

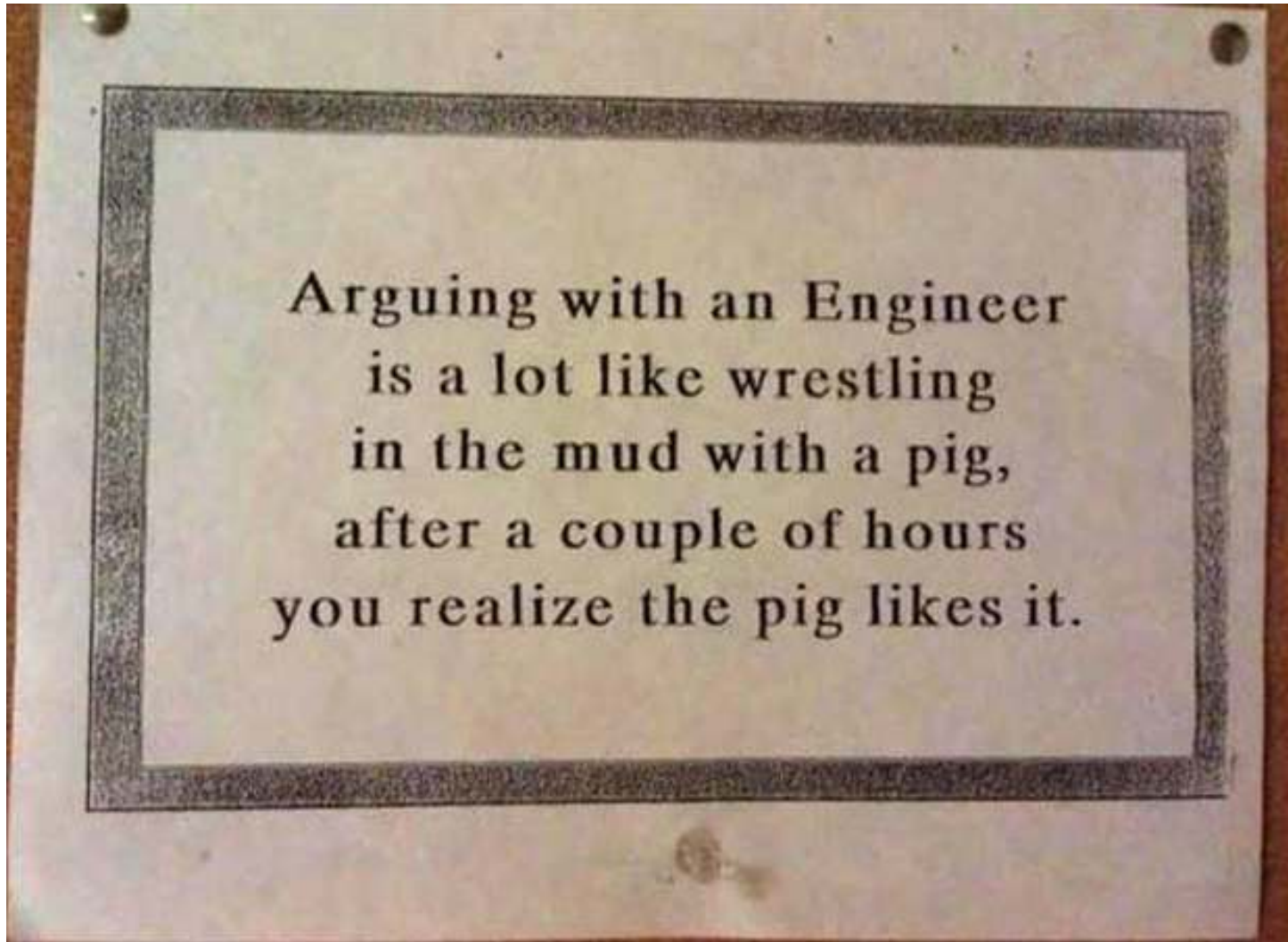


QUANTIFYING RISK, ENABLING OPPORTUNITY

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Operational Risk

Operational Risk: Banking vs. Insurance

# No Actuarial Jokes....



# What will I speak about?

- Quantifying Risk, Enabling Opportunity....
- Why the topic?
- Why is Operational Risk so interesting...?
- Factors to consider when considering the difference in different industries.
- Some of my personal practical experiences...

