

Building an AMA Framework that Satisfies Regulatory Requirements and Meets Business Needs

## Delivering Business Value and the Use of External Data

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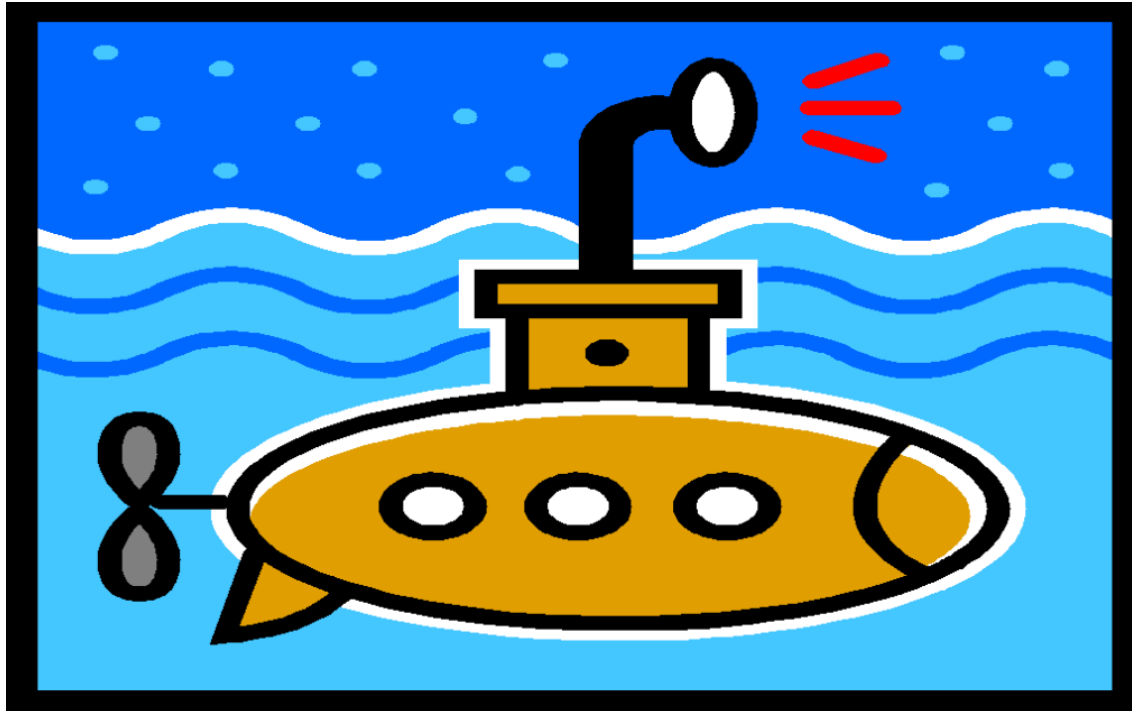


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## Use & Business Value of AMA Are Intertwined

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- ❖ OR framework **with AMA** should provide management with an actionable view of potential risks that is not otherwise available

