



# CENTRE *of* EXCELLENCE *in* FINANCIAL SERVICES

## Directed Risk Research Programme

### DIRECTED RESEARCH PROBLEM STATEMENT

<b>Research Theme</b>	Operational Risk capital allocation and pricing	<b>Problem Nr.</b>	PS21001
-----------------------	---	--------------------	---------

<b>Client Name</b>	Hans Bouckaert	<b>Client Org.</b>	FirstRand
<b>Designation</b>	Risk Head: Operational Risk Tools Systems and Processes		
<b>E-mail</b>	Hans.bouckaert@firstrand.co.za	<b>Tel (w)</b>	<b>Mobile</b>

#### 1. Project Title:

Operational Risk capital allocation and pricing

#### 2. Project Goal

Create an effective capital and pricing model/ methodology that will enable an optimised risk/reward profile

#### 3. Higher level description of problem

To create an optimized risk reward profile aligned to the values and objectives of the organization it is imperative that capital is allocated and pricing is implemented in such a way that drives business mitigation of risk facing the organization in an optimized way.

Currently loss data and Scenarios feed the Operational Risk Capital model. The model is applied to Units of measure which consists of Business lines and Event types which is at a much higher level than where the risk emanates which is in business units both cost and profit centers. Consequently, simple re-allocation of final capital amounts to these lower levels is not possible from the inputs used in the model.

Risk information in the form of losses, Scenarios (to some extend), Key risk Indicators, Risk and Control Assessments, Audit findings and other Key Risk Drivers is however abundant at the lower levels. This information can be utilized to device a methodology for optimized capital allocation. Complexities to consider is the allocation of capital to costs centers which capital will be internally "priced" back to profit centers as an example. This intern can lead to non-optimal mitigation being applied by the cost centers.

If an appropriate methodology/ model can be derived, then consideration needs to be given of if the cost of capital should be priced out into the market and if so how this can be done to again optimize the risk/ reward profile of the institution.

#### **4. Project objectives**

The objective of the project is to find ways to optimise the risk reward profile of the organisation by capital allocation which will drive the correct behaviors, mitigation and risk acceptances.

#### **5. Outputs required**

Deliver a methodology/ model to allocate capital across the lowest levels of the organization in such a way that will optimize the risk/ reward profile within the values and objectives of the organization. Also deliver a methodology for pricing the costs out to the market or advice otherwise.

#### **6. Funding for project**

**BASA CoE**

#### **7. Strategic value to directed risk research**