

Operational Risk Stress Testing System

Operational risk systems do not have a good reputation. Often expensive, complex, difficult to modify they often fail to quantify operational concerns in a way that is easily understood by management.

The regulatory requirements for stress testing are simple but are rarely met in most operational risk software. The system should:

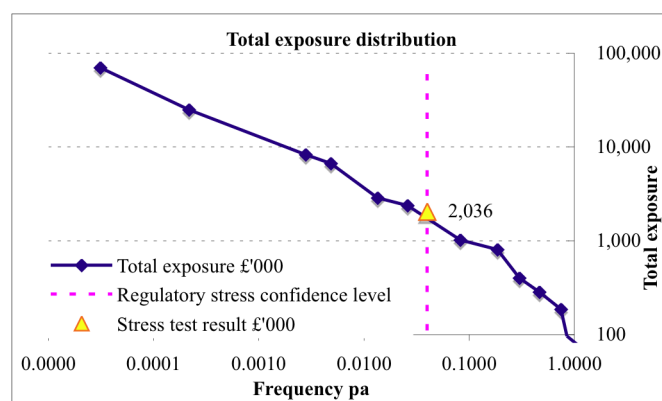
- Be forward-looking and reflect the current profile of the business.
- Look at operational risk to a 1 in 1,000 year event for minimum regulatory capital.
- Incorporate loss data to help validate the model.
- Incorporate scenarios and management judgement when data is sparse.

Risk Advisors software and approach, using the "Material Operational Risk Concentration" (MORC[®]) approach, meets all these requirements. The key benefits are that:

- It creates a clear framework for the consolidation and analysis of operational risk, which is both forward-looking and calibrated against historic losses.
- As it is based on a structured scenario analysis, it makes management discussions of operation risk capital requirements more objective, transparent and factual.
- It is consistent with the Advanced Management Approach (AMA) principles.
- The approach has been tried and tested in several regulated Financial Institutions.
- The system is built in Excel with extensive inbuilt validation. Hence, you may customise the outputs although we would not expect that material customisation is required.
- Group Operational Risk may easily maintain the system as part of their duties.
- The reports include a full graphic and numeric audit trail back to the underlying data to allow model validation and visual validation of the results.
- It performs the two operational risk stress tests required for the pillar 2 assessment, i.e. regulatory capital and the capital planning stress. These requirements are more than just a different confidence level.
- It is a platform to enhance the operational risk framework through controls, limits and an enhanced understanding of the business drivers.
- It is transparent and so can reflect management actions to reduce or mitigate operational risks.

The results can be shown either in a traditional risk map, graphs of distributions or tables suitable for the pillar 2 assessment in the ICAAP/ORSA.

In our experience the critical support is normally required in identifying scenarios, creating data feeds, calibrating the results, and documentation to fit the business strategy, rather than in the software installation and implementation.



If you would like to discuss your operational risk stress tests further, please contact us to arrange a meeting to discuss your current status and potential next steps at Risk@RiskAdvisors.co.uk. Tel: 020 7702 9255

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