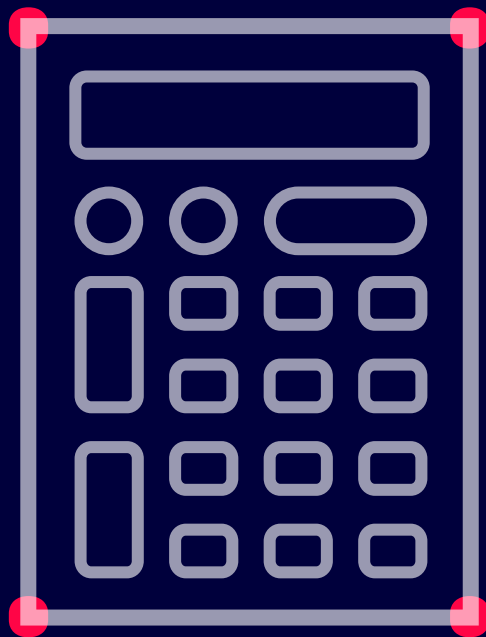

Capital Methodology Survey

Member report

January 2017



The ORX Capital Methodology Survey 2016

The ORX Capital Methodology Survey is conducted biennially and this year's survey was conducted in Q2/3 2016 with 41 banking institutions taking part.

Respondents included a global range of banks including both ORX Members and non-Members.

The survey was conducted after the Basel Committee on Banking Standards (BCBS) published its consultation in March to replace the Advanced Measurement Approach (AMA) with a standardised formula, the SMA (BCBS, 2016).

Though the SMA will remove the necessity for banking institutions to build internal models for Pillar 1 purposes, it is accepted that internal models will continue to play a role in both internal risk measurement and stress testing. Thus an appetite for benchmarking methodology remains and the full survey report serves as a reference for good model building practice.

Participants were surveyed on their current capital model building practices. The survey covered modelling philosophy, use of data, approaches to modelling frequency and severity, techniques for estimating the benefit of insurance mitigation, the modelling of correlation and the derivation of the aggregate loss distribution.

Questions covered each of the four major model building components: Internal Data, External Data, Scenario Analysis and Business Environment and Internal Control Factors (BEICFs).

Survey participants receive a full report presenting survey results at both a global and a regional level. This Member report presents some of the high level findings.

For further information or to participate in future surveys, please contact analytics@orx.org.

Headline findings

Results are broadly similar to those seen in the 2014 Capital Methodology Survey suggesting a period of relative stability has been achieved prior to the SMA introduction.

We continue to see agreement in many areas related to the building of the frequency and severity models. Almost all participants incorporate scenarios into their capital models however, results suggest the industry has not yet settled on a standard method for this.

There is some evidence that model approaches have simplified since 2014 although since the participation differs between the 2014 and 2016 surveys we make such inferences cautiously.

We see a fall in the average number of units of measures used by participants in both the LDA and scenario components of their models (Figure 1).

We see an increase in the use of a single model for the severity and decreased use of spliced models (Figure 2). Furthermore, we see an increase in the level of validation of severity and frequency models (Figure 3).

