




Risk Management Association
“Understanding External Risks for a Robust Operational Risk Program”






Agenda

- Overview and Context
- Background on Loss Data
- Loss Data Consortiums (LDC)
- Benefits of Using External Loss Events in an LDC
- Uses for External Loss Events Data
- Change Management
- Integrated Risk Management
- Regulatory OR Capital Modelling Overview
- Summary




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Overview and Context

- How to Extract Valuable Content from Operational Risk Events in order to inform all aspects of a robust operational risk program including:
 - Chang Management Initiatives,
 - Self-Assessments,
 - Scenarios, and
 - Basic Precepts of Using External Events in Capital Models





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Overview and Context (cont.)

- This seminar is Qualitative in it's focus and, as such, will not spend time on the mechanics of integrating external events into capital models.





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Background on Loss Data

- A financial loss is defined as a loss to the business due to inadequate internal processes, people or systems.
- A sound operational risk management framework including loss event collection and analysis is essential to identifying and monitoring risk exposure.
- Internal and external loss data tracking is a critical component of risk management by identifying emerging risks.





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Background on Loss Data (cont.)



- Loss data management does not relate only on a firm's ability to keep records of internal loss data but also to include comprehensive and relevant external loss data.
- Internal loss data tracks a specific Financial Services Firm's own loss experience.




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 **Background on Loss Data (cont.)**


- External loss data has two forms:
 - Public loss data, derived from public information (e.g., newspapers, magazines, industry publications, regulatory fines and penalties, etc.)
 - Pooled or consortium loss data referred to as Loss Data Consortiums (LDC), which is the Loss Data provided by member firms in similar business lines, product offerings, and geographies, for the mutual use by the consortium and its members

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 **Background on Loss Data (cont.)**

- Publicly reported Loss Data usually covers high-profile public events which are characterized by:
 - High-severity (e.g., above 1 million USD)
 - Low-frequency

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 **Loss Data Consortium (LDC)**

- Organizing entity creates LDC (e.g., industry associations).
- Similarly structured member firms voluntarily pool comparable loss or risk exposure data.
- Data is anonymized, quality assured and pooled.
- Pooled data is structured into a common taxonomy to allow cross-correlation of identified risks with actual losses.

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Loss Data Consortium (LDC)

- Pooled data is made available to participants, for analysis.
- Industry Consortia include RiskBusiness, ORX, and ORIC





Benefits of Using External Data in an LDC

- More comprehensive and statistically more complete loss data than relying on internal loss data alone.
- More homogeneous, because of similar business mix, business environment and business volumes.
- Pooled data is made available for analysis by the member firms.






Benefits of Using External Data in an LDC (cont.)



- Data categorization (Taxonomy of processes, risks, and controls) is a key element in creating an effective process of aggregation and comparison.
- Data is encrypted and the anonymity of the origination organization is ensured.






Uses for External Loss Event Data



- Complements internal loss data in business areas, product lines, service units, and risk categories.
- Assesses the effectiveness of internal controls based on analysis of the causal elements of Industry specific losses.
- Enables Loss profile benchmarking with peer firms.






Uses for External Loss Event Data (cont.)



- Produces management reports with valuable statistics that outline frequency and severity.
- Inclusion into internal data models as additional data points for capital calculation, scenario analysis, stress tests and business analysis.






Change Management



- Analyzing the external data for trends and understanding the “root causes” leads to several change management initiatives including:
 - Improving business processes,
 - Enhancing customer service,
 - Addressing control deficiencies,
 - Developing KRIs,
 - Exiting business/product lines as emerging risks are identified,






Change Management (cont.)



- Modifying the self-assessment processes,
- Enhancing scenario analysis,
- Creating a lessons learned education across the company,
- Protecting the Company's reputation, and
- Creating transparency







Change Management (cont.)



- Board of Directors and Management are responsible for ensuring adequate risk systems are maintained including:
 - Measuring risk exposure
 - Prioritizing resources in addressing risk issues
 - Minimizing or avoiding similar risk events and losses
 - Building credibility with the Regulators
 - Identifying trends and emerging issues







Change Management (cont.)


- Protecting the Firm's reputation by addressing risk issues quickly and thereby avoiding surprises
- Changing to a Risk Aware Culture



Integrated Risk Management

- “Connecting the Dots” of the risk data collected through self assessments, Audit Findings, Regulatory Concerns, KRIs, Loss Events, Scenario Analysis, and Capital Calculations represents an important management tool.






Integrated Risk Management (cont.)



- Identifying aggregated risk issues for a more robust risk management process includes operational risk elements of technology, IT security, operations, business continuity management, sales, credit, market, finance, and human resources.
- Evaluating loss data reveals, OR is perhaps the most significant risk faced by the Financial Services Industry.








Regulatory OR Capital Modeling Overview


- Factor Based (Product of a % against a base exposure) vs Loss Distribution (Quantitative modeling techniques utilizing Loss Data, Scenario Analysis, Business and Internal Control Information) Models:
 - Factor Based – BIA, SA, CAR, BCAR
 - Loss Distribution – AMA






Regulatory OR Capital Modeling Overview (cont.)


- Loss Distribution Models develop Frequency/Severity distributions for applying modeling simulations (e.g., Monte Carlo) to calculate Capital for Unexpected Losses.
- Hybrid approach utilizing Loss Data and Scenario Analysis to identify tail risks.


Summary

- Significant Operational Risks are occurring more frequently.
- Risk Governance and Culture are a significant influence on effectively managing operational risk and the Loss Event Review process is an important requirement.


Summary (cont.)

- Integrating Loss Data with self assessment, KRIs, Audit Results, and Scenario Analysis enables an organization to ensure the appropriate risk exposures are being monitored.
- LDCs provide the more effective and relevant data for comparison and analysis purposes.

