?

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### More Issues:

- Mis-pricing due to lack of data and quantification problems. *Can we ever quantify?*
- Adverse selection
- Moral Hazard
- Insurance as a cause of systemic risk?

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### Recommendations for the Banks

- 'Insurance' strategies to consider:
- Insure specific operational risks
  - Buy a comprehensive 'basket' product
  - Insure only 'big' (or small) risks?
  - Consider ART

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### Recommendations for the Banks

- A bank's insurance decision is very personal!
- It will all come down to:
  - Its circumstances (e.g. size, business lines, credit rating etc)
  - The level/quality of insurance cover
  - Product features
  - Price

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### Recommendations for Regulators

- Capital is not the only (or best?) way to finance risk
- Need regulatory support for insurance
- Is insurance a *substitute* or *complement* for regulation?
  - Pillar One
  - Pillar Two
  - Pillar Three

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### Recommendations for Insurers

- Need to be more dynamic and customer focussed
- Establish a common language for operational risk with the banks
- Data collection and accurate pricing
- Offer tailor made products with new features - e.g. pay now dispute later etc.
- Need for critical mass

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### Conclusions - Banks

- Insurance is not just about capital charge reduction, it must be justified on commercial grounds
- Banks already buy a lot of traditional insurance products, but will they buy more 'exotic' products like FIORI?
- What product features do banks want?

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### Conclusions - Regulators

- Must balance the cost and benefits of regulation. Insurance could help to reduce the costs and increase the benefits?
- Should regulators support the insurance and ART industries?

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### Conclusions - Insurers

- Revolution or Evolution?
- Comprehensive vrs specific
- Need greater variety of products
- Offer a bespoke service to banks?
- Must prove value of insurance

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### Further Reading:

- S Ashby and B Young “New Trends in Operational Risk Insurance for Banks” *Global Reinsurance*, October 2001
- S Ashby and B Young, chapter in *Advances in Operational Risk Management: firm wide issues for financial institutions*

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