

Institute of Risk Management

Solvency II Special Interest Group – Workshop 5

17th March 2010 9.30am-12pm, IRM Conference Room

‘Operational Risk Modelling’

What is the point?

What is best practice?

What is the utility of databases?

Item	Details discussed and agreed
1	<p>Philip Whittingham took the chair. There were about 55 people in attendance. The speakers were introduced. He made some introductory remarks about the topic and the challenges of addressing operational risk given the lack of data and the relatively novelty of the issue for insurers.</p>
2	<p>Survey Results</p> <p>See slides for details of the survey.</p> <p>Simon Allen from Amlin presented the findings of the survey he had designed. 53 people participated. Our thanks go to Institute of Operational Risk (IOR) members who assisted us with this.</p> <p>Broad conclusions are that:</p> <ul style="list-style-type: none">• 50% of participants have started attempting to model operational risk• 70% have either adopted a new or changed their existing approach• 62% organisations have the risk function responsible for this task, 28% rely on actuaries• 75% of participants have identified less than 50 operational risks and these represent less than 50% of their total list of risks• Most organisations use internal risk assessment and scenarios for doing this. About 20% use external databases, with 75% of those choosing ORIC.• Most participants rely on causal scenarios but 20% parameterise external data also.• 50% use excel or excel-based applications as a platform• The largest challenge is data quality (71%) but it was interesting 30% sited lack of resources and mgt commitment• There is no clear consensus on how to address boundary issues where operational risk data impinges on other categories of risk. <p>Thanks to Ian Fraser and Karina Chilton at the IRM for managing the</p>

	online survey process.
3.	<p>Dan Wilkinson, Head of Risk & Operations, Travelers</p> <p>See slides for details of the presentation</p> <p>Dan firmly believed Op risk modelling was worthwhile but presented the case for and against as outlined in the slides.</p> <p>Case for included:</p> <ul style="list-style-type: none"> • It is a cause / trigger for other risks • Rating agencies and Regulators see it as the ‘Achilles heel’ in many risk frameworks and are interestingly interested. <p>Main challenge apart from data credibility was the lack of capital saving available to justify effort.</p> <p>Operational risk failures after the event do cause management problems, especially to accept the ‘learning points’ and avoid blame. This is mainly because these events are essentially preventable.</p> <p>Key to doing this well</p> <ul style="list-style-type: none"> • Robust internal event reporting process • Consider ‘forced reporting’ not voluntary, accepting this may take time to implement and can be counter-cultural <ul style="list-style-type: none"> ○ You will need to have an ‘amnesty’ for people to report • Travelers consider three ranges <ul style="list-style-type: none"> ○ Expected loss (mean) ○ Foreseeable Loss (1 in 4) ○ Extreme Loss (worst case, 1/200 years) • They use correlation matrices to acknowledge events could occur together and this then feeds an actuarial model (Igloo) • Stress tests difficult to do if your approach is based on scenarios in the first place • Learning events are shared at risk committee level • The key value of the approach has been shown to demonstrate the return on investment in controls <p>Special thanks to Dan on sticking to the commitment to speak on his first day back from paternity leave.</p>
4.	<p>Daniel Butler, Head of Operational Risk, Aon Financial Services Group</p> <p>See slides for details of the presentation</p> <ul style="list-style-type: none"> • Internal risk data not rich enough to drive modelling and action • External databases improve scenario analysis by challenging expert judgement, they are not just a source of numbers for

	<p>models</p> <ul style="list-style-type: none"> • Daniel outlined a structured operational risk methodology and a 5-step process for using external data compatible with Aon's OpBase tool • The use of databases can challenge scenario selection particular for 1 in 200 year events • Don't forge the relevance of the analysis to corporate insurance programmes (E&O, D&O, Crime etc..) as these might have value as a capital mitigant if structured appropriately
5.	<p>Mariano Selvaggi, Director, ORIC (ABI)</p> <p>See slides for details of the presentation</p> <ul style="list-style-type: none"> • ORIC is a membership driven consortium with 23 members and growing steadily • ORIC have published a best practice on scenario analysis and how to use external databases to inform them. • Mariano reiterated that databases are more than feeds for models, they can inform and challenge scenario selection, management action plans and risk perceptions • ORIC are reviewing the Basel 2 event classification as this does not fit the industry well. They will develop and consult on a parallel insurance classification • ORIC provides services to members including benchmarking and scaling of risk data to their portfolio.
6.	<p>Questions & Answers:</p> <p>What is the impact on organisation's resourcing of having to do this?</p> <ul style="list-style-type: none"> • It is time consuming, particular event data collection and validation • But most organisations don't have extra resource so they focus on 'big ticket' events (over £100k) <p>Can databases inform on relative effectiveness of company control environments?</p> <ul style="list-style-type: none"> • Not directly • The information is held within the scenario descriptions <p>Is modelling the 'holy grail'?</p> <ul style="list-style-type: none"> • Rush to an answer is a danger rather than think what the data is telling us • Models are tools for managing risks, to make decisions, nothing else

	<p>Partial versus Full Models?</p> <ul style="list-style-type: none"> • Would using scenarios alone allow for full model approval for operational risk – view was unlikely. • Need to use internal and external data to ‘validate’ the model and scenarios • Banks just used external data in general with no scenarios. • Insurers being more pragmatic and also using blended solutions • Access to external data helps challenge internal data quality and scenario judgements • ORIC has started ‘quality’ checking and providing feedback on data provided to help raise the bar <p>Relevance to insurance buying?</p> <ul style="list-style-type: none"> • Many organisations use sophisticated models and analysis to determine reinsurance purchase strategies • Few have extended this to consider D&O, E&O, crime, PD/BI, cyber policy purchases for the entity or to recognise value in mitigating risk exposures.
7.	Phil Whittingham thanked the speakers for their contribution and the audience for their participation in a very instructive discussion.
8.	Alex Hindson reiterated that non-members of the SIG who had attended 2 meetings would be actively approached to join and we encouraged them to do so. Please pass on information about the SIG to colleagues and contacts.
9..	<p>Next meeting – 21nd April 2010, at Keele University during the IRM Forum. Topic: Can actuaries and risk professionals learn to love each other? 11am to 12 noon as outlined in the programme.</p> <p>To attend you need to book with the Forum organisers via the IRM office.</p>
10.	<p>Future meetings</p> <p>May – Talent and Solvency 2</p> <p>June – Risk Appetite</p> <p>July – Taking the stress out of stress testing</p> <p>Aug / Sept (to be confirmed) – How to embed a risk culture, a cross-sector view</p>

	<p>If you have any topics you want covered or speakers you would recommend please contact Phil Whittingham or Alex Hindson with your recommendations.</p>
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Please book early by contacting Alex Hindson, as places under demand

Minutes taken by Alex Hindson
With grateful help from Richard Hawkins
February 2010