



Session 4: Operational Risk

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Operational Risk



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Recently Evolved Practices @ A Multinational Firm

Corporate Goals of OR Process

1. Holistic – Form a discussion framework within operational areas of the company to assess risk exposures and their control processes in a workshop format.
2. Most critical scenarios with highest inherent and residual risks go through a capital requirement process

Areas of focus/discussion

- External Fraud (Agents)
- Cyber – Hacking (DDOS) & Fraud
- IT Failure
- Reputational Risk
- Litigation
- Customer/Client Service
- Third party vendors/suppliers

Chapter 4 Operational Risk

Key messages:

- Quality & maturity of risk management process are key indicators that can impact potential losses arising from operational risk (OR) events.
- OR is closely linked to the risk culture of an insurer; qualitative issues (such as strength of governance processes and oversight functions) play large role in management of OR.
- Reliability of any OR modelling exercise is strictly connected with actual quality of the overall data (internal or external data) - generally an unknown.

Chapter 4 Operational Risk

Key messages (continued):

- Appropriate model calibration in the data-poor environment of operational risk is one of the most significant and persistent challenges for insurers.
- Typically a capital charge or other mitigation method acts to reduce risk exposure, but adding an operational risk charge based on past losses (or the lack thereof) can be pro-cyclical.

Chapter 4 Operational Risk

Key messages (continued):

- Operational risk events for high-frequency/low-severity events can be captured & modelled; tail events that are low frequency/high severity are where a qualitative scaling assessment can be most effective.
- Credible approach for OR should include a blend of qualitative and quantitative assessments to evaluate the effectiveness of management processes to address OR exposures to both low and high-severity events.

Questions for Audience

Does your firm assess Operational Risk charge for economic capital?

- A. Yes
- B. No

How does your firm address OR?

- A. Quantitative Charge
- B. Qualitative Assessment
- C. A & B
- D. Is not deemed material

Which Risks Get a Quantitative Charge?

- A. External Fraud (Agents)
- B. Cyber – Hacking (DDOS) & Fraud
- C. IT Failure
- D. Reputational Risk
- E. Litigation
- F. Customer/Client Service
- G. Regulatory Landscape?

For Quantitative Assessments

- A. We use internal data
- B. We use industry benchmark data
- C. We use both data sources
- D. We just add a flat charge

For Qualitative Assessments

- A. We use a guided self assessment
- B. We only allow 2nd and/or 3rd line of defense to make assessments (via audit and operational control testing)



Your Questions?

References

1. IAA Risk Book Chapter on Operation Risk -
https://www.actuaries.org/LIBRARY/Papers/RiskBookChapters/Ch%204_Operational_Risk_Amended_March2016.pdf
2. “Mastering Operational Risk; A practical guide to understanding operational risk” by Tony Blunden/John Thirlwell, published Sept 2010
3. “The Complete Idiot’s Guide to Risk Management” by Annetta Cortez, published Feb 2010
4. ??
5. ??



Operational Risk: How we got here and where we're headed

Randi Woods

FSA, CERA, MAAA, Vice President—Operational Risk

Principal Financial Group

Definition

What is operational risk?



Summarizes the risks a company undertakes



Not inherent in financial, systematic or market-wide risk



Breakdowns in internal procedures, people and system

A brief history


History of operational risk

**Oldest type of
business risk**


**Measurement
since mid-90s**

**More focus on
managing**

Why it's important



Companies that do a good job of managing risk perform better in good and bad economic times.



Quantification and conversation

A photograph of two men in business suits sitting at a table. The man on the left is wearing glasses and looking down at a tablet. The man on the right is looking at the tablet with a focused expression. The background is softly blurred, suggesting an office or meeting room setting. A large blue circle is overlaid on the left side of the image, containing white text.

Quantification is
important

But not where the magic happens

Banks vs. insurance companies



Banks

Operate within one system,
regulated by Basel

.....

Focus on current cost vs.
known revenue

.....

Short term regulatory
framework



Insurance

Stand-alone operators

.....