# Quantifying Risk, Enabling Opportunity...

- Is this true for Operational Risk?
- The Economist's view: Yes & No
- Yes
  - Prioritise, understand
  - Fund mitigation
  - Capital
  - *Makes it sound sexier....(black sheep syndrome...)* ☐
- No
  - “Negative” value – not taken in exchange for reward
  - Cannot generally be adjusted as a strategy – not easily
  - Still lots of debate on quantification

# Why the topic?

- Banking appears to be ahead of the game
- Probably inherently better understood in Insurance
- Regulatory regimes following each other
- Lots of bankers moving into insurance
- Broader financial services industry
- Are we justified in putting the same effort into it
- What do we need to do differently?

# Why is OR so interesting?

- As a discipline, still in its infancy
- Unlike other risk types, the boundaries are vague
- Significant interaction between OR and other risk types
- A number of divergent views on many things (e.g. quantification, insuring OR, expected loss, etc.)
- Not a numbers game
- There are always unknowns
- Very applicable to our daily lives

# The sensational story...



- **ING Insurance : Australia's 2<sup>nd</sup> largest fraud**
  - 40 year-old Rajina Subramaniam worked for ING Insurance in Sydney for 20 years as an accountant.
  - Embezzled AUD 45,000,000 between 2004 and 2010 by transferring suspense account balances and unclaimed client money to personal accounts.
  - Became known throughout Sydney for her lunch-hour shopping spree's – in 2009 alone:
    - Chanel (AUD 98,452); Bulgari (AUD 3,300,000)
    - Paspaley – a jeweller (AUD 7,600,000, over and above AUD 16,000,000 in previous years)
  - Also bought 7 properties in her maiden name.
- Reason for the fraud – not valued or respected, manager delegated everything to her.



# Banking vs. Insurance: Factors to consider

- Relevance
- Regulation
- Quantification
- Data / data providers
- Boundary Risk
- Operational Risk sub-types
- Practices and Maturity of the discipline

# Relevance

- Clearly OR is relevant in everything...
- OR can be detrimental to survival
- Insurance - less transactional
- Can cause failure e.g. Model Risk
- Many banks have failed
- Scratch the surface and OR is probably the underlying cause of many insurance failures.

# Regulation

- Lots of focus over the past 10 years on the Banking environment.
- Significantly increasing focus in Insurance, specifically locally.
- BASEL II vs. Solvency (SAM).
- Twin Peaks – rigour of regulatory supervision is changing.
- Converging requirements

# Quantification

- Purpose of quantification
- Confidence level: 1in1000 vs 1in200
- Quantification in Insurance less prevalent
- Do the banks have it right?
- Limited quality data
- Unclear loss distributions
- Effort vs. Accuracy