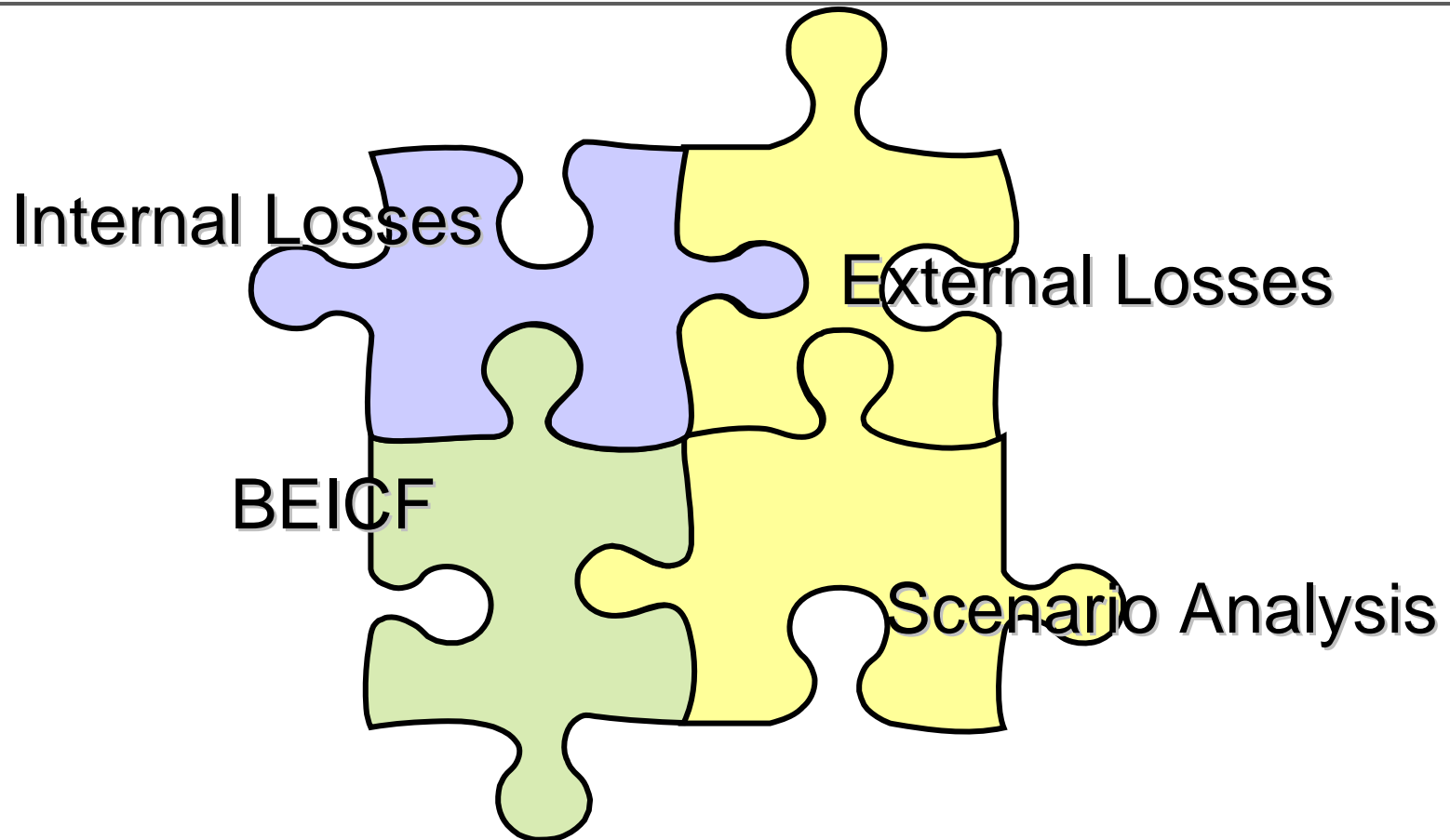
# Useful Op Risk Framework Should Deliver

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- ❖ Transparency of risks (individual, aggregate)
- ❖ Foundation for evaluating risk and return
- ❖ Foundation for establishing risk tolerance
- ❖ Bottom-line benefits in expenses and capital

# The Four Elements of AMA

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- ❖ Scenario analysis may include the well-reasoned evaluation and use of external loss event data (Final Rules)

## Use is Dependent on Understanding

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- ❖ The businesses need a way to estimate capital levels at confidence levels where intuition does not always help
- ❖ A risk capital model can help with this, but, even if complex, must produce results that are understood
- ❖ Well reasoned use of industry loss data as **SCENARIO ANALYSIS** can add transparency to AMA applications
  - Fostering understanding and acceptance of the model

# Industry Data

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- ❖ Thousands of data points for financial services
  - 25 or more years of data, covering multiple economic cycles
- ❖ Significant amount of detail about each event
  - Firm, LOB, event type, country, region, loss components, etc...
  - Business managers can see the relevance of actual (extreme) events to their LOB
- ❖ Use of Industry Data as SA does not preclude comparison of other potential scenarios to AMA results

# Steps to Using Industry Data as SA

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- ❖ Select the database(s)
  - Build vs. Buy
  - Consortium vs. Vendor
  
- ❖ Develop clear implementation procedures
  - “Rules of the Road”
  