Model future events

.....

Longer term regulatory
framework

Magic: Driving conversation

At the right audience level



Three lines of defense

- Risk management is everyone's business



The business



Enterprise risk
management



Internal audit

Where we're headed

Risk management

By design > One size fits all

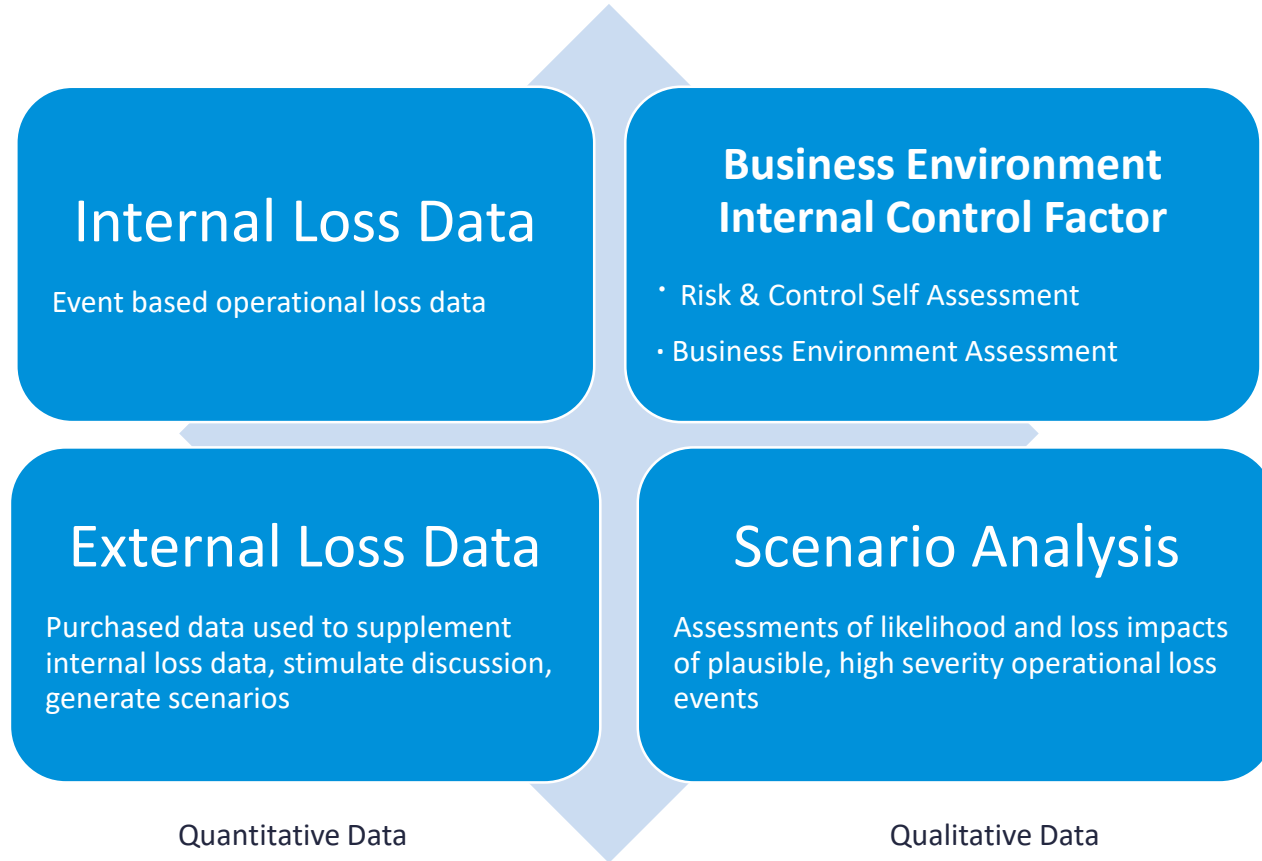


Digital is the new normal



Quantification of operational risk

Capital allocation and loss data evolution



Thank you