# Data

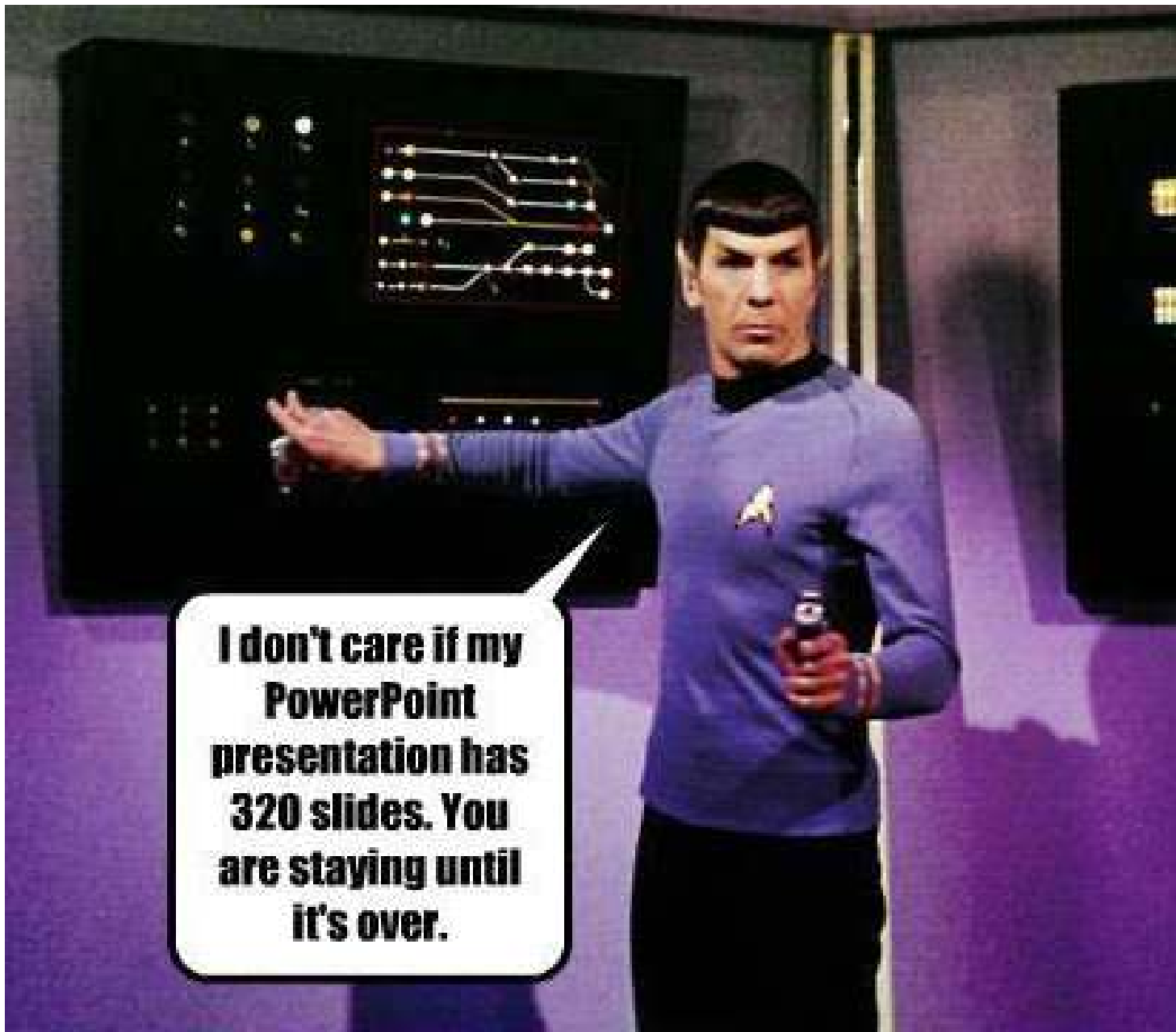
- Internal Data:
  - Banks been collecting it for 5 – 10 years
  - Generally not the case in insurance
- External Data:
  - Lots available, but not readily useable
  - ORIC
  - ORX and ORX Insurance
  - Fitch

# Boundary Risks

- Risks that are not clearly defined by risk type
- Banking – Credit and Market risk boundaries
- Insurance – Insurance and Market risk boundaries
- Boundary risks much more pronounced in the Insurance industry

# Operational Risk sub-types

- Fraud:
  - In SA, fraud appears to carry similar weighting in Insurance and Banking
  - More frequent in Banking
  - More severe in Insurance
  - Different fraud types (cash vs. non-cash businesses)
  - Internal vs. External Fraud profiles



**I don't care if my  
PowerPoint  
presentation has  
320 slides. You  
are staying until  
it's over.**



# Operational Risk sub-types

- Regulatory:
  - Broad range of regulatory requirements in both industries
  - Regulation in banking is fairly settled now.
  - Significant changes still underway in Insurance
  - Robust regulatory supervision in both industries

# Operational Risk sub-types

- Clients, Products and Business Practice:
  - Banking have seen significant class action
  - Similar risks within Insurance
  - Market conduct a key risk in Insurance
  - PPI issue experienced in the UK – impacts both industries
  - Product defect have a longer lifespan and impact in the Insurance industry

# Operational Risk sub-types

- Business Disruption & System failures:
  - Significant impact in Banking.
  - Relevant risk, but less significant impact in Insurance.
  - Longer business processes in Insurance (excl. Health Insurance)
  - High volume of transaction processing in Banking

# Operational Risk sub-types

- Execution, Delivery and Process Management:
  - Data entry errors – less likely to be detected in Insurance – bigger impact
  - Accounting errors – can impact insurance significantly
  - Process failures – can be significant in banking given high volume environments

# Practices and Maturity

- Governance and reporting
- Frameworks
- Tools
- Systems
- Quantification
- Reactive vs. Proactive
- Understanding of the discipline

# Some personal practical experiences

- Operations issues vs. Operational Risk
- No boundaries
- Credibility of the role – broad expectations
- 1<sup>st</sup> line vs. 2<sup>nd</sup> line roles
- Everyone manages OR, not everyone knows they do
- Risk functions are the worst risk managers
- Nobody understands OR until it happens to you...

# Conclusion

- Operational Risk are converging in the wider financial services industry.
- Lots of work still needs to be done in both industries – we are playing a bit of catchup.

# Questions?