- ❖ Execute with
  - Consistency
  - Transparency
  - Oversight



# Decisions About Processing Industry Data

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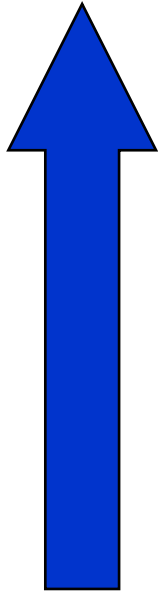
Ease

Processing

Usefulness

High

Low

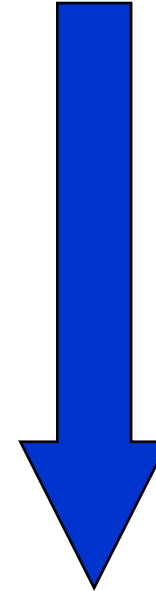


Low

Use external data as-is

Process centrally with automated rules

Decentralized, with detailed manual review by experts



High

# Granularity of Measurement Units

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- ❖ Determine measurement units for sorting industry event data
  - Basel LOBs (Level 1 or 2)
  - Basel event types (Level 1 or 2)
  - LOB X Event Types
  - Other
  
- ❖ How many measurement units?
  - 1, 7, 8, 56, 380...

# Measurement Units for Sorting Industry Events

Event Types	Business Lines							
	CF	T&S	R Bk	C Bk	P&S	Ag Sv	AM	R Br
Int Fraud								
Ext Fraud								
Emp Practices								
CPBP								
Physical Assets								
Bus Disruption								
EDPM								

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# “Rules of the Road” for Filtering the Data

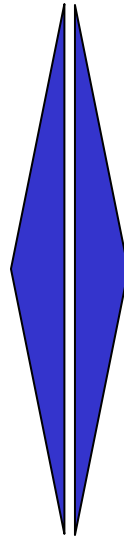
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- ❖ “Relevance to a bank’s operational risk profile and control structure” (Final Rules)
- ❖ Ownership / Responsibility
- ❖ Transfer / handoffs of events
- ❖ Internal and industry definitions
  - LOBs
  - Event types
  - Boundary events
  - Opportunity costs, etc.
- ❖ Multi-LOB events

# Rationale for Excluding Specific Events

## Stronger

- ❖ Not in LOB - broadly defined
- ❖ Event cannot happen in industry today (structural changes...)



## Weaker

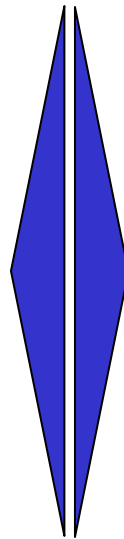
- ❖ Not in LOB - narrowly defined
- ❖ Event is unlikely here because of:
  - Better people
  - Good controls
  - Good track record



# Rationale for Excluding Specific Events

## Stronger

- ❖ The risk is unique to that country and we do not operate there
- ❖ Event occurred in LOB xyz (and has been transferred there with acceptance)
- ❖ Loss circumstances unique to entity not relevant here (e.g. gov.)



## Weaker

- ❖ That risk is generic to the product, but we do not do business in that country
- ❖ Event occurred in one product line but could occur in many other lines
- ❖ Behavior that caused the event is against policy here

## Discussion: New “High-Water Mark” Event

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- ❖ How timely should a firm’s AMA capital calculation reflect new “high-water mark” event?
  - Consider rogue trading as an example
- ❖ Would a new external event at Bank A change Bank B’s risk profile?
- ❖ Would Bank A’s loss event lead to change in Bank B’s AMA / risk capital requirements?
- ❖ What if the selected external database does not include a relevant “high-water mark” event?

# Advantages of Using Industry Event Selection as Scenario Analysis for AMA

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- ❖ Allows expert knowledge and experience to enter the AMA model, up-front
- ❖ Event selection takes place in process that is:
  - Structured
  - Controlled
  - Transparent
  - Consistent
  - Documented
- ❖ Participation by businesses leads to increased understanding, ownership, and buy-in to AMA model and results (and awareness of external events)

# Advantages of Using Industry Event Selection as Scenario Analysis for AMA

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- ❖ Business buy-in can lead to increased use, which can transform the value added of the AMA framework

From

To