Member report

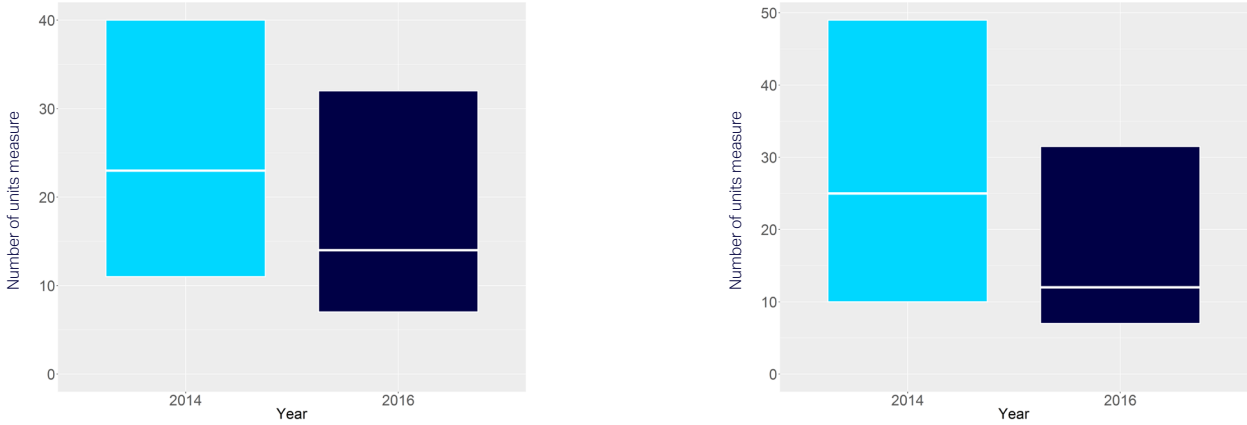


Figure 1: Box chart showing the number of units of measure respondents use in the LDA (left hand figure) and scenario (right hand figure) elements of the model.

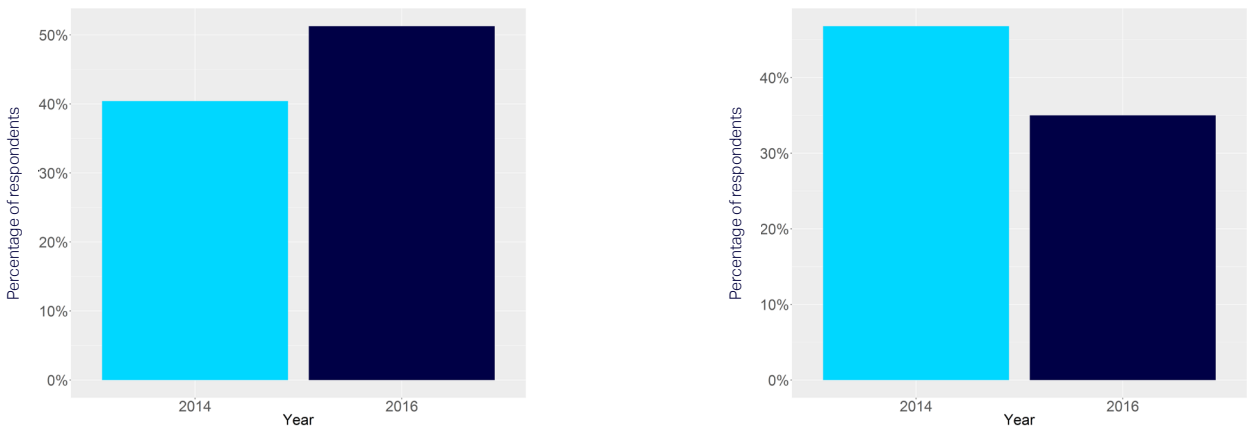


Figure 2: Percentage of participants using a single model for the entire severity distribution (left hand figure). Percentage of participants using a spliced approach to model severity distribution (right hand figure).

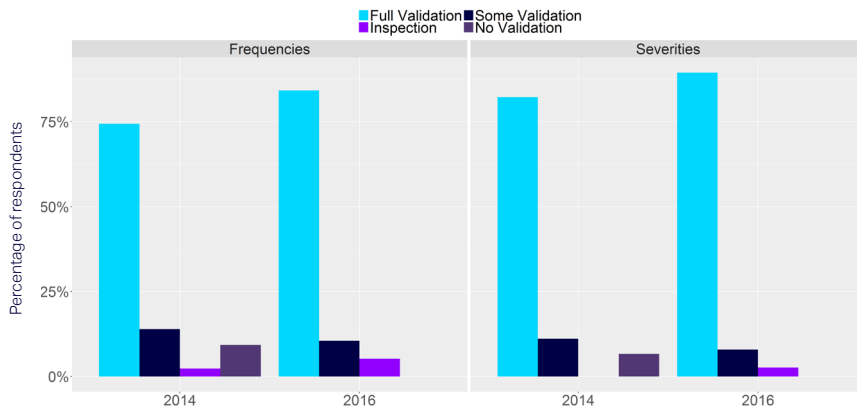


Figure 3: Level of validation applied to frequency and severity models.

Managing risk together

ORX believes many heads are better than one. We're here to bring the best minds of the international operational risk community together. By pooling our resources, sharing ideas, information and experiences, we can learn how best to manage, understand and measure operational risk and become less vulnerable to losses. We work closely with over 90 Member firms to develop a deeper understanding of the discipline and practical tools. We set the agenda, maintain industry standards, and garner fresh insights.

ORX is owned and controlled, on an equal basis by its Members.

For more information about ORX, visit our website at www.orx.org

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